

Ralph George Hawtrey, Charles Rist and the French translation of “Currency and Credit” (1935)

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Abstract

This paper develops the different point of view of Ralph George Hawtrey (1879-1975) and Charles Rist (1874-1955) on the nature of money and on the role of the central bank. In the interwar period (1920–1937), a debate was ongoing between economists concerning the relevance of the gold standard system. In France, Charles Rist, deputy governor of the Bank of France from 1926-1928, believed in the necessity of having a monetary system such as the Gold Standard. For him, it was inappropriate for the central bank to arbitrate the liquidity of commercial paper by conducting active monetary policies. Instead, he argued that the creation of credit should be conditioned by the in and out-flows of gold within the country; the main policy of the central bank should thus be the discount rate policy. Conversely, in England, Ralph George Hawtrey, who was the Director of Financial Enquiries at the British Treasury, proposed the measure of more efficient credit control by the central bank. He first developed this theory in “Currency and Credit” (1919, [4]) and later in “The Art of Central Banking” (1932, [6]), in which he argued that the central bank should manage domestic credit. “Currency and Credit” is one of Hawtrey’s major works in the sense that it outlines almost all of the essential elements of the theories developed in his subsequent publications. Like Rist, Hawtrey was consulted for advice on international monetary policies after the First World War. During the Genoa conference in 1922, he advised countries to return to the gold standard). In order to return to this system, countries had to reduce deficits financed by credit creation and had to stabilize their currency in order to settle a new parity with gold. But, by the end of the twenties, Hawtrey had ceased to believe in the power of the gold standard, partly because of the effect of the accumulation of gold by the Bank of France – who Hawtrey accused of being responsible for the worldwide depression ([6]) –, and also because of the increase of the value of gold in the United States during the years 1929-1931 ([10]). Rist continued to advocate the necessity of a return to the gold standard, and was not willing to adopt new monetary policies such as the ones Hawtrey advised. Rist defended the position of France on several occasions: in his book written in 1933 ([13]) and during a conference in February 1931 on the topic of “The International Function of Gold”. In this conference, Rist condemned the policies of open market and credit control followed by Britain and the United-States in the twenties. According to him, these policies were disrupting the functioning of the gold standard, because it hampered the movement of gold within the world ([15]).

0. Introduction

Ralph George Hawtrey’s monetary ideas were well known in France. Indeed, for most affluent French economists, Hawtrey was representative of the British economic thought. Philippe Schwob for instance, one of Charles Rist’s colleague at the Institut Scientifique de Recherche Nationale, Hawtrey’s articles was representative of the critics from English economists towards French economists: “I daresay I have chosen Mr. Hawtrey’s articles as typical of the English attitude towards French policy, because he is

considered, on this side of the Channel, as the strongest critic of this policy and one of the best champions of British economic thought.” (Schwob, [20]). Charles Rist considered *Currency and Credit* as the most important book written by Ralph George Hawtrey (Rist, [15]). He supervised the French translation of the third edition, which was realized by two young French economists, Georges Gausse and Leonard Rist (one of the five sons of Charles Rist). The translation was published in 1935 in France, three years after Hawtrey’s book *The Art of Central Banking* ([6]). In the first chapter of this book, Hawtrey criticized the French Monetary Policy, and more precisely the responsibility of the Bank of France in the worldwide depression.

A debate was ongoing between economists concerning the relevance of the gold standard system. In France, Charles Rist believed in the necessity of having a monetary system such as the Gold Standard. For him, it was inappropriate for the central bank to manage the credit creation of the banking system. Instead, he argued that the creation of credit should be conditioned by the in and out-flows of gold within the country; the main policy of the central bank should thus be the discount rate policy. Conversely, in England, Ralph George Hawtrey, who was the Director of Financial Enquiries at the British Treasury, proposed the measure of more efficient credit control by the central bank. He first developed this theory in *Currency and Credit* [4] and later in *The Art of Central Banking* [6], in which he argued that the central bank should manage domestic credit. *Currency and Credit* is one of Hawtrey’s major works in the sense that it outlines almost all of the essential elements of the theories developed in his subsequent publications.

