eabh Papers | No. 17-01 | March 2017

Market regulation and economic interdependence: Capital supply and aggregate demand in the twentieth century

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Abstract:

This contribution offers a comparison between the economic crises of the late-1920s and the first energy crisis of the 1970s through an inquiry into the changing balance between the transnational supply of capital and domestic aggregate demand for fixed capital formation and consumer goods. Its aim is to offer a new interpretation of the concept of international economic interdependence. It starts by outlining the early definition of interdependence offered in the international political economy literature and within the American policymaking elites from World War II to the 1960s. Then, it provides a reappraisal of the New Economic History School's approach to the subject. Thereafter, it investigates the two historical watersheds to cast light both on the different role of Federal Reserve and the international economic institutions to manage the ratio of liquidity supply to aggregate demand, and on the importance of transnational capital flows and gold.

Keywords: economic interdependence; financial crises; US foreign economic relations; supply side; aggregate demand; Federal Reserve; Great Slump; energy crises; Volcker revolution; cliometric revolution.

JEL Classification: N22, N12.

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1. Introduction

This contribution focuses on the concept of international economic interdependence through an historical comparison between the two worldwide recessions of the twentieth century. The aim is to provide a new interpretation about the changing interrelation between transnational capital supply and domestic aggregate demand when compared to extant explanations in the historical studies and social sciences literatures. Defined in the economics literature as the ratio of capital supply to fixed capital formation, the concept of economic interdependence has been the subject of abundant theoretical fine-tunings in international economics, political science, and historical studies. All these inquiries shared a least common denominator: the free flow of commodities, goods and capital across nations, had been considered a linchpin in the development of sustained growth rates. Different disciplinary fields focused on the topicality of transnational flows in capital and goods: both with respect to the late nineteenth century wave of international economic integration, and when the subject was the post-World War II international economic system, this scholarship made the argument that an expansion in cross-nation movements in capital and goods was a decisive factor in nurturing domestic economic growth and market openness.

Both the New Economic History school and the most prominent scholarship in international political economy based their historical and economic interpretations on this assertive assumption. Consider the international economic integration typical of the industrial economies of the western world from the late nineteenth century through the early twentieth century: breakthrough scholarship on the first wave of global economic integration revolved around the reportedly pivotal linkage between transnational movement in labor, capital, and merchandizes, and the repositioning of each national economy, with a recorded stunning increase in their share of world trade, in the international economic arena. Likewise, if one keeps an eye on the mainstream literature in international political economy appeared during the 1950s and 1960s, the concept of economic interdependence was grounded on the idea that the pillar of the post-World War II process of international market integration that increasingly connected the leading advanced industrial economies, was a rate of market integration higher than domestic growth. This literature fine-tuned this correlation so far as to argue that such freely-moving flows in capital, consumer and instrumental goods in excess of the sustained domestic growth rates nurtured the widely-known development of national consumer markets typical of the post war golden age.

This paper suggests a different concept of economic interdependence. It does so in order to strike the balance between oversupply of capital and the sluggish domestic aggregate demand that chronicled the period after the first oil shock of the 1970s. The argument is built on a comparison between the monetary and economic policies of the US Federal Reserve System during the Great Slump of the late 1920s, and the international financial assistance programs implemented under the auspices of the US monetary authority, the international economic institutions born out of the Bretton Woods conference, and the government of the United States.

After briefly reviewing the approach of the New Economic History School to the interconnectedness between capital supply and domestic growth through the historical case study of the first economic globalization of late nineteenth century, this contribution pinpoints the supposed impact of unfettered cross-national capital supply on domestic growth discussed in the international political economy literature. Then, the paper investigates the role of US national monetary authorities and international economic institutions during the two great slumps of the last century to point to a different interpretation about the changing ratio between international capital flight and domestic economic growth. In contrast to the literature reviewed in the first part, the centerpiece of this study is based on the historical experience; national monetary and international economic policies did contribute to recast an orderly equilibrium between capital supply and domestic investments.

Both in the early 1930s and after the first oil crisis of the 1970s the United States and its peer international economic institutions worked on redressing the balance between transnational capital supply and domestic aggregate demand. According to the reconstruction presented in the following pages, they played a vital role in redressing such balance. In this comparative framework, the paper highlights similarities and differences between the 1930s and the 1970s. On the one side, it confirms that from 1928 to the appointment of Roosevelt to the White House the US monetary authorities recklessly pursued a strict monetary policy. Indeed, this work suggests that until 1933 this strictness reduced capital offer below demand for productive investment, and crimped a steadily restructuring of fixed capital formation. However, the easing of monetary and credit policies undertaken by the Fed at the urgency of the newly-appointed Roosevelt administration was fundamental to revert capital outflows and restore appropriate capital supply to fuel domestic investments.

On the other hand, however, the last section suggests that during the first oil crisis of the 1970s the US monetary authorities straddled to cope with the implications of the first oil price hike on the US domestic growth through the implementation of expansionary policies. In light of the downward implications that the first oil shock had on the volume of international trade and payments and the rate of growth of the US economy, the paper points to the responses set out by the US on linking the restructuring of world payments to the recovery of the industrial and developing economies mostly affected by the economic downturn. This was done in order to prevent any of them from slipping away from the tangle of multilateral commercial and financial bonds. More specifically, the government of Washington worked on reaching this target by drawing upon the financial assets of the oil-rich countries to finance the developing countries' current account deficit and to stimulate domestic investments and expansion across the industrial nations. This contribution rounds off by pointing to the decade-end events that made the US governments and monetary officialdom toss aside their commitment to restore an orderly balance between international market integration and domestic growth. The so-called Volcker monetary revolution, unfettered depreciation of the US currency in foreign exchange markets, and disrupting events in the Middle East, all contributed to terminate the trajectory of international interdependence charted in this study. These historical events disrupted the American strategy aimed at borrowing from OPEC to balance the ratio of transnational capital supply to aggregate demand[1]. Since then, US authorities left aside any expansionary use of transnational capital flows to uphold domestic consumption[2].

2. The concept of economic interdependence from international political economy to history: market openness and domestic growth

The New Economic History School, founded in the 1950s, and the cliometric literature that hailed from it, laid the intellectual groundwork for a concept of international economic interdependence that revolved around the pivotal role of the free movements in capital and goods in stemming national economic wealth and market openness. Stuck to the idea that the removal of national controls on freely flowing commodities, goods and capital across nations is a function of each economy's share in international trade and capital movements, this historical literature established a positive correlation between market openness and national economic performance. *Globalization and History* by O'Rourke and Williamson fine-tuned this theoretical approach through the case study of the first economic globalization. According to these authors, the more the industrial economies can freely trade in merchandize and commodities each other, the better is the score of key domestic economic growth indicators as the cost of labor, real wages, fixed capital

[1] See now Selva, *Before the Neoliberal Turn.*.

[2] P.A. Volcker, Remarks before the Graduate School of Business Administration, New York University, 'The Recycling Problem Revisited', March 12, 1980, in National Archives and Records Administration, Archive II, College Park, MD [hereafter NARA], General Records of the Department of the Treasury [hereafter RG56], *Office of the Assistant Secretary for International Affairs, Records Relating to International Financial Institutions 1962-1981*, b. 8, f. IM-13-7 International Monetary Bank and Banking The Euro-Market 1 of 2; Archives of the Federal Reserve Bank of New York [hereafter FRBNYA], Board of Directors Minutes [hereafter BOD], Volume 88 (January 3, 1980-December 31, 1980).

formation, or the national share of world trade[3]. The financial repression argument that has long dominated the research agenda of the New Economic History took place before this scholarly backdrop based on a rational choice approach to historical development[4].

The intellectual debate on the post-World War II system of international economic relations that developed after the end of war traced this approach and reformulated the supposed virtuous circuit between transnational capital flows, market openness and domestic growth. During the 1960s the increase in the volume of international trade exceeded the rate of domestic economic growth enjoyed by most industrial economies. Before this macroeconomic framework a strand of scholarship in international political economy (IPE) defined the process of international economic interdependence as the ratio of trade exchange between two or more economies to each economy's growth rate[5].

