Financial Instability in Transition Economies during the 1920s: The European Reconstruction and Credit-Anstalt Insolvency

Michel Fior

This chapter discusses the connection between the reconstruction plans put forth by the League of Nations after WWI and the collapse of Central Europe in 1931. It focuses on the insolvency of the Credit-Anstalt, the starting point of the financial crisis that spread throughout the whole region. Although much has been written on the reconstruction schemes and the 1931 bankruptcy, it remains unclear how the League’s programs interacted with the situation of these transition economies. The aim is to analyze the link between the involvement of an international organization and insolvency during the 1920s, using a specific conceptual framework – that of institutional sociology.

It is argued here that the reconstruction schemes, far from leading to financial stabilization in transition economies, contributed, from the outset, to the very factors that would lead to the crisis. This chapter challenges the assumption that the Credit-Anstalt insolvency is best explained by domestic factors (dissolution of the Habsburg Monarchy, post-war inflation and failure of multinationalization strategy); instead, it presents this collapse as the very consequence of European reconstruction. Although they sought to restore confidence in national currencies in order to revive a global financial market and a liberal international monetary system (IMS), the schemes brought on destabilizing consequences on three interrelated levels. Budgetary policies constrained investments, monetary discipline inhibited domestic credit and the liberalization of financial flows led to an unbearable short-term indebtedness. With its strong involvement in industry, the Credit-Anstalt became a weak link between Anglo-Saxon financial markets and an Austrian economy in transition and depressed by the reconstruction scheme. While promoting a market-based reconstruction process, the League thus appears as a destabiliz-

---

1 I would like to thank José Corpataux and Paolo Di Martino for their comments on an earlier version of this chapter, as well as Sara Cotelli and Tim Di Muzio for their support in its English translation.

ing factor that opened the way towards international disintegration during this period.

The analytical underpinnings of this chapter rely on a definition of the international organization as a social relation expressing a duality of power and legitimacy. Through the application of a combined neo-Gramscian and Foucauldian approach, this chapter focuses on how power relations within society are legitimized and institutionalized through consensual procedures. Following Robert Cox (1996), it considers historical situations as a specific interaction of institutions, ideas and material capabilities that help to define the modalities of legitimacy. This perspective enables us to understand how the League’s philosophy of the reconstruction crystallized in a period of contested social hierarchies and how it could be implemented in transition economies. Institutions are considered here as a central process of social and economic change. They contribute to the convergence of patterns of behavior as well as the legitimization and reproduction of that behavior. As the example of the League shows, transitions in social political economy cannot be understood without examining the role of institutions.

The chapter first discusses and challenges two dominant approaches to the study of international organizations and shows why a critical approach offers a more convincing framework for understanding the link between institution and insolvency. The second section sets the historical context of power and legitimacy in transition economies after WWI. Building on this, the third section summarizes the emergence and nature of the League’s reconstruction schemes, whereas the last part develops their link with the Credit-Anstalt insolvency.

International organization and instability in theory

One can briefly distinguish between two trends in the theories of international organizations. A first trend is premised on rational behavior and the maximization of preferences. This neoliberal institutionalism currently represents the orthodox paradigm in political science. It relies essentially on the tools offered by the theory of collective action, or public choice. As Bruno Frey (1991, pp 8-9) mentions, this approach seeks to explain the political processes and the interaction between the political and the economic by means of theories developed by modern neoclassical analysis, which is then applied to groups. A second trend, inspired by constructivism or sociological institutionalism, is concerned with questions of legitimacy and intersubjective definitions of identities and interests.

---

For neoliberal institutionalism, institutions in general and international organizations in particular can be understood as an answer to market failures. Accordingly, they represent commitments settled by rational operators with the aim of solving the problems created by incomplete information. Institutions seek to decrease insecurity and risks, as well as to reduce transaction costs. In this perspective, as explained by Keohane – one of the main theorists of this approach – the international organization is the direct consequence of a maximizing will (Keohane 1988). The institution is therefore analyzed through its output -- in this case an international public good. Monetary stability, a liberal regime and the prevention of systemic risk are several examples of such public goods that come out of the harmonization of usage and transparency. The international organization is necessarily a positive sum game insofar as rational States would not cooperate if they rationally foresaw a negative output. According to neoliberal institutionalists, then, the international institution represents an essential source of security against financial crisis.

The influence of neoliberal institutionalism on the policies of the International Monetary Fund (IMF) and on research dealing with this organization is considerable, and it does not spare the League sometimes considered as its ancestor. Rudiger Dornbusch and Julio Santaella suggest an approach marked by the theory of rational choices in which the League’s structural adjustment schemes are presented according to their stabilizing virtues on the international monetary system (Dornbusch 1992, Dornbusch and Fischer 1986, Santaella 1992). Both researchers use the experience of the League’s Economic and Financial Organization (EFO) to justify the involvement of the IMF in the adjustment programs designed in the 1990s for the countries emerging from the Soviet bloc. They saw in the European reconstruction of the 1920s – at least in the role played by the League in this period – an example of the success of ‘external enforcement’ in solving credibility problems and in creating a regime of convertibility. Dornbusch and Santaella explain the League’s achievement (mastering inflation, stability of exchange rates and a balanced budget) by two essential factors. On the one hand, the flotation of a stabilization loan acted as a sign of financial rectitude and credibility, as well as financing the stabilization. On the other hand, a stiff political conditionality (full powers to governments and League’s commissioners) enabled the adoption of radical structural reforms. In short, the League acted like a stabilizing mechanism, structurally adjusting ‘non-successful’ economies, producing information and transparency, giving away liquid assets and finally restoring the confidence of investors in the stability of reconstructed countries. Both Dornbusch and Santaella avoid suggesting any connection between external enforcement and the 1931 collapse: the crisis breaks out as a detached phenomenon from the reconstruction schemes. In other words, it is understood as an exogenous process.
It is not the place here to explain in details the problems raised by neoliberal institutionalism for the study of financial crises. In addition to its methodological individualism, its rationalist postulates and the timelessness of the preferences ascribed to the actors, which ultimately deprive the analysis of any historical significance, it develops a restrictive conception of the international sphere. For neoliberal institutionalism, the international scene is essentially composed of States and markets and the cooperative agreements have no social depth: they are a sum of calculations transformed in institutional behaviors. This theoretical perspective thus considerably narrows the study of power relations within society. However, the most problematic aspect in our perspective is the impossibility to grasp the international organization as a source of instability and insolvency. As the institution maximizes the preferences of rational actors in a world now foreseeable, it cannot have the reverse effect; if it were so, states would abandon counterproductive cooperative agreements.4

