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The genesis of austerity (Part 2)

The post-WWI cauldron of neoliberalism

By Elisa Barwick

*Following World War I, European nations, which had paid for the manipulated conflict with the blood of millions of young men, faced heavy debt burdens, disrupted economies and crushed infrastructure, with a compounding crisis of supply shortages and mounting inflation. Any inclination towards the American System model of uplifting the real economy with national credit directed into productive development (Part 1), had been purposely killed. Europe was ripe to be swept into a new economic order, one that would reduce inflation and increase **relative** economic capacity by smashing the standard of living of the vast majority of the population through an austerity regime. The architects of the new arrangements imposed inviolable rules administered by supposedly independent experts, forming a veritable bankers' dictatorship.*

Echoing British Munitions Minister David Lloyd George's 1915 warning that WWI would unleash a "deluge" of changes in the political order, a month after the war ended US President Woodrow Wilson told staff onboard the SS *George Washington* that "Liberalism is the only thing that can save civilisation from chaos". To avoid "the typhoon", he intoned, "Liberalism must be more liberal than ever before". While the US Congress rejected League of Nations (LoN) membership (despite Wilson's key role in designing it), the USA would soon be swept up in the new economic framework the LoN set into motion.

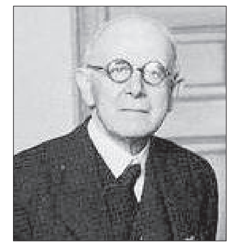
Liberalism was reinvented to lock nations into austerity, but the new post-war economic doctrine didn't fall far from the classical liberal tree. It stemmed, as economist Mark Blyth summarises, from John Locke's economic individualism, David Hume's denunciation of state debt, and Adam Smith's emphasis on parsimony (frugality) as the driver of private investment, via savings.[1]

The British austerity doctrine

Before launching the new order on an international scale, the British Treasury ran a pilot project at home. A key figure in devising the UK's severe post-WWI austerity policy was Ralph G. Hawtrey, a Cambridge mathematician and economist who had worked at Treasury since 1904. His prescriptions, which became known as the "Treasury view", were embraced by both the Treasury and the Bank of England. Hawtrey advised then-Chancellor of the Exchequer (1924-29) Winston Churchill and influenced two controllers of finance, a position with the greatest control over the chancellor: Sir Basil P. Blackett (1917-22) and Sir Otto Niemeyer (1922-27). Blackett went on to enforce austerity as finance member of the Viceroy Executive Council in India (1922– 1928); Niemeyer, a close friend of Bank of England Governor (1920-44) Montagu Norman, would later direct its use abroad, from Brazil to Australia.

Economic historian Clara Mattei has documented how Hawtrey translated this British austerity model into international doctrine at conferences held in Brussels, Belgium (1920) and Genoa, Italy (1922), which set the stage for supranational control of national economies.[2]

With a large war debt, British policy after WWI was focused on balancing the budget, debt reduction and reducing public expenditure. The top priority was price stabilisation—keeping inflation down and the currency stable. With around a million Britons killed in the war, the economy was in tatters, but Hawtrey's plan would crush it further with a radical adjustment of wages and prices, deemed necessary to stabilise currency values, trade flows, and restore the gold standard, which had been suspended or abandoned by most countries during the war. The gold standard, administered from the City of London, fixed the value of currencies to the price of gold, restricting the money supply and the ability of governments to issue credit.


British Treasury official Ralph G. Hawtrey. Photo: Wikipedia

This adjustment, Hawtrey admitted, would be a "painful and laborious journey", demanding national sacrifice. Treasury files examined by Mattei reveal that the Advisory Committee of Finance and Commerce of the Trades Union Congress and the Labour Party, in a June 1924 memorandum, protested that raising interest rates "looks very much like a sacrifice of the immediate interests of the general community to the immediate interests of the bankers."[3] For the Treasury technocrats, however, such a priority "even overwhelm[ed] any reservation about the lack of democratic representation", wrote Mattei; or, as Blyth put it, "[Y]ou can't run a gold standard in a democracy"—or at least only until the voters boot you out!