The opening pages of the French translation of *Currency and Credit* [4] exemplified the scope of the disagreement between Rist and Hawtrey. Although Rist considered Hawtrey’s thought as “both bright and contestable” (Rist, 1935, [14] p. viii), he disagreed with Hawtrey on two points. As we shall see, they do not share the same view either on the nature of money, or on the role of the central bank. The first section of this essay is a comparison of the authors’ respective views on the nature of money. In the second section, we explore Rist’s position. Disagreeing with Hawtrey, Rist found it dangerous to allow the central bank to conduct open market operations and other discretionary policies. Rist considered that such policies engendered inappropriate adjustments of the balance of payments and also disrupted the functioning of the gold standard. He wanted countries to return to the gold standard which guaranteed an ‘automatic play of interest rates and gold movements’ (Rist, 1927, [12], Archives of Charles Rist, Bank of France). In Rist’s theory, the central bank has a passive role in the economy: the level of its discount rate depends on the level of gold within its reserves, and the level of gold depends on the state of international trades. The third section deals with Hawtrey’s criticisms of the French monetary policy which he did not consider suitably adapted to the needs of trade. The fourth section analyzes Hawtrey’s view of the role of the central bank. The central bank for Hawtrey should have an active role within the economy. An active role is characterized by a control over the money market. By controlling the supply of liquidity to the money market, the central bank can manage indirectly the liquidity of commercial paper. Furthermore, to reinforce the discount rate policy, the central bank must be allowed to purchase securities on the open-market. The fifth section concludes our research.

1. On the nature of money

Rist was convinced that the essential function of money is to serve as a “reserve of value” (Rist, 1938, [15]). He argued that it is because money has an intrinsic value that people trust it, and that they use it as a means of exchange. Indeed, Rist considered that the first function of money is to be a reserve of value, and that only metallic money like gold can fulfill this function. He did not consider paper money as money (Rist, 1938, [15]). In the same book, Rist reproached several authors, notably Hawtrey, for having forgotten to give a third function to money, which is to be a “reserve of value” (1938, [15]).

Alloys Schumpeter (1954, [18]) noticed that Charles Rist’s monetary thought is similar to that of Cantillon, according to whom money enabled the circulation of goods, and credit enabled the circulation of money (as noted by de Boyer, 2013, [1]). Money and credit are considered as two distinct notions. Several authors like Hicks (1943, [9]) and Schumpeter (1954, [18]), explained that Rist underlined the differences between money and credit in his book *History of Monetary and Credit Theory from John Law to the Present Day* (1938), [15].



Hicks, in his review in 1943 of Rist's book *History of Monetary and Credit Theory* (1940, [9]) gave an historical explanation of the lack of trust from some French economists to the creation of new instruments of payment other than gold in the economy. Hicks emphasized the loss of confidence in the solidity of paper money in France because of several bad experiences where the French government defaulted on its debt; for instance, the Assignats. In the psychology of French people, French government's promise to pay was not a reliable asset. According to Hicks, French economist like Rist was concerned with finding a sound currency in order to avoid errors made in the past, and this could explain why Rist considered that the essential function of money should be to act as a store of value.

Hawtrey's monetary theory differed from Rist's. In Hawtrey's thought, money has a double function. Money is a means of paying debts, and when a debt is created, goods are exchangeable. Therefore, money enables goods to circulate ([4]). Hawtrey made a theory of credit before making a theory of money. In the first chapter of "*Currency and Credit*", he gave an account of a hypothetical economy based on credit only, in order to "find the logical origin of money" ([4], p.2)¹. In such an economy, credit is a medium of exchange. A credit/or debt is created when a delivery of goods is not immediately followed by a payment in monetary terms. Credit/or debt is a promise to deliver money at a future date other than that of the delivery of the good. For instance, if a retailer A delivers goods to wholesaler B and B promises to pay A in money at a later date then; a debt or credit is created from B to A ([4], p.2). Indeed, when retailer A accepts the debt or credit of wholesaler B, goods are delivered to B. There is a flow of commodities when a credit or debt is created. Confidence is the necessary condition for debt or credit to be created, and for goods to circulate within the economy. If merchants do not trust instruments of payment they would not be used and no trades would occur.