Sociological institutionalism offers another way of approaching the link between institution and insolvency in a time of transition. Rather than considering international organizations as rational and non-historical procedures created to overcome market failures, the advocates of this approach regard institutions as ‘social facts’ (Barnett and Finnemore 1999, p 703). The emphasis is no longer on the maximization of preferences, but on the normative and cultural aspects that shape international organizations. Legitimacy thus becomes the essential referent through which the institutions are analyzed. Whereas the upholders of the rational choice theory postulate the existence of maximizing behaviors external to social interaction, socio-institutionalists underline the cognitive dimension of institutions. Institutions shape identities and influence behaviors by providing patterns, by creating categories and by spreading cognitive models that are essential to act, as well as to interpret the world and the behavior of other actors (Hall and Taylor 1997, p 483). As social constructions and sources of normative models, international organizations are consequently viewed as social processes living their own existence and developing their own autonomy. They identify with social spaces (‘epistemic communities’) where information and knowledge are produced (Haas 1992). Barnett and Finnemore (1999, pp 707-715) define three main ways through which norms and knowledge are structured. International institutions classify and organize information and knowledge and thus help create categories such as ‘refugee’; they determine meanings, as, for instance, concepts such as ‘development’ or, as far as we are concerned, ‘monetary policy’ and ‘central banking’. Finally, they diffuse norms and models of social organizations, as, e.g., the ‘market’ or the ‘gold standard’.

4 Neoliberal institutionalists handle this problem through the hypothesis of an underlying and unavoidable constraint. From an historical perspective, this analysis seems of course insufficient because it is teleological.
The constructivist approach opens the way to the study of international organization and insolvency. The international organization evolves within its own bureaucratic and cognitive logic and does not necessarily follow a maximizing logic. The institution can thus free itself from its environment, develop an obsession with its own norms and survival and lead to counter-productive behaviors. Concerning this matter, Barnett and Finnemore (1999, p 699) write about their propensity ‘for dysfunctional, even pathological, behavior’.

However, sociological institutionalism presents its share of difficulties when one tries to comprehend the international organization and its link with insolvencies. Even if it is the result of social construction, the international organization – at least for Barnett and Finnemore – reaches autonomy and tends to become an ‘object’. It is endowed with its own qualities, its reactions and its social logic. In other words, although the international institution is the result of a social process, it is not a social process. ‘Many international organizations exercise power autonomously in ways unintended and unanticipated by states and their creation’, the two authors argue (1999, p 699). Influenced by Max Weber’s theses, some socio-institutionalists study international organizations as bureaucracies and underline their organizational and/or rational dynamics. This kind of approach undermines considerably the relevance of such an analysis of international organizations and tends to reduce dysfunctions to bureaucratic features. Finally, even if socio-institutionalists suggest disengaging from the state-centrism typical of classical theories in history and international relations, which leaves no space to actors other than States, they nevertheless study international organizations as actors in a world made up of States.

Overcoming state-centrism in the study of international organizations is one of the main ambitions of historical political economy.\(^5\) The purpose is not to deny the role of States in the working of international institutions; nonetheless, it is important to underline that international organizations cannot be reduced to a state-centered dimension, but that they express issues deeply rooted in fundamental and global social relations. This somewhat arcane definition becomes clearer once its main features are detailed. Rather than the convergence of maximizing behaviors, the international institution is seized here as a process endogenous to social relations in their historicity and their spatiality. Moreover, in order to soften an institutionalism that would end up considering international organizations as nearly autonomous objects, a historical political economy approach considers the international organization above all as a discursive construction. To draw on one of Michel Foucault’s concepts, the institution is understood as the expression of a ‘governmentality’ or a ‘regime of truth’, prevailing at a certain time in his-

\(^5\) On historical political economy, see Langley 2002 and Fior 2006. On its links with global political economy, see Palan 2000.
tory (Foucault 1997). International organizations thus cannot be distin-
guished from discourse and the constitution of legitimacy.

In this perspective, the international organization is defined along two
main lines. First, as a social relation, it is the expression of social dynamics
and institutionalized relations within society. An object external to social
relations would not determine identities and define, in a quasi-exogenous
way, categories of international political economy and their legitimacy. As a
social relation, the international organization is primarily a relation of power
and legitimacy between different social forces, classes or groups. In a neo-
Gramscian approach, power is indeed not conceived in terms of coercion
(Cox 1996; Gill 2003) and we try to avoid the risk of ‘false consciousness’
distinguishing some Marxist perspectives. The consensual dimension of
power relations are of chief interest here, namely ‘regimes of truth’ (Fou-
cault) or ‘hegemony’ (Gramsci). By these terms, I mean the social proce-
dures by which knowledge becomes power and in which power is connected
to an economy of knowledge. As a dual relation of power and legitimacy,
the international organization can be understood as a historical process defin-
ing a certain economy of truth between social forces on a global level. What
is at stake, in other words, is to underline the social and political dimension,
which is not emphasized enough by socio-institutionalists who mainly insist
on the cognitive procedures between actors that are socially equal when en-
tering the relation. The neo-Gramscian conception of the institution, on the
contrary, includes a material aspect of social hierarchy and presents society
as a network of legitimized tensions. Legitimacy is thus one aspect of power
in the sense that it expresses a consensual adhesion to a series of representa-
tions that are not a historical ‘necessity’ but that express a collective choice
and asymmetrical effects.