In this respect, the changing ratio of foreign trade to GDP per capita, as well as the consumption share of GDP in most advanced industrial economies over the decades following World War II, shed further light on the subject. From 1962 to 1972, France, Japan, Italy and the Federal Republic of Germany enjoyed an expansion in foreign trade three to four times as much that recorded from the late-1950s through 1962. By contrast, the upswing in GDP per capita was less dynamic, while personal consumption as a percentage of GDP lagged behind[6]. Clearly, the concept of economic interdependence fine-tuned in IPE is in striking contrast to this macroeconomic dynamic. Such contrast permits to catch the intellectual bias of that definition.

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[3] O'Rourke and Williamson, *Globalization and History.*

[4] for a thorough examination of this scholarship see North, "Structure and Performance", 963-978.

[5] Cooper, "Economic Interdependence and Foreign Economic Policy in the Seventies", 159-181; id., *The Economics of Interdependence,* chapter 3; Keohane, "The Theory of Hegemonic Stability" in *International Institutions,* ed. Keohane, 74-100.

[6] for a data set on this see Commodity Trade Statistics Database, www.comtrade.un.org/data; see also Center for International Comparisons at the University of Pennsylvania world table, https://pwt.sas.upenn.edu/php_site.

That concept was grounded in the intense debate that gripped scholars in international economics and political economy about the beginning of the economic reconstruction of western Europe.

Consider the literature appeared at the time. Gardner, Hirschman and Kindleberger, for instance, portrayed the construction and functioning of the international economic system set up at the 1944 Bretton Woods Conference as an international order resting on smoothly expanding domestic industrial economies[7]. This breakthrough scholarship focused on the interconnectedness between growing domestic consumer spending and rising foreign trade. In this framework, the economic sciences applied the theory of economic multiplier to international trade[8]. Kindleberger found a correlation between transnational capital flows and domestic aggregated demand. He argued that in post war Europe transnational capital movements provided capital supply required to set out fixed capital formation. He explained why, shortly after the end of World War II, European investors and banking intermediaries poured money into the American equity market: they financed securities issued by US multinationals to finance investments in manufacturing lines essential to set in motion the post war European recovery[9]. This early interpretation ascribed equal importance to transnational flows in consumer goods and capital mobility.

However, as international trade in consumer goods and commodities exceeded international financial transactions and foreign direct investments[10], the interpretations of economic

[7] Gardner, *Sterling-dollar Diplomacy*; Hirschman, *National Power*; Harris, *Postwar Economic Problems*.

[8] Machlup, *International Trade and the National Income Multiplier*; Polak, "The Foreign Trade Multiplier".

[9] Kindleberger, *International Capital Movements*, 14. Id., *Economic Response*, 207-209. Similarly, during World War II the largest share of US investors' foreign security holdings was in mid-term and fixed-term equities doomed to bolster productive investments. See Chitu, Eichengreen and Mehl, "History, gravity and international finance", 104-129.

[10] until the early 1970s the consumer goods and instrumental goods component of total export tripled in amount and increased in value two times as much. On the other hand, the global outlook for foreign direct investments and investments on the security markets suggests a total that amounted to only a little over 1 percent of total GDP in each advanced industrial economy included the United States. See respectively United Nations, *Yearbook*; UNCTAD, *Handbook of*

interdependence appeared during the 1970s developed a different theory. International trade in consumer goods were viewed as the key benchmark to assess the degree of interdependence between two or more national economies. In their inquiries, Cooper, Krasner and Katzenstein tossed aside transnational financial investments and established a correlation between domestic aggregate demand and international exchanges in commodities and consumer goods[11].

Such approach to the interrelation between transnational capital and national growth took place against a conceptual framework of the world economy based on the post-World War II principles of trade liberalization. Drawing from these accounts a wave of studies identified banking regulations and supervisions as stumbling blocks to international financial integration and to domestic economic growth in the industrial economies. Since the 1960s this approach viewed the economic role of the western state in promoting industrial recovery and technological upgrade as a hindrance to the free movement in consumer goods[12]. This perspective pointed to the protectionist trade policies of the nation-state[13], and focused on the twentieth century's role of

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International Trade and Development; OECD, *International Direct Investment*; United Nations, *Transnational Corporations*.

[11] Krasner, "State Power and the Structure of International Trade", 317-347; Katzenstein, *Between Power and Plenty.*

[12] for a vivid reappraisal of the new economic history school as it developed as a discipline revolving around the principles of economic rationality, free competitiveness and self entrepreneurship see Temin, "The Future of the New Economic History", 179-197.

[13] Schularick and Solomou, for example, targeted the ratio of tariff protection to domestic economic growth to disprove the argument -firmly contended by Paul Bairoch in his past contributions- that a correlation existed between protectionism and growth. See Schularick and Solomou, "Tariffs and economic growth", 33-70; for a rather different perspective tackling the role of tariffs in American economic development at the turn of the nineteenth century see Allen, "American Exceptionalism".

national governments in leading domestic growth through inflationary policies and exchange controls[14]. It considered both policies as stumbling blocks to freely flowing transnational capital.

Accordingly, the cliometric perspective viewed banking regulation as a process that discouraged international investors and stressed the role of fiscal policies in causing economic downturn. According to this scholarship, the tendency of the western state to fix up the problem of a decline in GDP through a raise in taxes on capital transactions helps to explain the historical phenomena of capital outflows that churned the advanced industrial economies since the 1960s. Making matters different, according to the financial repression argument during the 1970s the removal of national controls on capital flows in some leading western economies marked a path-breaking turn. Since the 1980s, does this scholarship suggest, the short circuit between fiscal policy and financial repression came to an end. During the 1980s and 1990s, the end of fiscal repression propped up the confidence of investors and rebounded transnational capital flows[15].

However, as this contribution charts, national economic policies did little to hinder the making of an interdependent international economy based on the free movement in goods and capital. By contrast, the paper suggests that the linchpin to reorganize the process of economic interdependence was a US monetary policy aimed at redressing the ratio of capital supply to demand for investments.

[14] see for example scholarship by Rory Miller, whom through the kaleidoscope of British multinationals in Latin America suggested that government regulations sloped down the financing of fixed capital to enhance productivity in manufacturing after World War II: Miller, "Financing British Manufacturing Multinational", 818-839.

[15] Battilossi, Foreman Peck and Kling, "Business Cycle and Economic Policy", particularly 365-366. For a national case study along this interpretative path see Battilossi, "Capital Mobility and Financial Repression"; for a recent and lucid overview of this perspective see Roubini and Sala-i-Martin, "A Growth Model of Inflation", 275-301; for a comprehensive and balanced overview of this scholarly perspective see the Gigliobianco, "Regulatory Responses and Financial Crises: In Search of a Pattern", 9-14, in *Financial Market Regulation,* ed. Gigliobianco and Toniolo.

3. Disproving the financial repression argument: the role of Federal Reserve in rebounding capital supply during the Great Slump

A stream of leading scholarship on the American economy amidst the turn-of-the-1920s Great Slump set forth a widely-accepted interpretation about both the macroeconomic dynamics of the recession that churned the country through 1933, and the sluggish US stock market. These works were based on the most commonly used data to measure growth and national economic development: GDP per capita, unemployment rate, manufacturing output, the ratio of productivity to capital formation, and financial transactions on the stock and equity markets. They spanned the time frame from the stock market crash of October 1929 through the following three years. This scholarship linked this prolonged contraction of US production both to the tight monetary policy inaugurated by the Federal Reserve System since the beginning of 1928, and to the federal laws passed between 1933 and 1935 to preside over the restructuring of credit policies.

Before outlining some more recent interpretative paths to offer a different interpretation of US domestic and international monetary policy, it is worth recalling this twin established view. On the one side, among others, Kindleberger pointed to the US inflexible refute to toss aside monetary stringency and begin serving as lender of last resort until after the appointment of Roosevelt to the White House[16]. Eugene White pushed forward this argument by stressing that during the crucial turn-of-the-decade years the Federal Reserve never increased base money. According to him, the US national monetary authorities did not alter nominal interest rates in order to ease off the cost

[16] Kindleberger, *The World in Depression*.

of borrowing to finance investments in fixed capital. Likewise, they did not pledge to expand currency in circulation in support for borrowers[17].

On the other hand, a stream of flourishing studies pointed attention to the legislative framework on banking erected in the early 1930s to explain the striking imbalance between capital supply and borrowings that struck the economy. In particular, Michael Bordo has established a connection between the wave of banking panics that took the American production chain to a standstill, and the law that enforced selected access to the Federal Reserve's discount window[18]. This legislative measure forced any private bank non member of the Federal Reserve to issue a guarantee fund or to draw on reserve assets as binding prerequisites to file a request for financial assistance to the Fed. Apparently, this correlation would tighten up the historical argument about the effects of the federal legislation of the early 1930s on the downswing of the American economy.