2. Rist on the gold standard and the specie flow mechanism

According to Rist, the central bank should not follow a discretionary policy. The gold standard is a way, according to Rist, of limiting the quantity of credit within the economy. The level of credit should depend on the quantity of gold contained in bank reserves. The central bank had a passive role in Rist's theory (as noted by Mouré, 2002, [11]). In light of the relative success of the gold standard in the 19^e century, Rist wished to return to the monetary system prevailing before the First World War which was the gold standard. In spite of the fact that Rist continued to argue on behalf of this system, countries were nonetheless still abandoning it (Austria, England, and Germany). He supported this view in several books, in his essays on money ([13]) and later in the conclusion of his "*Doctrines*" on money and credit (1938, [15]). Obstinate, he wrote in his *Essays on money*:

If we want to make the gold standard work again, it suffices to create all of the normal conditions under which this system was working in the 19^e century. Let us employ discount rates again; let us renounce the practices of « managed currency » whose bad effects stick out like a sore thumb [...] - let us establish international trade again as it has been almost deleted [...] The gold standard would function again, for the satisfaction of everyone, because we will have settled the normal routes by which gold should be distributed in the world. (Rist, 1933, [13] p.174)

The gold standard was seen as a good monetary system by Rist because it automatically stabilized exchange rates and currency value through the equilibrium of the balance of payment. Rist referred to these automatic adjustments in a conversation with Benjamin Strong and George L. Harrison held on the 29-30th June 1927 ([12]). In this conversation, he expressed the will of the Bank of France to come back to the gold standard ('Aide mémoire des conversations du 29 et 30 Juin entre M. Rist, M. Strong et M. Harrison', 1927, [12] archives of Charles Rist, Bank of France, n°1037200603).

According to Rist, credit creation should depend on the inflow and outflow of gold. Wages and commodity prices were the variables of adjustments which would lead to an equilibrium in the balance of payments. This idea, based on a price/specie flow mechanism, is expressed in his essays on money (Rist, 1933, [13]).

Domestic traders, whether paying for imports or making investments abroad, sell domestic currency in the exchange market and buy the currency of foreigners. In the case



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

Rist considered that discretionary policies disrupted the natural mechanism of prices which corrected overproduction under the gold standard. This is why he was not willing to give such rights to the Bank of France. Indeed, in Rist's thought, if the central bank reduces its discount rate while the balance of payment is in a deficit, according to him, it would be a "falsification of the real policy of the gold standard" (Rist, 1933, [13] p.173). Such a policy would prevent credit contraction from happening when gold flows out of the country. Keeping the bank Rate at a low level and/or purchasing securities on the open market while gold is flowing out of the country seemed risky to Rist because, he argued, it would provide liquidity to markets, and that a potential consequence of this was increased inflation within the economy. Rist found the "managed currency" policies dangerous and inappropriate because they disturbed the natural function of the gold standard. In the following passage, Rist criticized the low discount rate policy of the bank of England conducted in the early thirties. The bank of England should have raised its discount rate instead of lowering it (Rist, 1938, [15]).

3. **Hawtrey against "French monetary policy" (1932): a monetary system inappropriate to the needs of trade**

In his *Art of Central Banking* (1932, [6]), Hawtrey explained that credit creation was restricted in France. The regulation of credit was based upon the gold reserve, and the Bank of France did not possess powers to provide alternative backing for the currency. Therefore, the supply of money from the banking system was inelastic: "... an inflow or outflow of gold was assumed to mean an equal increase or decrease in the stock of currency." (Hawtrey, 1932, [6] p.195). Banks restored their gold reserves by selling credit assets and reducing loans. The consequence was a restrictive use of credit, and a high demand for gold in France (Hawtrey, 1932, [6]).

Hawtrey pointed another problem within the French economy: "A larger proportion of people's cash resources has been held in the form of currency and a smaller proportion in the form of bank credit than in other wealthy countries." (Hawtrey, 1932, [6] p.198).