However, if it is a social relation, the international organization is not
only a discursive ‘reflection’ of the process of power. Precisely because it is
theorized as a social procedure, the institution can be seen (second main line)
as the element of a structure: it contributes to the reproduction of ideas,
knowledge and production relations. As such, it takes part in the social
framework, material as well as normative, which builds a world in which
actors evolve, foresee themselves in the future and act at the reproduction
and transformation of their environment. The international organization thus
helps structure social relations in time, defining expectations and rationaliz-
ing inequalities.

These two dimensions of the social relation call for three more comments.
First, the international organization cannot be reduced to its legal, formal or

---

6 On the relation power-knowledge, see among others Foucault 1997, lesson of January 14,
1976.
7 This approach shares some perspectives with the French regulation school. For Aglietta and
Orléan (2002), the money as a social institution is best explained as a duality of violence and
confidence.
administrative dimension, as it is often the case in the history of international
relations or in economic history where the institution is grasped mainly
through the administrative papers that she produced. I do not want to refute
these aspects inherent to any organization, but on the contrary to define them
as expressions, rather than foundations, of the institution. It is thus in basic
social relations, notably in civil society, that we can find the decisive ele-
ments for the setting and reproduction of an institution. Such an approach
relies on a very wide definition of the international organization, close to the
concept of ‘State’ as developed by Antonio Gramsci: this notion encom-
passes civil society and political society, or rather represents a relation be-
tween civil and political society. Second, an organization can never be re-
duced to its first objectives, as institutionalists advocating the rational
choices theory would suggest (Thelen 2003). It requires historical processes
that go further than the rationality of social actors and expresses deep social
temporalities, referred to by Braudel (1958) as the ‘longue durée’. For in-
stance, international organizations that appear in the second half of the nine-
teenth century are indeed structured around a charter and a set of precise
goals: unify communication systems, protect authors’ rights, fight against the
propagation of illnesses, and so on. Their historical relevance, however,
makes sense in the broader perspective of liberal internationalism that tran-
scends the rationalities of the period, as well as it participates in the plan to
create a large integrated market and to reproduce a global capitalist system
more and more indebted to international institutions (Murphy 1994). Third,
and finally, as an institutionalised social relation, the international organiza-
tion is embedded in action/structure dialectic. As the expression of a regime
of truth at a certain time in history, or in Gramscian terms, as a quest for he-
gemony, it becomes the institutional and social framework in the midst of
which individuals act at the reproduction and transformation of the social
order (Gramsci 1971). Following these three aspects, the international or-
ganization can be seen as a social relation expressing a set of behaviors, dis-
courses and social networks that congregate, at a certain moment in history,
in an institutionalised form able to reproduce and/or reshape certain social be-
haviors.

Historical political economy, then, sets the basis for the understanding of
the link between international organizations and insolvency. Dissociated
from maximization logic and seen in relation with social power relations,
international organizations will thus be studied in the light of the kind of re-
gime of truth of which it is an expression and to the reproduction of which it
contributes. An analysis of the League’s EFO permits us to discover its em-
beddedness in the project to rehabilitate the gold standard, a project that acts
as a powerful vehicle to reach a consensus but is at the same time shaken by
insoluble tensions. A historical regime of truth, just as ‘world order’ in the
thought of Robert Cox (1996), is indeed a place where contradictions coe-
xist, which allows one to understand historical change. Thus, it is not in the
‘virtues’ or ‘efficiency’ of the international organization that one has to find its ability to stabilize the international system and contain insolvency, but in the dialectic of regimes of truth and the modes of regulation that have been implemented. International organization can therefore be understood in this combination or ambivalence of power and legitimacy. Insolvency emerges from this historical duality through which social forces interact in the making of history, and where institutions are engaged in implementing procedures of representations and in normalizing interests. Insolvency thus appears as an outcome of this historical duality. As Karl Gratzer and Dieter Stiefel argue in this volume, it represents indeed a tension.

International organization and the power/legitimacy dualism after WWI

The conceptualization that has just been presented enables one to analyze the League’s involvement in the reconstruction of Europe, as well as the role of the EFO in the regulation of the IMS after WWI. The organization appears as a social relation when one considers two main aspects: on the one hand, it is embedded in very acute social tensions that characterize the end of the war – revolutionary tendencies and the general contestation of the elites – and that are progressively overcome in the course of the decade.8 On the other hand, the mechanisms that it implements lie, above all, in the field of consensual procedures of power, notably the diffusion of the discourse on the gold standard in its re-examined version (gold-exchange standard). The European reconstruction and the monetary regulation are thus far from being a ‘philanthropic’ action: what matters is the social order, that is to say hierarchies, a regime of accumulation and a mode of regulation. In this section, I show how the social contestation after WWI is transformed in a legitimate model of orthodox financial reconstruction and implemented in the League’s reconstruction schemes.