However, since the mid-1970s most scholars interested in deepening understanding about the interconnectedness between the October 1929 collapse of the stock market and the crumbling of US manufacturing production and consumer spending, identified with the monetary measures undertaken by the Federal Reserve since October a set of pivotal stimulus policies. According to these studies, those measures were much needed to prevent large scale selling on the stock market from triggering a dangerous liquidity shortage. Due to the centrality of the Great Slump to

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[17] White, "Introduction" in *Stock Market Crashes*, ed. While, XI ff.; Temin, "The Midas Touch: the Spread of the Great Depression", 78; id., "Socialism in many Countries", 94-95; both contributions are in Temin, *Lessons from the Great Depression*; see also Schwartz and Friedman, *Monetary History.*

[18] The Federal Reserve discount window had been established to let any commercial bank non member of the Federal Reserve System get credit to finance collateral titles: Bordo and Wheelock, "The Promise and Performance of the Federal Reserve", in *The Origins, History, and Future,* ed. Bordo and Roberds. For a tidy classical reflection about the role of monetary authorities as lenders of last resorts see Bagehot, *Lombard Street*.

delineate the process of international economic interdependence during the twentieth century, this paper shall pinpoint the varying interpretations about the origins of the Great Depression and the monetary policies enforced to sort it out. It is noteworthy to stress that any thesis points to the role of Federal Reserve in rolling over the debt of private corporations on the securities and bond markets. Reasoning on this line, a variety of interpretations suggests how relevant it was the Federal Reserve's all-out commitment to purchase Treasury bonds and securities held by private intermediaries. In so doing, the US monetary authority went way beyond its statutory limits when in Fall 1929 Wall Street collapsed[19]. All interpretations stress that the Federal Reserve rolled over the Treasury's outstanding debts held by private intermediaries. Such intervention promptly freed on the private capital market disposable liquidity to fuel productive investments. This scholarship argued that this move reversed the repeated sequence of drying up capital supply, banking panics and large scale stock market sales that had contracted industrial output. According to this interpretation, this all-out undertaking by the Fed was topical. In fact, it came about shortly after the sequential dwarf in manufacturing output in Summer 1929, and in capital supply for fixed-investments immediately thereafter.

Christina Romer has convincingly contended that the Federal Reserve's large scale purchases of Treasury's bonds from private investors was vital to offset monetary stringency inaugurated the year before. She argues that in so doing the US monetary authority offset the negative impact of monetary strictness on domestic growth without causing inflation[20]. To put it another way, the Federal Reserve rolled over the exposure of private capital markets to the Treasury to stem funding for fixed investments without either relaxing its tight monetary policy, or expanding base money. The very objective of this policy was to set up expansionary policies.

[19] the most recent reference work is *The Great Depression of the 1930s*, ed. Crafts and Fearon.

[20] Romer, "The Nation in Depression".

If one outlines the scholarly works on the legislation enacted since shortly after the 1929 Great Contraction through the early 1930s, it is possible to detect further confirmation to this approach. The Banking Act and the Glass Steagell Act, the two most important legislative measures passed during the first half of the decade to preside over the reorganization of US banking system in the framework of the New Deal, provided much needed confidence to private investors[21]. The literature on the Great Slump tidily pointed attention to the positive effects of the separation between deposit banks and investment bankers enacted by the Glass Steagell Act. In so doing, the US Congress set out a legislative measure effective in preventing banking failures from turning into financial panics that close corporate bonds between deposit corporations and brokers would favor[22].

On the other hand, many economic historians argued that the creation of the Federal Deposit Insurance Corporation (FDIC), established with the 1933 Banking Act, was a stepping-stone in the history of banking supervision and set off a virtuous circuit between private capital markets and economic growth. The FDIC guaranteed sight deposits and call deposits held at banks member of the Federal Reserve System. It provided such guarantee through a fund established by the premium that each member bank paid out of the insurance they received. In light of this mechanism the FDIC would lay a shift from short-term financial assets, typically geared to finance the real estate market, to long-term capital markets best suited to enhance fixed capital formation. Therefore, the case study of the FDIC would track the essential role of banking regulation in financing American economic growth. Most literature convincingly views the New Deal policies to regulate banking as a linchpin in making the American bond and securities markets attractive to foreign investors.

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[21] for a comparison between the legislation of the early 1930s and the laws approved to cope with the Great Recession of 2008 see Eichengreen, *Hall of Mirrors*.

[22] Schwartz and Friedman, *A Monetary History*; Temin, *Socialism in many countries*, 119.

Besides, more recently some economic historians critical of the New Economic History School reappraised the financial repression argument[23]. They recognized the importance of the New Deal to bolster the confidence of private investors and banking. On his part, a quantitative economic historian as Foreman Peck, quite familiar to use historical data and statistics to showcase a neoclassical approach to economic growth, recognized that compelling banking regulations introduced in the US during the early 1930s prevented the banking system from pouring sight and time deposits into highly risky financial instruments. These measures averted liquidity shortages[24].

In the wave of this interpretative shift in the literature, it is worth advancing a rather different interpretation of the process of international economic interdependence based on the ratio of capital supply to consumer spending. In the following section the paper examines the expansion in base money under the early Roosevelt administration. The aim is to situate this increase in capital supply for investments in the framework of the legislation on bank regulation passed by the US Congress. The argument is that this legislation was essential both to attract investors on the US stock market, and to protect them from the instability of financial markets and industrial output.

4. The transnational dimension of the Great Depression and the ratio of investments to consumer spending, 1929-1933

The leading literature on the Great Slump of the early 1930s focused on the American economy and debated its origins. A cohort of historians and economists placed it against the system of international monetary relations, while others stressed the very endogenous nature of the Great

[23] the literature critical of cliometrics is abundant. Without carrying any pretence of comprehensiveness see Boldizzoni, *The Poverty of Clio*; and Clemente, "L'Italia e il commercio estero in età liberale", in *Quello che i numeri non dicono*, ed. Moricola, 17-46.

[24] Foreman-Peck, "Great Recessions Compared", 100.

Crash. Both interpretations argue that the onset of the Great Depression accelerated the making of twentieth century international interdependence based on the combining between international capital mobility and domestic aggregate demand.

The first historical account focuses on the role of Federal Reserve and other leading Central Banks in trying to redress the balance between money supply and industrial credit. According to a classical interpretation recently presented again[25], the Great Depression should be led back to a persistent lack of cooperation among the western Central Banks on how to best use gold reserves to re-launch productive investments and consumers' demand[26]. This approach pointed to the Gold Standard's compulsory rules on reserve requirements to explain why most national monetary policies failed: as Central Banks converted their dollar and pound holdings into reserve assets, they contributed to decrease liquidity for fixed capital formation[27]. On the other hand, a number of classical studies insisted on the limits that the Gold Standard posed on the US monetary authority's freedom to alter currency in circulation. As the Federal Reserve was the largest holder of gold reserves, its rather limited margin of action would account for its ineptitude before the 1929 Great Crash.

The first interpretation argues that in the early 1920s the western governments agreed on tackling the problem of decreasing the price of commodity goods[28]. In order to reach such target they pledged to undertake a set of productive investments that hinged on a substantial expansion in gold reserves in each western Central Bank. As far as in a gold pegged international monetary system the better it is the ratio of gold reserves to currency in circulation, the sounder it is the foreign exchange rate, this agreed intervention to expand gold reserves was aimed at stimulating

[25] see for example Goodhart, "The Past Mirrors", 138 ff.

[26] James, *The Creation and Destruction of Value*; a work consistent with James is Boyce, *The Great Interwar Crisis*.

[27] Schenk, "The Global Gold Market", in *The Global Gold Market and the International Monetary System,* ed. Bott, 22.

[28] see a classical study by Lee, "The Effects of Recession", 139-155.

a non-inflationary growth. The Federal Reserve Bank of New York opposed this strategy by refusing to cede gold to its partner economies, by freezing its gold reserves, and by implementing federal credits. This policy turned into an expansion in money supply and triggered price-push inflationary strains across the international economy[29]. From 1927 to 1931 this development uttered in an unprecedented expansion in US gold reserves. This policy proved to be detrimental to the US trading partners because lack of adequate gold reserves weakened Washington's partners on the foreign exchange markets and worsened their current account deficit.