The inelasticity of its supply of money and the hoarding of metallic currency are the two main reasons why, according to Hawtrey, the Bank of France absorbed gold in 1930-1931. Moreover, Bank of France was so constrained, and the need of markets so high, that it had to absorb gold in order to provide an expansion of the currency: "The gold was needed as an addition to the backing of the note issue" (Hawtrey, 1936, [8] p.67). This implies that the French banking system was not able to respond to the need of currency from French markets without importing gold. Controversially, Hawtrey presented his view to a French economist, Philippe Schwob, one of Rist's colleagues at the *Institut Scientifique de Recherche Economique et Sociale* in 1936.

Schwob disapproved Hawtrey's view. For the French economist, the needs of trade were managed efficiently by the four main French commercial banks (*Crédit Lyonnais*, *Société Générale*, *Comptoir National d'Escompte*, and *Crédit Industriel et Commercial*). But again, Hawtrey disagreed: the French clearing banks did not increase their clearings to respond to the needs of trade, they did it in order to supply liquidity to financial markets (Hawtrey, 1936, [8]).

Because its power was limited, explained Hawtrey, the Bank of France did not manage actively the liquidity of commercial credit. Therefore, the French banking

system might not be able to respond efficiently to the needs of trade (Hawtrey, 1932, [6]). Hawtrey underlined another important policy from which the Bank of France was precluded: open-market purchases. The ability of the central bank to purchase bills in the open market, as Hawtrey explained, when a low discount rate policy does not increase credits, enables the economy to avoid a depression of trades (Hawtrey, 1932, [6]).

In *Currency and Credit*, Hawtrey had already underlined the danger of credit contractions engendered by a monetary system based on a metallic currency. In such a system, an outflow of gold under the gold standard system is followed by a credit contraction. Hawtrey wrote that credit contraction is “the weapon for the defense of the gold reserve” (Hawtrey, 1919, [4], p.107). Indeed, an outflow of gold followed by a credit contraction diminishes the consumers’ outlay, and puts a downward pressure on domestic prices; in this way, imports tend to be reduced and exports tend to be stimulated. But, as explained by Hawtrey, wages and prices do not vary immediately after a disequilibrium in the balance of payment. In the first instance, credit restriction engenders variations of profits, and then of output and of employment, and then it impacts the level of prices and wages (Hawtrey, 1919, [4]).

Credit contractions damage the industry in the short run, as Hawtrey explained. Before impacting the level of prices and wages, the credit contraction has a direct impact on bank capacity of issuing new credits, and thus on the liquidity of traders for goods. Being less able to borrow through the discount window of the central bank, commercial banks try to sell their assets and reduce the loans they had in the productive sphere. In this situation, traders are deprived of short-term credit and may become unable to borrow in order to finance its holdings of stocks of goods awaiting sales. The demand for credit from traders, Hawtrey explained, does not necessarily diminish after a rise of the interest rate: there exists a “latent demand for credits”. A credit restriction can engender a liquidity crisis in the banking system and a disruption of commercial activities (Hawtrey, 1919, [4]).

4. Hawtrey, the money market and the open-market operations

Hawtrey advised a monetary system in which the central bank has the monopoly in the issuing of legal tender notes in order to supply an elastic currency. The legal tender notes are held in the reserves of commercial banks, and they enable them to extend/restrict credits. In doing so, the central bank could control the level of credit issued by the banking system, and thus it could manage the level of the unspent margin which is “the aggregate of the money and bank deposits in the community” (Hawtrey, 1927, [5], p.11, as noted in de Boyer and Solis, [2], and Hawtrey, 1919, [4]). Indeed, in order to diminish the capacity of the banking system to extend their loans, Hawtrey explained, the central bank should raise its discount rate. This rate of interest influences the lending operations of commercial banks (Hawtrey, 1919, [4]). The central bank provides liquidity to the banking system, which supply and/or withdraw the means of payment to agents of good markets. In this way, banks have a central role in the economy: they induce and/or deter traders from borrowing. Therefore, the central bank is able to manage the level of credit in the economy: it is able to smooth the business cycle (Hawtrey, 1932, [6]). Although a rise of the discount rate is an efficient policy to check an excessive expansion of credit, a reduction of the discount rate does not always prevent the economy an excessive contraction of credit. Hawtrey underlined some limits to the low discount rate policy. If traders and banks do not borrow when the discount rate diminishes, the central bank should purchase directly securities on financial markets. This is how Hawtrey introduced a new channel of liquidity supply. The purchase of securities engenders a rise of the price of securities. Because commercial banks and businesses hold these securities in their balance sheet, they become more liquid, and encourage extending spending (Hawtrey, 1919, [4] and Hawtrey, edition of 1950, as noted by Sandilands, 2010, [17]).

