Barry Eichengreen. Globalizing Capital: A History of the International Monetary System. (Princeton, N.J.: Princeton University Press, 1996), pp. 3-92.
Reviewed by Martin Dimitrov

Central puzzle: *In the first half of the book, Eichengreen asks how it was possible for countries to move from bimetallism to the gold standard. Once the gold standard arose, what prompted countries to switch to a floating exchange rate during the interwar period? Finally, why did the second attempt to restore the gold standard in the 1920's fail as well?*

Answer: *The rise of the gold standard after 1870 was the result of a random congruence of events. First, governments were not subject to domestic pressures and could thus maintain a credible commitment to supporting the currency pegs. Second, capital flows were predictable. Third, Britain sat on top of the system and the sterling could shore up the new system of global exchange. In the interwar period governments became prone to domestic constituencies, capital flows became much more erratic, and Britain lost its preeminence to the US. Collectively, these events resulted in the collapse of the gold standard and the adoption of floating exchange rates.*

Chapter I: Introduction, p. 3-6
In the introduction, Eichengreen stresses the importance of network externalities (p. 5) and path dependence (p. 6). Network externalities explain the fact that individual countries were not truly independent in their decision to adopt the gold standard --they had to consider the benefits to be reaped from monetary convergence. Path dependence is exemplified by Britain's initial decision to adopt the gold standard in 1717, which made it easier for subsequent countries to converge to the same standard.

Chapter II: The Gold Standard, p. 7-44
p. 7-20 Here Eichengreen traces the transition from bimetallism to the gold standard. Prior to 1870, only Britain had a de facto gold standard. The other countries operated on a bimetallic standard, issuing both silver and gold coins and having complicated terms of exchange, which allowed for entrepreneurial individuals to engage in arbitrage. However, after Germany adopted the gold standard in the 1870's, Europe's two most powerful countries had made the move to the gold standard, which created incentives for the others to follow suit. Although the initial shrinking of money supply after the adoption of the gold standard resulted in deflation, due to network externalities countries did not revert to bimetallism.
p. 20-44 A true gold standard operated only in Britain, Germany, France, and the United States. These four countries had significant amounts of gold in circulation and large enough bank reserves that allowed them to maintain their currencies pegged to gold. The currency convertibility was buttressed by the commitment of the governments to maintain the gold standard. Thus, when the exchange rate would fall and gold would leave a certain country, foreign investors would start to invest money in the country with the faltering currency, expecting to reap benefits after the inevitable appreciation of the currency. The stability of the gold standard was also maintained by international solidarity --foreign banks would lend money to a central bank when it needed it to maintain the convertibility of its currency. However, each country not only had committed to maintaining the gold standard, but also functioned as a lender-of-last resort, a potentially dangerous function that could compromise the gold standard, since it required central banks to bail out commercial banks at times when the country was

hemorrhaging gold and the bank reserves were low (this was resolved by a temporary escape clause). Overall, the stability of the system came as a result of (1) British pre-eminence and ability to "call the tune" that other countries followed, (2) international solidarity, (3) the openness of markets, and (4) insulation from domestic politics.

Chapter III: Interwar Instability, p. 45-92

In this chapter Eichengreen traces the demise of the gold standard in the interwar period. At first countries adopted a floating system of exchange, then they reverted to the gold standard again (1926-1931), only to realize that its maintenance was no longer possible. The second gold standard lacked the credibility and durability of the first, since (1) international cooperation to maintain it was not forthcoming, (2) gold became scarce as more countries adopted the gold standard, and (3) some countries such as Britain had a continuous balance of payments deficit, while others, such as France enjoyed a continuous surplus. However, the most important factor that undermined the stability of the gold standard was the lack of investor confidence that governments could commit to maintain the stability of the exchange rate in the face of mounting domestic pressures. Policymakers were much more likely to inject credit in the banking system in an attempt to reduce unemployment than to think about preserving a no longer viable parity. The suspension of the sterling convertibility in 1931 marked the disintegration of the gold standard. The whole system relied on the sterling, which was overvalued. Countries reverted to a floating exchange system.

The most important changes in the interwar monetary system were: (1) domestic concerns such as reducing unemployment took precedence, (2) financial flows became much less predictable than before WWI as a result of the inability of central banks to guarantee their commitment to fixed exchange rates, and (3) Britain lost its place as the world hegemon to the US.