The second wave of studies points to a different understanding of the Great Slump: they link the policies of Federal Reserve to the internal dynamics of the American economy. Notwithstanding this different approach, even this scholarship establishes a linkage between US monetary policy, and the uncertain balance between capital supply and consumer spending. This thesis expands upon a well-grounded scholarly point about the high degree of monetary cooperation among western Central Banks to stabilize gold reserves since the very early-1920s.

Recently, Cassis maintained that prior to the outbreak of World War I, during the first Gold Standard France had repeatedly provided the sterling area with gold tranches drawn upon its metallic reserves in order to stabilize the gold parity of British sterling. The inflow of metallic reserves into the Bank of England supported British sterling on the foreign exchange markets and propped up London's balance of payments on current account[30]. By the mid-1920s the Federal Reserve transferred gold coins to several central banks in support of their respective currencies on the exchange markets. From 1926 to 1928 this foreign monetary policy led Washington to suffer from a sharp decline in its gold reserves[31].

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[29] see Rothermund, "War-Depression-War", 841-842.

[30] Cassis, "Financial crises and the balance of power", 927-928; id., *Crises and Opportunities,* 114.

[31] Green, *Central Bank Gold Reserves*.

Therefore, does this scholarship suggest, on the eve of the 1928 historical decision of the Federal Reserve to peak up nominal interest rates, a turn laying at the origins of a contraction in base money between 1929 and 1931[32], the US gold reserves were in shortage. According to this interpretation, the United States raised nominal interest rates to attract much-needed gold from abroad[33]. While stimulating the inflow of gold into the United States, such rise in nominal interest rates led many European investors to pour money into the very lucrative American equity markets. This process caused mounting expectations for further increases in the cost of money that laid the groundwork for the very late-1920s' financial bubble.

By contrast, upward real interest rates led the most interest-sensitive manufacturing sectors as the car industry or the construction industry to sink, thus paving the way for the collapse of Wall Street and industrial output. Peter Temin forerun this interpretation. In his view the collapse of Wall Street anticipated the contraction in industrial output, while the following wave of financial divestitures preceded the decrease in consumer demand since 1930. To put his thought the reverse side, a dwindling stock market triggered a contraction in aggregate demand which he considers a function of it[34]. A wide-range of reliable statistical series confirms further that interconnectedness. Both data on the stock of money for investments, GNP and inflation-adjusted per capita consumption in the US from 1929 to 1931[35]; and the NBER aggregate figures on money supply and consumer spending between 1929 and 1934 track two trends. By combining such data it is easy to chart a substantial decrease in disposable money supply for fixed capital investments, and

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[32] see data set on money supply and growth money respectively reported in Friedman and Schwartz, *Monetary trends,* and Castaneda, *Gold Statistics Worldwide*.

[33] Temin, *Lessons from the Great Depression*; Hamilton, "Monetary Factors", 145-169; Eichengreen, *Gold Fetters.*

[34] against this backdrop, a fall off in the American households' consumer demand prevented the ongoing decrease in industrial credit from bankrupting the American family. See Olney, "Avoiding Default", 319-335.

[35] Board of Governors of the Federal Reserve System, *Banking and Monetary Statistics*; Temin, "Lessons", 40-45.

an unfettered contraction in private consumption from 1929 to 1933[36]. This combined contraction in stock of money and consumer spending took place in the framework of the conflict between Washington's high interest rates policy and the European Central Banks, which raised the cost of borrowing to avert capital flight from western European countries to the US[37].

Christina Romer and Michael Bordo acknowledge that Federal Reserve's high interest rates contributed to let the Great Depression run unchecked. However, they stress that the Federal Reserve upheld high interest rates way after 1930, when US gold reserves rebounded substantially. In their view, this incongruity between the cost of money and the re-establishment of gold reserves should prevent scholars from linking US domestic monetary policies to the Gold Standard international system.

By contrast, they point to a number of internal dynamics to explain the beginning of the Great Slump. To summarize them, they mention the appearance and endurance throughout the 1920s of rigid nominal wages caused by the introduction of a set pay scale. Besides, they stress a widespread attitude of American corporations to peak nominal wages in order to revamp market confidence.

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[36] Balke and Gordon, "Appendix B: Historical Data", in *The American Business Cycle,* ed. Gordon. According to this historical data money supply contracted between 1929 and 1933, while real consumption experienced a proportional decrease only between 1932 and 1933. For the following years data can be retrieved at this address: https://www2.fdic.gov/hsob/HSOBRpt.asp.

[37] between 1919 and 1930 US foreign investments by absolute value doubled up to a peak outstripped only in the very late-1940s: R.L. Sammons (Associate Director, Division of Governors of the Federal Reserve System at the Senate Antitrust and Monopoly Subcommittee Hearings on the International Aspects of Antitrust), 'US Business Investment and Financial Activity', April 16, 1966, in NARA, Records of the Federal Reserve System [hereafter RG82], Division of International Finance and Predecessors, International Subject Files 1907-1974, b. 184, f. Economic and Financial Conditions General 1966-1967.

Furthermore, Romer argues that the Federal Reserve raised real interest rates to cool off the upturn in borrowing for industrial credit to halt inflation[38].

What matters most about this interpretation is that even Romer and Bordo establish a clear connection between transnational capital flows and the stock of money, and the dynamics of domestic demand. Romer singles out a causal sequence heading from the downfall in US industrial production starting at the end of Summer 1929 to the meteoric expansion of open market sales of bond and securities on Wall Street that uttered in the financial crash of October. This interpretation suggests that the early contraction in consumer spending that hit the American economy during the second half of 1929 caused the eruption of the banking crisis and the beginning of open market sales of securities. Therefore, she links the interrelation between slipping aggregate demand and the decline in money supply to the interwar process of transnational flows in money and gold. Shortly after the Federal Reserve increased US interest rates, gold drew to the United States. Washington's following decision to convert gold inflows into paper money sparked a non inflationary expansion in liquidity that laid the groundwork for the industrial policies of the New Deal[39].

The main interpretations of the turn-of-the-1920s Great Slump suggest that both when the balance between capital supply and aggregate demand critically deteriorates, and when policies successfully redress it, the process of international economic interdependence develops along two directions. On the one side the historical appraisals of the Great Slump confirm that the rapport

[38] a variety of data-sets helps to track the upturn mode of Wall Street. Among others, short-term time deposits flared up in 1926 and since 1928 thereafter. See for example yields on three-month time securities: *The National Bureau of Economic Research, NBER Macrohistory:XIII. Interest Rates*, http://www.nber.org/databases/macrohistory/contents/chapter13.html. Romer, "The Nation in Depression".

[39] Romer, "What Ended the Great Depression?", 757-784.

between transnational financial transactions and domestic consumers demand is topical to better define economic interdependence. On the other hand, the historiography on the Slump has argued that the linkage between international capital movements and domestic aggregate demand revolve around the pivot of cross-national gold movements. Either historical accounts stress that open market sales of securities, the option for divestitures and other capital movements cast light on the sharp decrease in liquidity for investments. They suggest that this process developed notwithstanding the Federal Reserve's commitment to acquire Treasury bonds held by private investors to uphold high powered money.

5. The governing of international finance and the restructuring of aggregate demand in the 1970s

The US design to erect a free-trade system of international economic relations set in motion after World War II carried a pretension to intertwine transnational flows in goods and capital with full support for expansionary domestic economic growth within the advanced industrial economies. Unlike what the aforementioned IPE literature and the New Economic History School argued, since wartime through the early post war era, American foreign economic policymakers resorted to expansionary national economic policies. They also erected a set of regulatory frameworks to foster domestic markets and the free transnational flow of commodities and capitals.

From the mid-1940s to the 1970s the US worked on recasting a dollar-pegged system of international trade and payments by continuously searching for a balance between domestic aggregate demand, and a steady rise in transnational capital mobility. The Employment Act of 1946, essentially strengthened by the Reserve Reform Act of 1977, made provision for heading the US Federal Reserve Bank to promote employment, to increase the private consumption share of GDP, and to expand the US capital market[40]. These legislative actions were the litmus to the American effort to make the process of international interdependence hinge on the Federal Reserve's twin support for consumer spending and stock of money[41]. By contrast, amidst the two energy crises of the 1970s, the US monetary authorities and the Bretton Woods economic institutions countered the unevenly changing transnational capital flows in a rather different manner.