Financial elites play an essential role in the creation of economic and financial institutions within the League, as well as in the vast procedure of European rehabilitation and reconstruction of a social order. Far from staying inactive when faced with the contestation of the social order and when Europe was experiencing severe financial instability, bankers from several countries – essentially European – gathered several times in Amsterdam as soon as Spring 1919. Their purpose was to unify their positions on the transition towards a peaceful economy and the reconstruction of Europe. These international conferences welcomed, among others, prominent international experts such as Keynes, Bruins and Cassel (Vissering 1920, Silverman 1982,

8 On this subject, see the two classical works of Maier 1975 and Mayer 1967.
The bankers did not part before having set the basis for common action in favor of European reconstruction: the outcome was a memorandum signed by a large variety of famous personalities and submitted to their respective governments in January 1920.9

This bankers’ memorandum focuses on two points: the signatories call immediately for an international conference bringing together financial experts to join forces to define the basis of the international cooperation necessary for the reconstruction of Europe. The urgency is explained by the political and social instability threatening European social structures in 1919. The text, however, does not amount to the proposition of an international conference on the reconstruction: it also sets the basis for the policy to follow in this case. Against the continuing growth of the money supply and State expenses, the suggested therapy promotes monetary and budgetary discipline. Consumption must be reduced while production and taxes are to rise. If these remedies are not promptly administered, continues the memorandum, the financial experts feared that the depreciation of currency would continue, “wiping out the savings of the past and leading to a gradual but persistent spreading of bankruptcy and anarchy in Europe” (quoted in Keynes 1977, p 137).

This appeal did not go unnoticed by the governments to which the text was submitted. The responsibility to organize a large international conference was soon passed on to the League that had just started its activities. At the end of September 1920, 86 delegates from 39 countries, representing three quarters of the world population, gathered in the Belgian capital to discuss the international financial situation. The Brussels conference has been the focus on numerous studies and is sufficiently known so as not to dwell on too many details here (e.g., Eichengreen 1992, p 153sq). However, it exemplifies two important aspects for our problematic: one, the resolutions unanimously adopted and legitimized in Brussels will inspire the League’s reconstruction schemes, and two, the conference will result in the foundation of the EFO, responsible for enforcing the resolutions and their implementation.

In the extremely troubled social dynamic of the aftermath of the war, and in the context of radical contestation of the legitimacy of capitalist elites, civil society became the incitement for establishing the international institutions of the reconstruction. Here, financial elites can be recognized through their active commitment to the setting up of a form of the State and international economic system that was in accordance with their understanding of an ideal regime of governance. However, even if this process inevitably involves a moment of power, we should also understand the role of the League in its consensual dimension. The notion of legitimacy in the process of

---

9 See the memorandum and Keynes’ correspondence on this subject in Keynes 1977, pp 136-150.
European reconstruction will be shaped around three main themes: the metaphors of a paradise lost, the mythology of self-regulation and the doctrine of rationalization.

Discourses of bankers and international financiers moving within the League are full of metaphors of a paradise lost, which act as a way to legitimate the reconstruction of a social and economic order ended by the war. The nineteenth century is constructed as a period of peace, comfort and stability and thus operates as a real consensual reference. As Arthur Salter, head of the EFO, later remembers:

> It was therefore natural that the first effort of reconstruction after the war should have been directed, in nearly all countries, not to changing the main structure of either society or its economic and financial framework, but to repairing and rebuilding on the old foundations and to the old design. By comparison with 1919 the world of 1913 seemed to most of us a paradise from which we had for a time been excluded by a flaming sword. It seemed a sufficient goal for our efforts to win our way back to what we lost (Salter 1961, p 193).

Keynes was not an exception and his *Economic Consequences of the Peace* (1920) presents the war as a fatal blow to a golden age. This myth of a paradise lost entails a vast array of biblical and civilizational references – as shown by Salter’s paradise and flaming sword – conceived as the intellectual cement of an ideal order to be recaptured. One can also read in this a moral discourse on monetary discipline, debts ethics and the healing virtues of financial rigor, which will all appear in the philosophy of the reconstruction supported by the League.

Growing on this nostalgia, the emergence of a mythology on the self-regulating gold standard is best explained in the same context of power legitimized through a discourse of consensus. Even if it is nearly two centuries old, the Humian model of ‘price-specie flow’ becomes the pivot around which the Anglo-Saxon conceptions of price and money unite (Eichengreen 1992, p 32-35). The Cunliffe Committee, in 1918, sets this Newtonian model at the center of its demonstration of the success of the gold standard before the war. This British committee of bankers, in charge of characterizing future political monetary policies, defines it similarly as the mechanism that will assure the stability of a monetary system rebuilt on its old foundations. The gold standard, conceived as a system of gold flows that, as hydraulic circulation, automatically adjusts the prices and the balance of payments, owes much to the spread of this mythology after the war. Contested by some groups, the gold standard and its apolitical metaphors become in the aftermath of the war a very important instrument for financial circles eager to restore favorable conditions to the stability and circulation of capital on a transnational level. The main objective of the reconstruction schemes was
also to seek to restore a universal standard and free international convertibility through structural adjustment.

These references to a ‘paradise lost’ and the mythology of the gold standard coincide with a rationalist discourse, meant to confer a modern and progressive intimation to references that are, for the most part, reactionary. Following the principles of Taylorism, the doctrine of rationalization was connected to a larger trend stating that science and organizations can improve the functioning of the market and even society. In the League’s perspective, the scientific understanding of business cycles supposedly lead to a rationally foreseeable world from which unemployment would be forever banished. The scientific organization of production, as shown notably by the resolutions of the 1927 economic conference, called for an optimal allocation of resources beneficial for all. Even international relations became the object of science whose practitioners intended to identify the causes of conflicts, thus becoming able to eradicate this dark specter in the future. The expert – apolitical and showing universal knowledge – is a central figure, the only person, according to E. H. Carr ([1939] 2001, p 17), to enjoy some respect within the League.