Hawtrey was obsessed with inflation, which stemmed, he believed, from the "unruly nature" of credit. Increased credit would lead to increased production, higher employment, heightened consumer purchasing power and therefore greater demand, stimulating more growth, more credit and so on. Such a spiral was incapable of self-correction, he believed. Viewed through the monetarist lens, employment and higher wages were seen not as an achievement of economic progress but a threat to fixed standards of value such as the gold standard (and to the power of the City of London bankers who managed it), through inflationary pressure. In a memo to the Chancellor, Blackett blamed inflation on the increased purchasing power of the poor classes, previously "restricted by the narrowness of their purses". As Blyth describes, to uphold the gold standard, "the domestic economy was quite deliberately going to be squeezed so that the value of sterling and, not coincidentally, the profits of finance, would be maintained."

Regressive taxes were increased to impose "compulsory thrift" on the poor. The focus on debt reduction meant funnelling money to the holders of that debt, namely the wealthiest layers of society. In a 1921 note to the Chancellor,

1. Mark Blyth, *Austerity: The History of a Dangerous Idea* (Oxford U. Press, 2013).
2. "Hawtrey, Austerity, and the 'Treasury View', 1918-25", *Journal of the History of Economic Thought*, Dec. 2018.
3. Clara Mattei, *The Capital Order: How Economists Invented Austerity and Paved the Way to Fascism* (U. of Chicago Press, 2022).

A 1926 rally demanding adequate housing for Britons. Photos: historic-uk.com

Niemeyer stated outright that "debt repayment extracts money from those who are not likely to save and invest [the poor] and makes it available to those that are more likely to do so".

New government spending would be met, said Hawtrey, by "taxation or loans drawn from genuine current savings". A Hawtrey memo inspired an infamous 1929 budget speech by Churchill in which the Chancellor levelled the now popular argument that government borrowing in the market crowds out private enterprise. Hawtrey argued in a 1925 article in the economics journal *Economica* that the "contention that public works give employment themselves is radically fallacious".

A 1921 Committee on National Expenditure that earned notoriety as the "Geddes Axe", named for its chair Sir Eric Geddes, shuttered public housing programs, universal healthcare plans, defence, and planned compulsory education; but unemployment payments grew. The number of unemployed workers had already quadrupled in one year, from 1920 to 1921, to 17 per cent of the labour force. The Treasury simultaneously ran a privatisation program, eradicated "superfluous ministries", slashed public service salaries, and laid off 11 per cent of public employees in one year. All up, some 20 per cent of central government spending was cut.

To put down dissent, the British government engaged in restrictive actions, including the October 1920 *Emergency Powers Act*. With the declaration of a "state of emergency", it was utilised during strikes, allowing interventions for any "purposes essential to the public safety and the life of the community". New legislation limited strikes and made participation in unlawful strikes a criminal offence. In 1927-28 the number of strikes halved, compared with three years prior. Union membership halved within ten years. This increased what Mattei calls industrial austerity, and the erosion of workers' rights and conditions. Industrial wages declined by two-thirds from 1920 to 1922.

The bankers' plan

Britain's post-WWI financial plans would involve the delegation of powers through an international network of bankers, including those ensconced in the central banks of nations. With European nations reeling from the loss of life and economic capacity (some 4 per cent of the German and 3 per cent of the Italian population, for example, had been wiped out by combat and disease within less than five years, not counting the influenza epidemic of 1918, which killed millions more across the continent), the proposal to subject these nations to further sacrifice would require some craft.

British government officials worked closely with prominent banking families (including Baring, Warburg, Rothschild, Morgan), insider Carroll Quigley explained, to enshrine the absolute "sanctity of all [monetary] values and the soundness of money" into an immutable economic system.[4] The banking network, he said, was "devoted to secrecy and the secret use of financial influence in political life". It "was necessary to conceal, or even to mislead, both governments and people about the nature of money", to accomplish their task. As Hawtrey wrote in a 1925 memo, "The future of currency notes", absolute economic power belonged to a "closed oligarchy".

In 1925 Montagu Norman told Benjamin Strong of the New York Federal Reserve Bank there was need for a "private and eclectic Central banks' club, small at first, large in the future". A mid-1927 meeting in New York would kick off this process. Norman, Strong, Charles Rist of the Bank of France, and Hjalmar Schacht of the German Reichsbank took part.