Since the wartime effort, the US project to tear down the interwar grid of protectionist trade barriers in order to erect a highly-interconnected international economic system was bound to sustain an expansion in aggregate demand for primary consumer goods. Since 1943 the US representatives pressurized the Allied Commission to unfreeze a substantial share of hard currency reserve assets accrued to the Central Banks of several belligerent powers prior to their surrender. In so doing, Washington wished to prop up its allies' balance of payments on current account[42]. The US representatives on the Allied Commission made a case for providing most allied European countries with civilian supplies and instrumental goods in excess of basic requirements to foster industrial production and to stimulate smoothly growing domestic markets[43].

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[40] on the Federal Reserve Reform Act see the debate that gripped the Board of Directors of the Federal Reserve Bank of New York in FRBNYA, BOD, Vol. 85, January 6, 1977-December 29, 1977.

[41] Bernanke, "A Century of US Central Banking", 7 ff.; Mishkin, *Monetary Policy*.

[42] the American policy toward Italy is a paramount case in point: Disposition and Control of Italian Foreign Exchange Credits. Agreed Memorandum by U.K. and US Treasuries, December 21, 1943, in NARA, Records of the US Joint Chiefs of Staff [RG218], Geographic File 1942-45, b. 97, f. CCS 091.3 Italy (12-21-43).

[43] Headquarter Allied Commission Economic Section, 'Economic Policy in Italy', November 6, 1944, in NARA, Records of the Foreign Economic Administration [hereafter RG169], Bureau of Areas European Branch, Records Relating to Economic Relief Program for Italy 1943-1945, b. 2 (Documentation-Procedure to Foreign Missions Financial Letters), f. Economic policy.

Shortly after the end of World War II, the US authorities linked the onset of a free system of international trade and payments to the recovery of private consumer spending. This US commitment was straightforward since Washington engaged in lengthy discussions on the most feasible ways of resurrecting the European and Japanese economies, considered end-markets for US manufacturers and the retail industry [44].

In the early 1960s, in contrast with most European Central Banks' decision to face up to the economic slackening through monetary stringency, Washington bolstered an increase in the stock of money for fixed capital investments. Along this line, in 1964 the US endorsed agreements on expansion of IMF member countries' quotas[45]. Likewise, the loans and credit lines that from the first half of the 1960s to the mid-1970s the international economic institutions of Bretton Woods shared out with some advanced industrial economies were to balance the impact of tight monetary policies on industrial credit. This was much the case of the IBRD loans to some industrial economies in response to the European tight credit squeeze typical of the early 1960s[46].

[44] see the official report drawn by Harland Cleveland, then Executive Director of the Economic Section of the Allied Commission, 'Some Conclusions and Recommendations on US Policy and Organization in Italy', May 28, 1945, in NARA, RG169, Bureau of Areas European Branch, Records Relating to Economic Relief Program for Italy 1943-1945, b. 2 (Documentation-Procedure to Foreign Missions Financial Letters), f. Financial Directives.

[45] Briefing Paper prepared by the Department of State and the Department of the Treasury, "Visit of Prime Minister Harold Wilson", in *FRUS 1964-1968, Vol. VIII*, 51-56.

[46] to borrow once more from the Italian case, shortly after the Italian government went for bumping on the economic slowdown by means of decreasing money supply to fight the inflationary strains, the IBRD launched a package of stimulus measures. They were aimed at financing productive investments in the country in order to address unemployment: 'Recent IBRD Mission to Italy and Italian Stabilization Program', August 17, 1964, in NARA, General Records of the Department of State [hereafter RG59], Bureau of European Affairs, Country Director for Italy, Austria and Switzerland, Records Relating to Italy 1943-1968, Lot file 67D319, b. 1, f. Finance; S.E. Cope (World Bank Director of Operations Europe) to Emilio Colombo (Minister of Treasury), May 4, 1964, in World Bank Group Archive, Washington Dc [hereafter WBGA],

Accordingly, from 1974 to 1976 the IMF allotted a number of credit lines to fund the balance of payments on current account of capital-deficit countries as the UK and Italy[47].

Both the IBRD and the IMF considered long-term private capital assets a prerequisite to re-launch fixed capital investments. In so doing, the institutions of Bretton Woods did not impose on the beneficiary countries a tradeoff between extending credit lines, and adoption by them of economic policies widely-regarded as the hallmark of international financial respectability such as decontrol policies on the national labor markets or the tearing down of national barriers to transnational capital movements. Rather, the two institutions called on the beneficiary member countries to improve their credit standing before international investors. Likewise, the IMF and the IBRD fully endorsed the issuing of relatively long-term fixed rates loans. This policy was intended to prioritize an increase in employment rate and consumer spending.

Shortly after the first four-fold oil price hike of 1973 this guideline clearly run the IMF in conducting bilateral negotiations with its member countries on the Fund's assistance packages designed to resurrect their current account deficit. As both the Italian and British economies suffered most from the impact of the so called "oil bill" on their current account, the governments of Rome and London are a case in point. The IMF position toward London and Rome showcases this intertwining between financial assistance, the adoption of binding domestic economic policies, and the pursuit of sustained domestic growth. The Fund bound its financial assistance to the adoption of both tight monetary and fiscal policies to fight inflation, and to expansionary credit

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Records of the Office of the President, Records of President Robert S. McNamara, Contacts-member countries files, Italy-Non Project-Cassa per il Mezzogiorno-Administration 02, Loan n. 419.

[47] IMF European Department, 'Briefing Paper -1974 Article VIII Consultation approved by A. Pfeifer', June 17, 1974, in Archive of the International Monetary Fund [hereafter IMFA], Central Files, C/Italy/810 Mission Italy and Staff June-July 1974; see also the documentation in IMFA, J. Polak Papers Fonds, Chronological Series, b. 4, fold. 17(Coordination of Demand Policies 1978).

policies. Such stimulus policies were intended to make up for capital outflows caused by the inflationary strains of the recession[48].

The IMF viewed either policies as prerequisites to increase the GDP and to stimulate consumer spending. This search for a balance between external equilibrium and domestic investments run American foreign assistance policy through the second oil crisis[49].

As soon as Jimmy Carter came to power, such stance was extended to US domestic economic policy. The adoption of internal expansionary policies, quite extensively discussed within the Ford Administration[50], became a top priority issue on the agenda of the Economic Policy Group under the Carter Administration[51]. Furthermore, the new US government strove to enforce coordination of private capital markets to prop up gross capital investments. This policy led Carter's approach

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[48] this was exactly the case of the IMF negotiations with Italy to let Rome draw on its quota of the Fund's Special Drawing Rights. See A.D. Crockett, 'Note for file "Italy" ', June 19, 1974, in IMFA, Office of Managing Director Witteveen, Chronological Files, b. 1, f. 2; Witteveen to Emilio Colombo (Minister of Treasury), April 23, 1976, in IMFA, Office of Managing Director Witteveen, Chronological Files, b. 2, f. 10; IMF European Department, 'Italy Briefing Paper 1974 Article VIII Consultation 17 June 1974', in IMFA, Central Files, Country Files-Italy*,* b. 6, f. 26 (Mission Rose and Staff June-July 1974). It is worth placing along this line several more measures that the US government suggested to Italy since 1977: see AmEmbassy Rome to Secretary of State Washington DC, 'Possible additional labor costs measures being studies by GOI', January 28, 1977, in NARA, RG56, Office of the Assistant Secretary for International Affairs, Office of the Deputy Assistant Secretary for International Monetary Affairs, Office of Industrial Nations and Global Analyses, Records relating to Portugal, Italy and Spain 1976-1981, b. 2, f. I-10 January 1977).

[49] A. Pfeifer to Witteveen, 'Italy. Briefing Paper for the Managing Director', March 24, 1975, in IMFA, Central Files, Country files-Italy, b. 6, f. 27 (Mission Witteveen April 1975).

[50] Stein, *Pivotal Decade,* chapter 3.