The quest for legitimacy or, following Gramscian terminology, hegemony, is particularly well exemplified by a mythological rhetoric that can be understood through its three functions. First, they appear as a unifying discursive device meant to play the role of a common social foundation at a certain time in history, particularly in a situation of transition such as the reconstruction. The gold standard embodies the idea of a social ‘naturality’, which sets the common rules of value and wealth. It is probably not by chance that the collapse of the gold standard during the war was directly associated with the decline of Western liberal civilization: the materialist society, in search for wealth, suddenly stood deprived of the communal foundations on which it rested. On this account – second aspect – the mythology is a form of power in as much as it erases the divergences inherent to any social order. Its rhetorical procedures operate in depoliticizing the canvas of the social fabric through an idealization of a set of forces or external references: the gold standard is considered as being a part of hydraulic physics, displaying in parallel an extra-social essence. Thus, it should not come as a surprise that the most eminent central bankers sought to give banks of issue an independent status and to assign monetary policy only to financial ‘technicians’. Finally, the consensual and mythical aspect of power is not only meant to legitimize a form of social organization considered as ideal but also to discredit possible alternatives. In other words, one can interpret it as a strategy aiming to reduce the ‘limits of the possible’ to an optimality presented as unavoidable. The myth of progress, as it is expressed in the doctrine of rationalization, generates a form of fatalism that negates the possibility of alternatives and, as it is mentioned by Stephen Gill (2003, p 139), prevents us from analyzing history as the product of collective human actions.
We now have to turn to the way in which this conception of money and finance is implemented in the reconstruction schemes.

The League and European reconstruction schemes

European reconstruction, the rehabilitation of the gold standard and the re-establishment of a global market for the circulation of transnational capital merged into a unique social project after WWI. The reconstruction schemes advocated by the League were intended to function along three lines. The first lays in the fluctuating exchange rates of the post-war years that prevented the development of financial flows and weakened the IMS; the return to a gold standard and its consequence, monetary discipline, thus become the essential objectives of the reconstruction. For the financial conference held in Brussels in 1920 under the patronage of the League, “it is highly desirable that the countries which have lapsed from an effective gold standard should return thereto”.¹⁰ This first aim cannot be detached from budgetary unbalance, the second source of crisis identified by the financial experts. The discipline of public finance thus appears as a preliminary condition to reach stability. Finally, exchange control prevents investments from countries with a surplus from using these surpluses to invest in countries in need of capital and is therefore said to hinder the good functioning of international convertibility. According to the financiers gathered at the League’s Conference, “attempts to limit fluctuations in exchange by imposing artificial control on exchange operations are futile and mischievous”.¹¹ Financial liberalism is therefore an indispensable counterpart to a reconstruction scheme based on the premise that free financial flows necessarily lead to an optimal distribution of liquidities in a productive system. Indeed, for the League’s very orthodox experts, the market is supposedly driven to a state of equilibrium by its own ‘natural’ mechanisms. If it enforces these three conditions – monetary stability, budgetary discipline and financial liberalism – any country will be able to join the IMS to attract capital for its investments and it will mechanically enter a period of growth. As the Financial Committee argues in its preliminary reconstruction scheme for Austria, “If the appropriate financial policy is adopted and maintained, the Austrian economic position will adjust itself to an equilibrium by the increase of production and the transfer of large classes of its population to economic work”.¹² Thus, the reconstruction is conceived as an automatic process relying on private capital. This ‘market-based reconstruction’ advocates investments along the unique law of supply

¹⁰ International financial conference, Brussels (1920), II/VIII.
¹¹ International financial conference, Brussels (1920), II/XV.
and demand. Rather than a wider reflection on the priorities of the reconstruction, these two concepts of profitability and confidence determine the allocation of capital in transition countries.

According to the financiers, an intermediary step is nonetheless necessary: as the stabilization of the budget cannot be obtained overnight, the League’s reconstruction schemes provided a transitional program of approximately 3 years. During this period, so as not to hinder monetary stability, budget deficits were to be covered by an international loan. This loan is not aimed at financing the reconstruction and its investments; rather, it takes part in a process of structural adjustment – in this instance budgetary.\textsuperscript{13} In this way, only private investments will lead to the rehabilitation of economies ruined by the war. The League’s policies take the form of a reinforcement of measures concerned with the flow of international capital and because capital flow is considered a stabilizing factor, there is no need to embed it in procedures that could control its possible negative effects on the country’s solvency. Moreover, in the whole process, the financial Committee hardly ever worried about the risk of insolvency that could hit a financially fragile country once it is integrated in the new IMS; the only concern of the financial experts regards the deflationist effects of the increase in the purchasing power of gold, but, according to them, this will arise very late: too late, as the crisis of 1931 and the suppression of convertibility will make these quantitative meditations obsolete.

Nine schemes were implemented by the League in six countries: Austria (1922), Hungary (1923), Greece (1923, 1927), Danzig (1925, 1927), Estonia (1926) and Bulgaria (1926, 1928). Moreover, Geneva’s programs closely inspire reconstructions such as the German Dawes plan.\textsuperscript{14} Even if the League is only a secondary actor in the establishment of reconstruction plans in the 1920s, its influence should not be forgotten.\textsuperscript{15} It is notably through its medium that the philosophy of the reconstruction was elaborated and it was the institution responsible for drafting the first plans. Austria, in a nearly desperate situation in 1922, can be seen as a kind of laboratory where the League tested the method later applied to other countries in Europe.\textsuperscript{16}

\textsuperscript{13} In practice, the loans will be partially used for investments. A quick return to a balanced budget in Hungary and Austria actually made it possible to redirect part of the sums that were not necessary any more to pay deficits.

\textsuperscript{14} On the LoN’s schemes generally, see LoN 1945; Fior 2006.

\textsuperscript{15} The LoN’s schemes comprise 44% of the sums drained from international financial centers in the scope of international reconstruction schemes.

The League, reconstruction and insolvency

European reconstruction began in Austria, and it was in this new Republic that the crisis broke out, leading nearly the whole of Central Europe into insolvency and to the introduction of exchange controls. The coincidence is of course totally accidental, especially because the League took charge of countries (Austria and Hungary) that were particularly weakened in the aftermath of the war, as well as victims of the most severe inflationist phenomena after Germany. The parallel, however, allows us to draw a line between the reconstruction schemes advocated by the League and the bankruptcy of reconstructed economies.