A series of international conferences in Paris in 1867, 1878, and 1881, and in Brussels in 1892, had attempted to coordinate international financial relations among national financial agencies. Proposals had been entertained for a single gold (and potentially silver) standard; decimalisation and coordination of currencies; an international currency; and an international clearing house. Gianni Toniolo, historian of the BIS and economics professor at the University of Rome, wrote that the conferences "aimed to codify a monetary utopia".[5]

The Venetian financier Luigi Luzzati, an Italian Member of Parliament, Treasury minister (late 1890s until mid-1921) and prime minister (1910-11), was one of the earliest voices pushing for coordinated central bank control of national economies. In a 1907 article he argued that the liquidity crisis, or "monetary famine", of that year, combined with a US stock market slump, had sparked a "monetary war". He called for an international financial commission, free from political interference, to coordinate "international monetary peace", so that national interests did not colour what should be—so he claimed—technical and apolitical interactions. US Treasury Secretary George Cortelyou, a close adviser to Wall Street favourite President Theodore Roosevelt, reacted positively to Luzzati's ideas, proposing a European central bankers' conference to flesh out the proposal.

These ideas were taken up at a 1912 Brussels conference of European nations, many of which saw the newly established American Federal Reserve as a model for an international central bank. Coinciding with the outbreak of war, the financial crisis of 1914—the most serious liquidity, currency, stock market and banking crisis the UK had ever seen[6]—saw the matter pushed up on the agenda. Luzzati continued to preach his vision for "monetary peace" at conferences in Paris in 1915 and 1916, and would do so in Genoa, Italy at one of the major post-war conferences.

At a 1916 London economic conference, French Commerce Minister Étienne Clémentel demanded "a new economic era, one which permits the application of new methods, founded on control, on collaboration ... a new order of things, which will mark one of the great turning points in the economic history of the world." He saw potential for France, Britain and the USA to control key raw materials, with European integration a crucial facilitator. Jean Monnet, who had assisted Arthur Salter in setting up the wartime resource and goods cartels (Part 1), was his collaborator in this endeavour.

The international financial conferences held at Brussels in September-October 1920 and Genoa in April-May 1922 brought this agenda closer to fruition. After the Brussels

4. Carroll Quigley, *Tragedy and Hope: A History of the World in Our Time* (Macmillan, 1966).
5. Gianni Toniolo, *Central Bank Cooperation at the Bank for International Settlements, 1930-1973* (Cambridge U. Press, 2005).
6. "National banking as war prevention strategy", *AAS*, 15 Dec. 2021

forum, Bank of England Governor Montagu Norman wrote a manifesto, the "General Principles of Central Banking" (1921), which specified "autonomy and freedom from political control" for all central and reserve banks and mandated cooperation among them. This work laid the foundations for the creation of the Bank for International Settlements (BIS) in 1930, but the concept would first require a proving ground.

Brussels, 1920

The League of Nations convened the Brussels conference, with delegates from 39 nations. (The USA was there unofficially; Soviet Russia, still in the throes of its brutal civil war, was not represented.) Its purpose was to find a "means of remedying and of mitigating the dangerous" financial crisis, according to League documents. On the agenda was the Treasury checklist: tackling the inflation threat by balancing budgets and raising interest rates; restoring exchange rate stability; and implementing price stabilisation to free up trade flows.

Based on preparatory documents submitted to Brussels and Genoa and verbatim transcripts of the events, Clara Mattei shows how the conferences ushered in a major ideological shift in economics.[7] Despite claims that those conferences failed because concrete agreements were not achieved, in fact a new "financial code" came into existence, with economic austerity at its core.

Both conferences were dominated by business and financial experts, bankers and treasury officials, rather than politicians and diplomats. A handful of economists drafted the austerity agenda for the Brussels conference, including prominent Italian economist Maffeo Pantaleoni, who was representing the Financial Commission of the League of Nations and would go on to draw up the early phase of Mussolini's economic program. Additionally, the League requested detailed financial information from states attending. In what was, retrospectively, a preview of Bank for International Settlements' surveillance and record keeping, a pre-conference was held in London to assist nations in standardising their data. Hawtrey memos circulated at that event.

Fearing that workers' movements would agitate for continued government intervention to support the economy, as during the war, bankers at Brussels stated that, far from the population expecting "some great betterment of their lot", a "painful" solution was now required. This would include "reducing the home-consumption to the strictly necessary and avoiding the superfluous, e.g., excessive consumption of butter, sugar, etc." That this would require enforcement was acknowledged. Pantaleoni stated outright: "[W]here democracy is strong, public finance will go the wrong way".

These arguments for austerity echoed those of Smith, Ricardo and Malthus, wrote Mattei, but needed to be couched in new terms, since the tenets of those "experts" had failed during wartime.