[51] the minutes of the Economic Policy group are located in NARA, RG56, Office of the Assistant Secretary for International Affairs, Office of the Deputy to the Assistant Secretary for International Affairs, Records Relating to International Financial Institutions 1962-1981, b. 2, f. IM-5 Boards, Committees, Organizations, Panels, Working Groups 1977-1978.

to the Federal Republic of Germany and Japan, at the time the largest consumer markets, on the occasion of the industrial nations' London Summit held in Spring 1977[52]. Therefore, still amidst the two energy crises the US foreign economic policymaking elites drew upon a long-lasting model of economic interdependence based on the interconnectedness between transnational capital supply and domestic aggregate demand.

Apparently, American policy did work out: the ratio of domestic demand to the balance of payments recorded in Japan around 1977 smoothly improved, while after that year most industrial economies adopted mild expansionary fiscal measures[53]. This approach also underpinned the development assistance programs of the IBRD. Shortly after his appointment to the head of the IBRD, the new president McNamara initiated economic contacts with most industrial nations to finance his announced 5-year development assistance package. From 1967 to 1969 he reached agreements on both public and private placements with several of the Bank's member industrial

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[52] the minutes of the London Summit can be found in NARA, RG56, Office of the Assistant Secretary for International Affairs, Deputy Director of the Office of International Monetary Affairs, Subject Files 1977-79, International Monetary Group to Sdr, b. 2, f. London Summit 1 of 4. In this respect see the following US Treasury documents: 'Multilateral Balance of Payments. Financing Arrangements and Options for Expansion', February 7, 1977; 'US Strategy for Easing Strains on the World Trade and Payments system', February 7, 1977; 'Talking Points on Witteveen Proposal for IMF Supplementary Credits for use with Aba al-Kahil Saudi Finance Minister', all of them in NARA, RG56, Office of the General Counsel. Assistant General Counsel, Records relating to OPEC Financial Affairs 1974-79, b. 1, f. part 2 of 4 1977-79.

[53] American Embassy Tokyo to Secretary of State Washington DC, 'Tokyo Summit Preparation', telegram, June 20, 1979; American Embassy Tokyo to Secretary of State Washington DC, telegram, June 20, 1979, both in Jimmy Carter Presidential Library and Museum, Atlanta, GA [hereafter JCPL], RAC Project number NLC-16-12-5-21-3; regarding the fiscal policies of the most important West European countries see Helmut Schmidt to Jimmy Carter, telegram, December 22, 1977, in JCPL, RAC Project number NLC-102-3-4-1-0.

economies, from the UK to Italy[54], from Belgium to the Netherland and Sweden[55]. It is worth focusing attention on the negotiations involving president McNamara and the German government, on the purchases by the German commercial banks of bonds issued by the IBRD to fund its development finance plans designed to resurrect the current account deficit of the non oil producing less developed countries (LDCs)[56]. These negotiations clearly highlights that the IBRD linked development finance and domestic growth. McNamara himself stated that restructuring GDP and the consumption share of GDP in each Latin American economy was a prerequisite to reorganize the Latin American countries' import of low capital intensive consumer goods from European manufacturers. Such economic recovery was also aimed at recasting the export of commodities from Latin America to European markets[57].

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[54] See telephone conversation, The UK Chancellor of the Exchequer-R. McNamara, 'Annual Meeting 1969. Meeting with Governors of Part 1 countries. United Kingdom', note on the telephone conversation by Vice President D. Rickett, September 24, 1969, in WBGA, Records of the Office of the President, Records of President Robert S. McNamara, Contacts-member countries files, United Kingdom-Correspondence 01.

[55] telephone conversation, The Governor of the Bank of England-McNamara, 'Annual Meeting 1968. United Kingdom', October 9, 1968, in WBGA, Records of the Office of the President, Records of President Robert S. McNamara, Contacts-member countries files, United Kingdom-Correspondence 01.

[56] On the issuing of bond and debt securities denominated in US dollar and in DM in Germany see Memorandum of Conversation 'Visit of Minister Strauss with President McNamara on July 24, 1968', July 25, 1968; Memorandum of conversation Guth-Feith-Krebs (German government)-S. Aldewereld (IBRD)-R.W. Cavanaugh (Deutsche Bank), August 2, 1968, and R. McNamara, Memo of telephone conversation Aldewereld-McNamara, August 2, 1968, all in WBGA, Records of the Office of the President, Records of President Robert S. McNamara, Contacts-member countries files, Germany-Correspondence 01.

[57] For example, McNamara made a case for this approach during the negotiations conducted with the Bank of England on London's Central Bank purchasing of debt securities from the Bank in Washington: Office of the President, Meeting with Sir Geoffrey Howe, Chancellor of the Exchequer, UK, September 29, 1979, in WBGA, Records of the Office of the President, Records of President Robert S. McNamara, Contacts-member countries files, United Kingdom-Correspondence 04, b. 209355B; see also R. McNamara to Jen Pronk (Netherland Minister of Development Cooperation,

In striking contrast with this long-lasting foreign economic policy, during the first oil crisis all leading macroeconomic indicators and the shape of private capital markets suggest a rather different ratio of money supply to demand for investments. Besides, when compared to the early 1930s, the Federal Reserve took a rather different approach.

In his pioneering comparison of the ratio of stock of money to consumer spending between the early 1930s and the macroeconomic effects of the first oil shock in 1974 and 1975, Peter Temin argued that in 1975 real consumption slackened much less in proportion to both the decline in GNP and the contraction in money supply. Furthermore, he made the point that both money supply and the consumption share of GNP experienced a contraction but did not dwarf as in the very early 1930s[58]. Temin established a correlation between the stock of money and consumer spending: he argued that from 1974 to 1975 the real growth rate of the American economy slipped down less than at the end of the 1920s. Temin focused on the patterns of real per capita consumption, stressing that the early 1930s deflationary strains made the average household debt grew larger and bumped on private consumption. By contrast, amid the first oil crisis a peaking inflation made household debt contract, thus expanding disposable income and per capita demand for consumer goods[59].

If we tackle the most recently released statistical series, money supply dwarfed neither within the United States nor across the international financial system. This is all the more remarkable as

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October 14, 1975, in Library of Congress, Manuscript Division, Washington DC [hereafter LOC], McNamara Papers, Part I, b. 29, fold. 1 (International Development Association-Replenishment fifth).

[58] Temin, *Lessons from the Great Depression*; for a snapshot about this tendency featuring money supply, GNP at 1958 current prices and inflation adjusted private expenses see Council of Economic Advisors, *Annual Reports*, 1975, 1971; *Survey of Current Business*, years 1974-1976; Standard and Poor, *Trade and Securities Statistics*, years 1974, 1975.

[59] Temin, *Lessons from the Great Depression*; Mishkin, "The Household Balance Sheet"; id., "Illiquidity, Consumer Durable Expenditure".

a wave of banking failures shook up the western banking system from late 1973 through 1975. Furthermore, over the few months following the first oil price hike the cost of money did not flare up: from January to Summer 1974 neither yields on investment loans nor output prices skyrocketed[60]. Moreover, during the entire period stretching from 1972 to 1977 the US manufacturing system registered a yearly increase in capital stocks that outpaced by one-third the one recorded from 1977 to 1982[61]. This scarce impact of the first oil crisis on the cost of fixed capital investments and on industrial productivity, coupled with a set of monetary measures undertaken by the Federal Reserve, help to better understand the ratio of money supply to consumer spending and its striking contrast with the early 1930s.

From October 1973 through Fall 1974 a series of banking failures hit both the American and the European banking systems[62], soon followed by the collapse of some 29 regional and local American intermediaries through 1975[63]. From the collapse of the US National Bank of San Diego in October 1973 to the eye-catching failures of German Herstatt in June 1974 and Franklin National Bank in the United States a few months later in the Fall, banking panics spread out and

[60] IBRD, Trends in the Euro-Bank Loan, and the Euro-bond Market, undated (probably September 1974), in NARA, RG56, Office of the General Counsel. Assistant General Counsel, Records Related to Opec Financial Affairs 1974-79, b. 2, fold. F Part 4 of 4 1974-1978. See also OECD Working Party n. 2 of the Economic Policy Committee, 'The Macro-Economic Impact of higher energy Prices over the medium term ', December 2, 1974, in NARA, RG56, Office of the Assistant Secretary for International Affairs, Office of the Deputy Assistance Secretary for International Monetary and Investments Affairs, Records Relating to OECD monetary committees and working groups 1961-1974, b. 15, fold. EPC/WP-2 Documents 1973 Cont'd 1 of 2.