The analysis of the Austrian financial crisis of 1931 completely merges with the crisis of the Credit-Anstalt. It follows two general tendencies. 17 On the one hand, some studies underline the domestic aspects of the crisis and show that the collapse of the first Austrian bank – a real state within the state – is part of an evolution characteristic of the Austrian financial and economic structure since the end of the nineteenth century. 18 Fritz Weber, e.g., suggests three reasons for the collapse of the Austrian financial system after the end of the war: the dissolution of the Habsburgs’ monarchy (and the Austrian banks’ attempt to maintain their positions in Central Europe taking the shape of multinational companies developing a ‘Danubian strategy’), post-war inflation (which considerably thinned out the banks’ equity capital) and the poor performances of the Austrian economy. Dieter Stiefel (1983, p 417) puts emphasis on the failure of a multinationalization strategy and notes that the huge industrial commitments of the Credit-Anstalt that made the company “as much an industrial holding company as a bank”. On the other hand, historians because they are more concerned with worldwide financial history, look for the origins of the Austrian collapse in the pathological functioning of the gold standard at a macro level. Barry Eichengreen (1992) links the Austrian crisis with the propagation of the IMS deflationist effects after the Wall Street crash in 1929. He sees Austria, Hungary and Germany as the weak peripheries of a global financial system drawn to failure because of lack of credibility and cooperation.

I show in this section that the Austrian bankruptcy deserves to be analyzed in a global perspective, i.e. in the interaction between domestic and international levels. The League’s reconstruction scheme plays an essential role in the crisis because its logic was in contradiction with the domestic

17 On the Credit-Anstalt crisis, see among others, Rathkolb et al. 2005, Schubert 1991 and Stiefel 1983. On a formal level, one cannot talk about the bankruptcy of the Credit-Anstalt. Schubert argues that the Credit-Anstalt failure started as a solvency crisis because of losses and immobilizations. Then, it evolved to a liquidity crisis when deposits started to be withdrawn. The confidence crisis spread to other banks (financial crisis) and then ended with a currency crisis when international lenders massively withdrew their credits (Schubert 1991, p 32sq).

18 For more on this approach, see Weber 1995; one can also refer to Stiefel 1983.
specificities of Austria – and the Hungarian case is not different from this. Without entering into the large debate about the origins of the Credit-Anstalt’s insolvency and illiquidity, I will merely focus here on the link between the philosophy of the reconstruction, based on the logic of global financial markets, and its effects on the economic system characterized by a strong commitment of the banking system to industry.

Capital flowed to the countries in reconstruction. Thanks to monetary stabilization and the liberalization of capital circulation, the League worked in favor of the financial community and its aspiration to rehabilitate a large global financial market. The League will note a few years later that “the Austrian reconstruction scheme, from 1923 on, followed a year later by Hungary’s led to stabilization, and […] turned these two countries into an active field for investment and short-term lending” (LoN 1944, p 150). However, rather than strengthen the financial and productive system of Central Europe, capital contributed from the very start to its insolvency. Two main causes explain this.

First, it is well known that capital meant mostly short-term assets that (predominantly) Anglo-Saxon banks lent to Vienna or Budapest. Following Nötel’s evaluations, which are, however, not without contestation, on average 70-80% of capital flows are short-term liabilities; in Hungary, too, where the estimations are more accurate, this phenomenon covers more than half of the liquidities present in the banks’ statement of account.19 It seems unnecessary to note that such commitments, which do not obey a logic of long-term reconstruction, are very risky for an economic system in transition: either they are used in the short term and their effect is consequently reduced or they are invested in the long term and they put the entire financial system at risk. Moreover, in such a situation they are liable to generate systemic risk. The countries reconstructed through the League evidently followed the second option. Lacking capital in the long term, which investors did not provide, Austria and Hungary had to resort to short-term credit facilities. Two League’s experts, Layton and Rist (1925, p 127), note in their 1925 report that banks in these two countries had no difficulties in finding liquidities in amounts larger than could possibly be put to use.

The second problematic aspect of the reconstruction by the market lies in the cost of indebtedness: until 1925, foreign assets in Austria were paid up to about 12%, commissions included. Domestic credit was even more expensive than international facilities and amounted to up to 14% during the second half of the decade, at a time when rates tended to fall in comparison with the first half of the 1920s (Layton and Rist 1925, p 127; LoN 1925, p 95; Stiefel 1988, p 300). In this situation, new credits were frequently subscribed

19 Nötel 1984, p 156; for Hungary, see Péteri 2002, p 138, 145. A part of Nötel’s calculations rely on estimations according to the balance of payments; this method is problematic as other financial elements can have an influence.
to abroad in order to repay interests owed on another credit, or to pay back a credit limit that had not been renewed.

These financial facilities are not for the direct use of financial houses like the Credit-Anstalt. Instead, credit is ultimately extended to productive enterprises. What this means is that financial institutions in central Europe played an intermediary role between Anglo-Saxon investors and the productive enterprises of central Europe. It is hardly surprising, then, that Austrian financial institutions (not to mention Hungary and Germany), extended these credits to their own industrial sector because they had a history of frequently supporting their own companies. Alice Teichova (2005, p 153) argues that Central-European banks – and especially Austrian ones – had to keep their industrial debtors afloat in order to sustain their own credit worthiness and thus concealed losses. In some cases, as Dieter Stiefel (1989, p 101-103) points out, the Credit-Anstalt even directly managed the financial department of its industrial companies. The control exerted by the Viennese banks over the Empire’s productive system since the end of the nineteenth century has often been underlined: in 1921, the big universal banks of the former imperial capital controlled 44% of companies in the field of Austrian metallurgic industry, as well as 45% in the electric industry. Sixty-seven percent of the paper production and 38% of the sugar industry belonged to financial institutions (Berger 1995, p 411). Each of the large Viennese banks owned a substantial industrial portfolio and actively partook in administering the companies via their board of directors. The example of the first Viennese bank, the Credit-Anstalt, speaks for itself: while the flagship of the Austrian financial system controlled 102 companies before the war, it controlled 136 in 1923 (März 1981, p 536sq.). As the crisis began, the Credit-Anstalt network owned about 40% of the Austrian industry. This dependency of industry towards finance is also a dependency of finance towards industry: to protect themselves from hyperinflation, banks had taken refuge in equities; further-

---

20 Out of the total number of the Credit-Anstalt’s capital and credit participations, 11% consisted of capital participations only, whereas 40.6% had both capital and credit participations. Thirty-two per cent of the Austrian debtors had taken up credits from the CA in excess of their own equity (Teichova 2005, p 154).