The Resolutions adopted at Brussels indicated the new platform of admissible economic and financial policy.

Resolution I railed against the tendency of states to regularly "incur fresh expenditure", proposing "the need for re-establishing public finances on a sound basis".

Resolution II added: "The country which accepts the policy of budget deficits is treading the slippery path which leads to general ruin; to escape from that path *no sacrifice is too great*". (Emphasis added.)

Resolution IV condemned welfare spending, unemployment benefits, price controls, and subsidisation of public services as "uneconomical and artificial measures", specifically "the artificial cheapening" of bread and coal, and "the maintenance of [stable] railway fares, postal rates and charges for other government services" to assist the population.

Resolution VI declared: "Fresh taxation must be imposed to meet the deficit and this process must be *ruthlessly* continued until the revenue is at least sufficient to meet the full amount of the recurrent ordinary expenditure." (Emphasis added.) *Except*, a later caveat stated, for taxation which "might be a burden on private industry".

Conference organisers believed a "sense of alarm had to be spread", Mattei noted. Alberto Beneduce, a future economic adviser to Mussolini,[8] said it was necessary to "act upon public opinion, on the psychological state of the masses, so that they would no more impede but help to re-establish the budget of the State". Everything hinged on "savers", i.e. the wealthy class who had money to invest and were considered the "sole driver of capital accumulation", in Mattei's words. They got off scot-free, while the lower classes were squeezed relentlessly.

Resolutions reached by the Commission on Currency and Exchange specified that central banks should be independent of political forces and beholden solely to "the lines of prudent finance"; that interest rates must be raised in the name of "wise control of credit … to promote economy"; and that governments should be subjected "to the normal measures for restricting credit", as are individuals. They also promoted privatisation, touting private business as "a far more potent instrument for the recuperation of the country" than governments. The Commission on International Credit advocated a return to the gold standard.

The final resolution of Brussels, **Resolution X**, stated that thrift was the only virtuous action for both governments and people. Any nation that did not execute such a prescription "is doomed beyond hope of recovery". Stated the final clause: "It is the duty of every patriotic citizen to practice the strictest possible economy and so to contribute his maximum effort to the common weal". The mandate was clear.

The principles of austerity were endorsed by all nations present, which also recommended that the League of Nations establish a "committee of bankers and business to frame measures to give effect to certain decisions of the conference", according to British historian Patricia Clavin.[9] The League's "economic and financial committee was not officially an intergovernmental forum", writes Clavin, "but rather a body made up of 'independent experts'…."

Genoa, 1922

International financiers from 34 nations converged on Genoa, Italy on 10 April-19 May 1922, at the behest of then British PM Lloyd George, to secure economic cooperation among European powers and resolve issues with Germany and Soviet Russia. There had already been fierce disagreements among the major powers over how to solve German reparations difficulties and what to do about Russia, now under the control of the Bolshevik Party of V.I. Lenin, who was seeking economic relations with the West.

Hawtrey played a major role in preparations for Genoa,

7. Clara Mattei, "The Guardians of Capitalism: International Consensus and Fascist Technocratic Implementation of Austerity", Laboratory of Economics and Management, Sant'Anna School of Advanced Studies, Pisa, Italy, Sept. 2015.

8. Claudio Celani, "Britain's Role in Creating Fascism, Yesterday and Today", AAS, 25 Jan. 2023, covers Beneduce's role in Mussolini's government.

9. *Securing the World Economy: The Reinvention of the League of Nations, 1920-1946* (Oxford U. Press, 2013).

his prescriptions incorporated word-for-word into conference resolutions. He led the UK delegation, meeting with delegates privately every day. His memos specified that only cooperation among central banks could rein in inflationary tendencies, by altering interest rates and regulating credit, "with a view of preventing undue fluctuations in the purchasing power of gold" and thereby promoting stable currency values. The first Genoa resolution said, "[A]n effective gold standard should be aimed at" internationally.[10]

By 1919 most countries had abandoned the gold standard, upon which London's hegemonic role in global finance hinged. The gold standard, Hawtrey would point out in a 2 September 1925 *Times* article, "had special importance for this country owing to the magnitude and leading position of the English financial market", which "had suffered...", he wrote, "while the gold standard had been in abeyance." Hawtrey bragged that despite the post-war rise of the USA, British "power over world credit" was still superior. Hawtrey advised Chancellor Churchill that an unstable currency was untenable: tying itself and other nations back to the gold standard was priority number one.