[61] See Bartelsman and Gray, "The NBER Manufacturing Productivity Database".

[62] *Annual Report of the Federal Deposit Insurance Corporation,1970-1977.*

[63] Sinkey, "Identifying Large Problem/Failed Banks", 780-781.

induced several investors to sell equities[64]. Besides, since Summer 1974 the most important commercial banks declared their increasing unwillingness to finance industrial credit[65].

Notwithstanding this trend, throughout the first half of 1974 the largest American commercial banks increased their foreign lending through the activity of their overseas branches[66]. Mostly based in Europe, the overseas subsidiaries of US banks experienced an expansion in their portfolio as they specialized in marketing short-term interest-sensitive financial instruments such as the Eurocurrency assets. Born out of the exceptional expansion in both foreign investments of US resident banks and American overseas public expenditure during the 1960s[67], the Eurocurrency market consisted of financial instruments that accrued to the European capital markets. The Eurocurrency market was a result of foreign investments by third countries, most notably the US, whose capital and yields were not repatriated but reinvested into the European equity and security markets. Notably, these investments were denominated in currencies other -mostly in US dollar- than the resident European country in which they accrued[68]. Due to the uneven rise in the oil

[64] T.D. Willet (Treasury Ministry) to Under Secretary Bennett and Assistant Secretary Cooper, 'Report on Discussions with New York Bankers Concerning Prospective Problems in International Financial Markets', August 7, 1974, in NARA, RG56, Office of the General Counsel. Assistant General Counsel, Records Relating to OPEC Financial Affairs 1974-1979, b. 1, fasc. E Part 1 of 2 1974-1979.

[65] C.D. Keyser to T.D. Willett, Memorandum 'Contingency Planning: Consultations with Bankers', August 5, 1974, ivi; Department of State to OECD Paris, telegram, 'OECD Committee on Financial Markets Meeting', December 11, 1974, in NARA, RG56, Office of the Assistant Secretary of International Affairs, Chronological Files of the Office of Financial Resources and Energy Finance 1974-1977, b. 1.

[66] 'Outlook for International Lending by Banks in 1975', March 24, 1975, in NARA, RG56, Office of the General Counsel, Assistant General Counsel, Records Relating to OPEC Financial Affairs 1974-1979, b. 2, f. G Part 1 of 3 1974-1975.

[67] Harvey, *The Condition of Postmodernity*, 177 ff. ; Fowler, "The Monetary Fifth Column", 825 ff.

[68] the literature on the Eurocurrency market is too vast to summarize here. See Giddy, "The Public Policy Implications", 4-7. Emminger, Otmar. 'The Monetary Consequences of the Oil Price Explosion and its Implications for the Euro-

revenues accumulated by the OPEC countries after the first oil price hike, the oil producing countries invested a significant share of their booming financial assets into short-term Eurocurrency markets: they grew from $160 billion in 1973 to $ 485 billion at the end of 1978 to peak up at $ 600 billion in 1980[69].

Therefore, although the repeated banking failures made most US commercial banks reluctant to reinvest the OPEC member states' financial assets[70], during the first half of 1974 the US banks accepted Arab placements and financed an amount of loans up to $ 12 and a half billion[71]. In the framework of mild inflation and expected price rise, this dynamic short-term capital market was suitable to let lenders acquire short-term assets issued by manufacturers to finance their investments.

In fact, since the last trimester of 1973 the US corporations issued an increasing number of bonds and expanded their borrowing from American banks. At the same time, the so called prime lending rate, technically the cost of loans lent to the most creditworthy enterprises, increased[72].

Currency markets, Address of the Deputy Governor of the Deutsch Bundesbank at the Bank of Spain on October 14, 1974', in IMFA, Central Files, Economic Subject Files, b. 380, fold. 11.

[69] P.A. Volcker, 'The Recycling Problem revisited', Remarks by the Chairman of the Board of Governors of the Federal Reserve System before the Graduate School of Business Administration, New York University', March 1, 1980, in NARA, RG56, Office of the Assistant Secretary for International Affairs, Office of the Deputy to the Assistant Secretary for International Affairs, Records Relating to International Financial Institutions 1962-1981, b. 8, fold. IM-13-7 International Monetary Bank and Banking The Euro-Market 1 of 2.

[70] *World Financial Markets*, January 21, 1975.

[71] see the address by Morgan Guarantee Trust Company vice President De Vries held at the conference organized by the Financial Times in Beirut on 23 September 1974: US Department of the Treasury, Memorandum 'Petrodollars Recycling: Aspects of Financial Market Behavior', September 27, 1974, in NARA, RG56, Office of the General Counsel, Assistant General Counsel, Records Related to OPEC Financial Affairs 1974-1979, b.2, f. G Part 2 of 3 1974-1975.

[72] *OECD Financial Market Trends*, February 1, 1975, CMF 75 (2).

This steady increase in demand for borrowing suggests that the economic slackening stemming from the oil price hikes of 1973 decreased industrial productivity and export. This triggered an excess in demand for borrowing over capital supply. This process was expected to bring about an upswing mode in both the cost of money for investments, and consumer goods prices. In contrast to it, throughout 1974 the price of commodities rose slightly, while in the aggregate currency in circulation and call deposits experienced a slight but constant expansion[73]. Furthermore, from the end of 1973 through early 1975 total net assets of US banks increased by around 30 percent[74]. Therefore, despite any macroeconomic and financial tendency sparked expectations for a striking imbalance between capital supply and demand for investments, this trend was rather limited.

Certainly the involvement of western commercial banks in channeling the OPEC countries' liquid assets after the first oil price shock accounts for this balance between capital supply and demand for borrowing[75]. However, from Summer 1974 onward the US Federal Reserve began playing a crucial role in propping up such balance. As the oil-producing countries' oil revenues were likely to over flood the international private capital markets, Washington's monetary authority struggled to prevent the international economic system from plunging into deflation. From the second half of 1973 to the third trimester of 1974, when the oil producing nations made heavily placements in the Eurocurrency markets, consumer spending kept stable[76]. Therefore, at

[73] We borrow data on currency in circulation and deposits from *Federal Reserve Bulletin*, multiple issues, years 1973-1975.

[74] Federal Deposit Insurance Corporation, "Historical Statistics", in https://www2.fdic.gov/hsob/HSOBRpt.asp.

[75] some preliminary aggregate data on the OPEC deposits and other direct places with US commercial banks from December 1973 and September 1974 are in M. O'Conner to Assistant Secretary of the Treasury Parsky, Memorandum 'OPEC investments in the United States', December 23, 1974, in NARA, RG56, Office of the Assistant Secretary for International Affairs, Chronological Files of the Office of Financial Resources and Energy Finance 1974-1977, b. 1, f. TEFRP Office of Financial Resources Policy Coordination, Permanent Chronological File 1974.

[76] Balken and Gordon, "Appendix B", in *The American Business Cycle,* ed. Gordon.

an early stage the recycling of the oil supplying countries' revenues proved to be successful in upholding the equilibrium between transnational capital supply and domestic aggregate demand.

However, at least a couple of reasons led Washington's monetary authorities to leave aside this strategy based on the Eurocurrency markets. In first instance, it is worth mentioning the impending banks' exposure to poorly rated debtors[77], mostly Latin American governments, which the western commercial banks were used to re-channeling a substantial portion of oil revenues not reinvested in the Eurocurrency markets. Secondly, one should consider the striking maturity imbalance problems between OPEC's short-term placements and the American banks committed to re-invest long to finance structural payments imbalances[78]. Making matters worse, over the following four years a number of macroeconomic changes made it impossible to keep stable the balance between capital supply and aggregate demand in that way. In fact, since as early as 1975 the international recession, coupled with the OPEC countries' domestic investments, significantly reduced the disposable liquidity of OPEC.

Prior to these developments, in Summer 1974 the highest monetary policy makers in Washington worried about what a potential capital oversupply might trigger[79]. The US Department of Treasury and the Federal Reserve brought under pressure the OPEC members to diversify their investment policies. The oil supplying economies should invest their financial assets in three ways:

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[77] IMF Staff Paper SM/74/232, September 26, 1974, in NARA, RG56, Office of the Assistant Secretary for International Affairs, Records Relating to International Financial Institutions 1962-1981, b. 8, fold. IM-13-7 International Monetary Bank and Banking The Euro Market 2 of 2.