23 Weber (1985, p 128). According to Mosser and Teichova (1991, p 140), who draw their numbers from different estimations, the share of the Credit-Anstalt in the entire cumulated capital of Austrian companies could amount to more than 60%. Alice Teichova’s (2005, p 154) calculations show that the companies ‘in the sphere of influence’ of the CA represented 18.6% of the total number, but 68.8% of the total capital of Austrian joint-stock companies. This doesn’t mean, however, that the CA controlled such a proportion of the Austrian economy.
more, they often converted credits in capital participation to avoid being paid back in depreciated money (Weber 1985, p 126).

This specificity of the Central European financial and industrial system confronts us with a problem in view of the reconstruction schemes designed by the League: as a consequence of their industrial networks, the banks – and most probably above all the Credit-Anstalt – never dithered about financing companies that belonged to them. Assets were indeed requested for reconstruction and to face international competition. As only short-term liquidities were available on foreign markets, these volatile assets were tied up in the long term. The Credit-Anstalt presents a good illustration of foreign indebtedness on the financial system of reconstructed countries. The proportion of debts compared with the bank’s equity capital was on the rise between 1924 and 1930. Depending on various evaluations, between 36 and 50% of all its credits at the time of the collapse come from abroad (Schubert 1991, p 34, 44.). The debt equity ratio of the Credit-Anstalt reveals very clearly the bank’s growing indebtedness after the monetary stabilization and the implementation of the reconstruction program: whereas on January 1, 1925 the ratio was under 6%, it kept on growing until the summer of 1923 when it nearly reached 11%. Indeed, as mentioned by Schubert, this ratio bears witness to the failure of the banks to restore adequate capital endowments in the aftermath of the hyperinflation in 1922. But the quick rise of illiquidity mostly shows the short-term indebtedness during the years of monetary stabilization.

Table 1. Debt equity ratio of the Credit-Anstalt

<table>
<thead>
<tr>
<th>Year</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>1913</td>
<td>3.64</td>
</tr>
<tr>
<td>1924</td>
<td>5.68</td>
</tr>
<tr>
<td>1925</td>
<td>6.86</td>
</tr>
<tr>
<td>1926</td>
<td>9.28</td>
</tr>
<tr>
<td>1927</td>
<td>7.90</td>
</tr>
<tr>
<td>1928</td>
<td>8.98</td>
</tr>
<tr>
<td>1929</td>
<td>8.82</td>
</tr>
<tr>
<td>1930</td>
<td>10.9</td>
</tr>
</tbody>
</table>

Source: Schubert 1991, p 34

As noted by Aurel Schubert, this structure of the banking sector and its industrial network made the banks (the Credit-Anstalt in particular) subject to a double pressure on its solvency: ‘one emanating from the losses that were due to frozen loans, another that was due to the deterioration of the value of their very extensive portfolio holdings’ (Schubert 1991, p 39). As the League’s reconstruction plans and their market-oriented philosophy took effect, the Austrian financial sector became the weakest link in the system. Once Anglo-Saxon capital becomes scarce, nothing could prevent the Austrian financial system from exposing the extent of its unsound debt structure and lack of liquidity.

24 On the total of the Credit-Anstalt losses, 10% are due to losses on industrial holdings and more than 40% on Austrian debtors, of which a ‘considerable amount’ was due to firms owned by the CA.
The form and the magnitude of foreign indebtedness in the Austrian industrial and banking system do not explain on their own the move towards insolvency and the 1931 crisis. Other elements of the logic of reconstruction by capital markets are also relevant, namely monetary discipline and ‘sound budget’ policies, both closely linked to the project of rehabilitating the gold standard and a global financial market. Regarding monetary discipline, high rates of interest attracted foreign capital and thus helped to maintain a strong currency, at least until 1931. In this perspective, the Austrian National Bank systematically maintained its rate above the Reichsbank’s rate. But the deflationist tendency noted in the wholesale price, as well as the handicap of having a strong currency in a European environment still characterized by the floating of some currencies, facilitated the aggravation of the economic depression and helped weaken industrial companies already fragile because of their indebtedness. As was already noted regarding the Austrian context, companies’ financial problems have a deep influence on the Credit-Anstalt solvency; all the more, because the industrial network run by the Viennese bank includes in its numbers some of the most fragile firms (Stiefel 1989, p 18).

Regarding the budget, very few public investments were possible because of Geneva’s philosophy of financial orthodoxy. According to the Minister of Finance at the time of the reconstruction, Victor Kienböck, this aspect was not even mentioned during the negotiations with the financial Committee in 1922 (Kienböck 1925, p 128-129). However, right after the war, the coalition government had admitted the role of public spending aimed at encouraging some economic development and the reduction of unemployment. In January 1919, it had launched a program of investments focusing on the renovation of public buildings, the extension of the communication network and the electrification of railway and tramways in Vienna. This venture had even gained the support of the conservative Minister of Finance, Joseph Schumpeter. However, after the League, plans had come into effect and until 1926 at least, public investments are subjected to very strict limits, owing to the corset imposed by the League on budgetary spending. Until the end of the decade, only the surplus of the League loan was allocated to investments, such as the electrification of railways. Still, the Austrian government had to face the opposition of the financial Committee for which the loan should be assigned to reductions in the budget or to repay the floating debt to the central bank.