As historian Quigley explained, the aim was to "force all the major countries of the world to go on the gold standard and to operate it through central banks free from all political control, with all questions of international finance to be settled by agreements by such central banks without interference from governments." The gold standard the British were pushing, however, was not "a" gold standard, but "the" gold standard, i.e. fixing currency values to gold holdings *at the same exchange ratio as in 1914*. Austerity policies would be required, to revalue currencies.

The gold standard would restrict nations' creation of credit and prevent the economic "poison" of inflation, as Hawtrey described it. Expansionary policies would otherwise lead to an outflow of gold (to pay for more imports, demanded by a population that was better off), making it difficult to keep enough gold on hand to maintain a stable currency value. Only austerity, including lower wages, could restore competitiveness.

Genoa conference resolutions approved the recession-inducing return to "sound currency" and "prudent finance" directed by private corporations, namely central banks, "free from political pressure". Foreshadowing the future mandates of the BIS, financial stability was the foremost objective and in a preview of conditions attached to IMF loans, Genoa resolutions stated: "Proof of serious efforts to improve the condition of its public finances will be the best guarantee which the borrowing country can offer to prospective lenders."

The Financial Commission of the Genoa conference established the "code of Genoa" for financial stability: limiting the issue of paper currency, fixing of a parity with gold, and international control of credit. Its Resolution VII stated: "The most important reform of all must therefore be the balancing of the annual expenditure of the State without the creation of fresh credit". Government budgets would have to be covered "by taxation or loans drawn from genuine current savings", as Hawtrey specified. This echoed Brussels resolutions that had declared capital loans must be sourced only from "the real savings of the people". Only by "reducing internal consumption", that of the people and that of the government, can a nation balance the budget, the Genoa resolution specified.

Genoa Conference delegates, with British PM Lloyd George at front, left. Photo: Wikipedia

Germany and Russia did not go along with their problems being "solved" under the international financiers' schemes. German Foreign Minister Walter Rathenau (an industrialist, musician and artist) and Soviet Foreign Minister Georgy Chicherin (author of scathing memoranda against the British Empire) took their delegations 25 km down the coast to the town of Rapallo, where they signed a treaty forgiving each other's reparations debts in favour of joint industrial and resource development. The Genoa conference was thrown into disarray. Rathenau would be assassinated two months later, but the ghost of Rapallo—the spectre of German-Russian co-operation for economic progress—has haunted London financiers' designs for supranational control over Europe ever since.

The Italian government of Luigi Facta, which had bent over backwards to accommodate Britain's plans—travelling to London for preparatory meetings and spending millions of lire to provide secure facilities in Genoa, though the city was besieged by economic breakdown, social instability and influenza—was forced to resign within three months of the conference closing. American historian Carole Fink depicts Genoa as a "bridge between Giolitti's Italy and [that of] Mussolini", the man who would soon take centre stage.[11]

Despite the withdrawal of Germany and Russia, and the refusal even of France to sign key conference documents, London plunged ahead with Genoa's "new financial code", as President of the Financial Commission Sir Laming Worthington-Evans, then British secretary of state for war, called it. This code, he asserted, was "no less important to the world today than was the civil code of Justinian", which under Byzantine Emperor Justinian I (in power 527-565) established a comprehensive legal code by unifying past juridical decisions. "Here at Genoa", wrote Worthington-Evans, "there have been assembled experts in finance and economics, each known in its own country as the leading authority upon the subjects with which we are dealing, and their combined wisdom ... has resulted in agreement upon a series of resolutions which will be a guide, and I hope a code, to be followed and observed in the same way as the laws due to the learning of Justinian."

A new financial order was being established based on "pure" monetarist economics administered by technocrats, to prevent subversion of private power by governments. We must avoid "adoption of such measures of nationalisation and socialisation which might substitute Government action to private enterprise", Belgian Prime Minister Léon Delacroix had told the Brussels gathering. "The austerity experts' overarching goal was to bulwark economic relations from the influences of politics and state intervention", states Mattei in *The Capital Order*; "even in a parliamentary democracy like Britain ... austerity was (and still is) an outright repressive project."

Next: *Test tubes: Austria and Italy*

10. Citations in this section regarding Genoa are sourced from various pieces by Mattei.

11. Carole Fink, "Italy and the Genoa Conference of 1922", *The International History Review*, Feb. 1986. Giovanni Giolitti preceded Facta as head of government.