[78] IMF Staff Paper SM/74/232, September 26, 1974, in NARA, RG56, Office of the Assistant Secretary for International Affairs, Office of the Deputy to the Assistant Secretary for International Affairs, Records Relating to International Financial institutions 1962-1981, b. 8, f. 2 of 2 (Im-13-7 International Monetary Bank and Banking The Euro-Market).

[79] Memorandum of Conversation Foreign Department of the Federal Reserve of New York Representative (sanitized)-Senior Vice President-Dirck Keyser (Treasury/OASIA), July 26, 1974, in NARA, RG56, Office of the General Counsel, Assistant General Counsel, Records relating to OPEC Financial Affairs 1974-79, b. 1, f. E part 1 of 2 1974-79.

first, they would acquire US Treasury-issued bonds and securities. Secondly, the oil producers were expected to get involved in financing international development assistance either directly by means of providing concessionary credits to the oil-supplying economies, or indirectly, by funding the development programs of the IBRD. In third instance, American monetary authorities exerted pressure on the OPEC countries to undertake a fundamental shift from short-term to long-term investments[80]. In spite of the US commercial banks' reluctance to favor this joint Federal Reserve-US Treasury strategy, by the end of 1974 a significant shift in the OPEC investment patterns had occurred. From the end of 1973 to early 1975 the largest US commercial banks involved in re-investing the financial assets of OPEC countries reshuffled their international lending substantially. In the aggregate, purchases of debt securities and short-term financial assets by the home branches of American banks rose from \$ 26 billion to \$ 45 billion, equal to 70 percent. During the same period, purchases by their foreign subsidiaries surged from \$ 36 million to \$ 51 million, equal to a yearly rise of only 41 percent[81]. Therefore, the American initiative to remake the international capital markets in order to sustain productive investments through an expansion in long-term financial instruments, was successfully implemented.

Soon thereafter, during 1975, on the one side the effects of oil producers' diversification of their financial investments reduced their current disposable assets. On the other, the impact of the 1975 recession hit international demand for oil and OPEC's prospective profits[82]. These two dynamics, coupled with the attitude of the industrial economies to uphold current consumption levels, contributed to set off the widely-known inflation of the decade generated by an excess in

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[80] Council of International Economic Policy, Executive Director Memorandum 'Proposed CIEP Working Group Review of Direct Investment in the US by Oil Producers', July 29, 1974, in Declassified Documents and Reference System.

[81] 'Outlook for International Lending by Banks in 1975', March 24, 1975, in NARA, RG56, Office of the General Counsel, Assistant General Counsel, Records Relating to OPEC Financial Affairs 1974-1979, b. 2, f. G Part 1 of 3 1974-1975.

[82] FRBNYA, Central Files, Records Relating to meetings with New York City bankers.

demand for consumption and investments over capital supply. This process eventually took to a critical juncture the equilibrium between the supply of capital and economic growth.

The Carter administration strove to keep up this policy to stabilize the process of international interdependence[83]. However, the increasing weakening of the US dollar on the international exchange markets[84], the rising financial dependence of the advanced industrial economies on OPEC to finance capital supply, as well as the impending Iranian revolution of 1979 and the ensuing political instability that upset the Middle East in the very beginning of the 1980s, interrupted this story. Such path-breaking transformations paved way for the Federal Reserve's decision to set off a landmark monetary stringency.

6. Conclusion

The ratio of capital supply to consumer spending lies at the center of most historical reconstructions on the Great Depression of the late 1920s. Likewise, it is the subject of a few macroeconomic explorations on the economic downturn of the early 1970s. So far, the economic and historical literatures produced two different approaches to the changing balance between stock of money and consumer spending. On the one side Romer and Bordo, among others, drew it back to the endogenous dynamics typical of the turn-of-the-1920s American economy. On the other hand, scholarship by Kindleberger and Temin placed it against the backdrop of the Gold Standard's

[83] Carter to Lloyd Bentsten (Chairman, Joint Economic Committee US Senate), June 23, 1979, in JCPL, White House Central File, Subject File, Foreign Affairs, b. FO-46.

[84] See John Karlik and Peter Kenen to Undersecretary Solomon, Memorandum 'The International Role of the Dollar and Related Issues', August 2, 1978, in NARA, RG56, Office of the Assistant Secretary for International Affairs, Office of the Deputy to the Assistant Secretary for International Affairs, Records relating to international financial institutions 1962-1981, b. 2, fold. IM-5, Boards, Committees, Organizations, Panels, Working Groups 1977-1978.

international monetary system pegged to British sterling. Based on the reconstruction presented in this contribution, in both historical junctures the changing balance between transnational supply of capital and domestic aggregate demand for fixed capital formation and consumer goods is linked to a reorganization of international economic interdependence distinct from the concept of interdependence formulated in the IPE literature during the 1960s. In the 1960s the linkage between a steady increase in the volume of transnational financial flows and the unevenly booming mass consumer society was the cornerstone of the process of international interdependence among national markets.

This contribution began by outlining this early fine-tuning to then turn attention to the approach and limits of the New Economic History School to the historical dynamics of the international economy. Thereafter we advanced a comparison between the early-1920s and the early-1970s to pinpoint the interconnectedness between financial crises and international economic integration. Along this line of inquiry, we brought forth a new concept of international economic interdependence revolving around a key role played in either case by the international monetary institutions in recasting such a linkage between capital supply and consumer spending. We focused attention on the role of the US Federal Reserve to explore the changing balance between stock of money and consumer spending in the late-1920s and during the first energy crisis of the 1970s.

This contribution helps to understand that during the Great Slump a striking decrease in liquidity for productive investments triggered a contraction in both consumer spending and lending by bank intermediaries. On the other, we pointed to the role of Federal Reserve and the Bretton Woods international economic institutions in upholding the balance between stock of money and consumer spending. We stressed how the US foreign financial policymakers pursued this target through the implementation of redistributive financial policies to make the oil exporting countries diversify their investment patterns on the international capital markets. A comparison between the two historical watersheds casts light on the different role played by the Federal Reserve. From the late 1920s through to the coming of Roosevelt to the White House the US monetary authority financed the supply side by means of purchasing Treasury bonds held by private investors. In contrast, by the mid-1970s the Federal Reserve and US Treasury had to cope with an uneven redistribution of financial assets of the OPEC oil producers. Shortly after the first four-fold oil price increase the Federal Reserve straddled to curb this purchasing power shift from the industrial economies to developing economies with low propensity to long-term investments. In so doing, US authorities aimed at reversing the oil producers' attitude to invest in short-term highly liquid financial instruments. Instead of facing up to the impending inflationary strains that stemmed from the oil price rise by peaking interest rates, American monetary authorities called on OPEC members to diversify their investment patterns by pouring their financial assets into financing US Treasury bonds and securities, and by investing in the American equity market. This policy was intended to dry up the meteoric financial flow from the Middle East to the Eurocurrency markets and to re-launch investments in fixed capital formation. This process developed smoothly from the second half of 1974 to the first half of the following year. During the first part of 1974 the oil producing countries invested their financial assets in short-term inflation sensitive capital markets owing to the expected inflationary uptick in the cost of money. In this framework, we can explain why consumer prices kept stable, while by contrast a sharp decrease in output and consumer spending would lead the monetary authority to raise the cost of money to stimulate capital inflow.

The ratio of disposable capital supply for investments and domestic aggregate demand was far different during the two historical economic downturns. During the late-1920s, notwithstanding the Federal Reserve's attempt to make foreign capital inflow into the American economy, money supply decreased and consumer spending dwarfed. By contrast, in 1974 deflation substantially contributed to decrease household debt, thus supporting consumer spending, while the ascendancy of the oil producing countries on the world financial stage accounts for booming Eurocurrency markets and the stability of money supply.

Therefore, a comparison between the two most striking financial crises of the twentieth century heads to argue that recasting the interrelation between liquidity on the supply-side and aggregate demand on the demand-side was in either case based on the least common denominator of transnational capital flows. On the other hand, the timing and extent of the Federal Reserve's intervention to stem the crisis should be placed against this far different balance between stock of money and consumer spending.

Acknowledgments

The German Historical Institute in Washington DC and L'Orientale University of Naples (Italy) are kindly acknowledged for funding research and writing to finalize this research. A first draft of this contribution was discussed at the Multidisciplinary Research Workshop "The Political Economy of Regulation", May 20, 2016, European University Institute, Italy.

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