In Hawtrey’s theory of the central bank, the money issue is flexible. The central bank has an active role within the economy. Indeed, the central bank should manage the level of credit of the banking system. In a situation where credits are scarce, the central bank can increase the quantity of money by lowering its discount rate, and it can reinforce its discount rate policy by purchasing securities on the open market. On the contrary, the central bank can reduce the level of inflation in the economy by raising its discount rate and also it can reinforce its policy by selling securities on the open market. To sum up, the discount rate and open

market policies, which are discretionary policies, enable the central bank to control the level of credit issued by the banking system. It also permits to smooth the business cycle and stabilize the value of money.

5. Conclusion

During the inter-war period, Hawtrey's monetary ideas were well-known in France both by economists of the Bank of France (Moreau, Quesnay) and by academics (Nogaro, Pirou, Schwob). The reader of the opening pages Rist wrote to the French translation of *Currency and Credit* let suppose that it was an opportunity for him to position himself against Hawtrey's monetary theory while countries were abandoning the monetary system Rist believed in, which was the gold standard. As seen in the first section, Hawtrey's and Rist's disagreements are rooted in their respective views on the nature of money. Hawtrey conceived of money as the means of payment of debts and as a unit of account in which debts and credit are denominated; whereas Rist emphasised the fundamental role of money as a reserve of value. Paper money, for Rist, was not a sound monetary instrument because it fails to act as a store of value. Gold is the most dependable currency which a monetary system should rely on, because people trust the stability of its value.

The monetary system Rist was advising was the gold standard - as I have described it in the second section of this essay. Rist believed that the gold standard, if adopted by all countries, was an efficient way to stabilize internal and external prices. He referred to "adjustments" as an automatic consequence of adopting the system of the gold standard. These adjustments rely on a price specie flow mechanism. For instance, when the balance of payments is in deficit, the gold flows out of the country, and as a consequence the central bank raises its discount rate in order to protect its gold reserves. This policy forces banks to reduce their loans and businesses to borrow less. When wages and prices have decreased sufficiently, export increases and gold flows into the country. Credit creation depends on the movement of gold. The gold standard was a way to chasten excessive credit creation, and also to limit over-production. This is one of the reasons why Rist considered such a system as a safe and necessary means by which to limit monetary disorders between countries. The role of the central bank was passive in Rist's theory: it had to change its discount rate according to the level of gold contained in its reserves.

On the other side of the channel, as seen in my third section, Hawtrey wrote in opposition to monetary systems based on metallic currencies such as the gold standard. His views appear first in *Currency and Credit* (1919, [4]), where he emphasized the danger of the credit contractions engendered by the movements of gold. According to Hawtrey, countries were too greatly constrained under the gold standard. This monetary system obliged countries to conduct restrictive monetary and fiscal policies in order to limit gold losses and to reestablish the equilibrium of the balance of payments. These restrictions were even more difficult in debtors' countries which did not possess large stocks of gold, which was the predicament of almost every country except France and the United-States, who, in 1931, respectively held 60 per cent of the world's monetary gold (Mouré, 1999, [11]). Later, in his *Art of Central Banking* (1932, [6]) Hawtrey blamed the monetary policy conducted by the Bank of France. He attributed the lack of power within the Bank of France to its management of commercial credit. Indeed, the Bank of France was constrained in its monetary operations because it was not allowed to purchase securities in the open market; instead, it only had the right to vary its discount rate.

My fourth section deals with the role Hawtrey attributed to the central bank both in *Currency and Credit* (1919, [4]) and in his *Art of Central Banking* (1932, [6]), where he formalized solutions by which central bankers could fight the worldwide depression. In his theory, the central bank has an active role within the economy: it should supply an elastic currency to the banking system which enables banks to guarantee the liquidity of commercial paper. In doing so, the central bank could smooth the business cycle and stabilize the value of money.

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