Conclusion

In contrast to classical institutionalist approaches, historical political economy provides an ideal alternative to the understanding of the link between institution and insolvency in a transition economy. It also allows one to go beyond current neoclassical orthodoxy and its propensity to consider any external intervention on the functioning of the market as an obstacle to general equilibrium. The heterodox approach, which conceptualizes international organizations as a social relation, places emphasis on the historical dynamic of power characteristic of each social system and each international order. Moreover, it particularly underlines consensual processes of convergence on a dominant mode of regulation. International organizations thus appear as an ambivalent relation between power and legitimacy. As the expression and the reproducing agent of a ‘regime of truth’, the international organization is indissociable from the social order from which it stems and which it helps to maintain.

In the case of European reconstruction and its ties with the 1931 crisis, the League was analyzed here in the light of a ‘regime of truth’, which legitimizes the reconstruction of a global financial market and the circulation of transnational capital. The League therefore plays a role in the reproduction and diffusion of the classical view, which states that free circulation of capital and the market mechanisms allow an optimal allocation of liquidities in the production system. As a result, European reconstruction takes the form of the rehabilitation of international private investments. In a center-periphery dynamic, the international organization highlights a power relation between the creditor and its debtor. In the perspective of the dynamic between social forces, it underlines the influence of transnational financial elites on social sectors more concerned with productive activity, state intervention and the interests of organized labor.

Accordingly, legitimacy is the way through which this power relation appears in the political economy of the reconstruction. Thanks to its illusion of exteriority, neutrality, apolitical stand and expert knowledge, the international organization partakes in the creation and diffusion of a consensus. Rather than the ‘creation of information’ and the solving of dilemmas involving uncertainty, we refer here to a mimetic behavior: as it legitimizes discourses and knowledge, the organization is active in helping operators converge on a mode of regulation and in discrediting any alternative. The gold standard and its mythology owe much to the League’s scientific aura, just as the myth of the self-regulating virtues of capital flows and their favorable consequences on the reconstruction. As a result, capital flows to Central Europe developed into a speculative bubble.

As a social relation embedded in a duality of power and legitimacy, the institution makes sense in the light of contradictions – cognitive, social or macroeconomic – that are found in each social order throughout history and
that help explain social change; it is thus in the propensity to overcome these tensions that lies a potential source of relative stability. The IMF during the period of ‘embedded liberalism’ contributed to such an issue while authorizing countries to maintain exchange controls to protect their national policy autonomy and productive capacity against external shocks. In the case of the European reconstruction by the League, one notices a key tension between short-term capital surpluses in core countries and the financial needs of transition economies in long-term assets. More broadly, the reconstruction process involves further tensions such as a contradiction between, on the one hand, the reconstruction of an international monetary system and, on the other, the disruptive effects of capital mobility. Moreover, one also notices an asymmetry between the stabilization of currencies in the perspective of a liberal international monetary system, involving deflationary tendencies, and the quest for more expansive monetary policies by social groups preoccupied by the domestic level of activity and employment. Finally, budgetary discipline collides with the demand for public investments in transition economies. These contradictions are at the heart of the League’s programs that advocate a reconstruction based on private capital and that confuse the rehabilitation of global financial markets with that of Europe. All these contradictions contribute to our understanding of the collapse of the Credit-Anstalt and the development of a global financial crisis.

In the case of Hungary and Austria, the high demand of capital, combined with a marked commitment of the banking system in the industrial sector, made the economic system particularly vulnerable. The banks, as the example of the Credit-Anstalt shows, acted as intermediaries between western financial places and the Central European economic apparatus and thus appeared as the ‘weak link’ in a reconstruction process primarily directed through financial markets and their propensity for liquidity. The capital inflow in the short term, which was moreover granted with unfavorable conditions, made the economic system even more dependent on new liquidities meant to settle previous credits and execute interest payments. From 1929, the decrease of short-term deposits by American investors in Europe marks, for a bank such as the Credit-Anstalt, the beginning of a crisis that would take on global proportions.

References
und Tschechoslowakei 1918-1929, Wien: Verlag Verband der wissenschaftlichen
Gesellschaften Österreichs.
des politischen Systems Österreichs. Erste Republik, 1918-1933, Wien: Manz-
sche Verlags- und Universitätsbuchhandlung, pp 395-411.
el: quels enseignements pour la théorie de la régulation“, L’année de la régula-
tion 7, pp 167-203.
Carr, E.H. (1939), The twenty years’ crisis: 1919-1939, ed. by Cox, M. (2001), Lon-
don: Macmillan.
Cox, R. (1996), Approaches to world order, Cambridge: Cambridge University
Press.
end of the Austro-Hungarian Empire”, Weltwirtschaftliches Archiv 128 (3), pp
391-424.
Weltwirtschaftliches Archiv 122 (1), pp 1-47.
Eichengreen, B. (1992), Golden fetters. The gold standard and the great depression,
Nations et la reconstruction de l’Europe, 1918-1931.
Foucault, M. (1997), Society must be defended. Lectures at the Collège de France
Frey, B. (1991), “The public choice view of international political economy”, in
Vaubel, R. and Willett, T.D. (eds.), The political economy of International Or-
Macmillan.
Publishers.
ismes”, Revue française de science politique 47 (3-4), pp 469-496.
Studies Quarterly 32, pp 379-396.
Macmillan.
Kienböck, V. (1925), Das österreichische Sanierungswerk, Stuttgart: Ferdinand Enke.
Langley, P. (2002), World financial orders. An historical international political
League of Nations (1944), The League of Nations reconstruction schemes in the inter-
Maier, C.S. (1975), Recasting bourgeois Europe: stabilization in France, Germany,
and Italy in the decade after world war I, Princeton: Princeton University Press.

