Interwar Poland's Late Exit from Gold: A Case of Government as 'Conservative Central Banker'

Thea Don-Siemion, London School of Economics
(t.d.don-siemion@lse.ac.uk)
Supervisor: Albrecht Ritschl

I. Introduction and Survey of the Literature

In the modern literature on the Great Depression, monetary policy stands out as the central transmission mechanism of the crisis. The degree of commitment that governments showed toward the gold standard, and the extent to which central banks were willing and able to act to maintain gold reserves above the legally-required minimum, have been implicated in recent literature as the single most important factor explaining why certain countries suffered so much more in the Great Depression than others.[1]

The case of Poland stands out in this literature as a significant, yet under-appreciated, puzzle. Uniquely among Central and Eastern European countries, Poland maintained its commitment to free movement of capital under a fixed gold parity until almost the last days of the interwar gold standard. Only in April 1936 did Poland leave the 'Gold Bloc' via the imposition of capital controls, later than Belgium and ahead of only Switzerland, the Netherlands and France. Poland's resilience is especially remarkable in the light of its external position. Uniquely among the 'Gold Bloc' countries, Poland was a substantial net debtor, with a peak burden of foreign-denominated (public and private) debt on the order of 90% of national output.[2] What is more, for its external surplus Poland depended the export of primary commodities, especially agricultural goods whose prices on world markets had begun to collapse already in 1928. Remaining on gold under such circumstances, the Polish economy suffered tremendously. Living standards fell sharply and the decline in real GDP was at least on the order of 25%,[3] with no robust recovery before 1937.

Two questions thus present themselves: how did Polish policymakers manage the Herculean effort of keeping the Polish economy on gold for so long, and why did they continue to maintain the gold standard even as both the cost and the alternatives became apparent? The literature on the matter is small in volume and at present inconclusive. Western authors have largely overlooked Poland as a case study. Eichengreen (1992) devotes almost no attention to Poland during the Depression era. despite the country's struggle providing a prime example of the cost of 'golden fetters'. More recent empirical studies, most notably Wandschneider (2008) and Wolf (2007, 2008), only touch on the question of Poland's long adherence to gold, by including the country in panel regressions aimed at identifying the determinants of the timing of a country's exit from gold during the Depression. Wolf's findings in particular are striking: he finds that the exit date predicted by covariates such as the (authoritarian) political system, trade ties with the Gold Bloc, and past inflation predict a Polish exit as early as 1934, leaving a large unexplained residual.[4]

A detailed survey of the Polish literature is not feasible within the abridged scope of this paper, but there, too, there are large gaps relating to interwar Poland's monetary policy. Landau and Tomaszewski (1983), in their work on the Depression, give only a tangential survey of the Bank of Poland's activities, and while two scholars associated with the Bank of Poland, Leszczyńska (2013) and Allen (2020), have gone some way toward filling the gap, their work is much more archival than quantitative.

To the extent that these scholars have attempted to explain Poland's exit from gold, their hypotheses contradict one another. The Polish authors—Landau and Tomaszewski and Leszczyńska—claim that Poland persisted on the gold standard largely out of inertia, with exit an

[1] The seminal papers in this literature are, most notably, Eichengreen and Sachs (1985) and Bernanke and James (1991).
[2] Don-Siemion (2021). Working draft in preparation.
[3] Kubiczek et al. (2012)
[4] Wolf (2008), pp. 396-398.

"unwanted but necessary" result of the depletion of the Bank of Poland's gold reserves. Wolf and Allen, meanwhile, suggest, albeit without an archival 'smoking gun', that Poland's exit was driven by changing strategic imperatives: the declining value of the alliance with France and the urgent need to rearm. My contribution in this paper is to bring an unprecedented amount and variety of qualitative and quantitative evidence to bear on the question of Poland's late exit from gold. I find that foreign policy indeed predominated: the need to signal commitment to the French alliance accounted for the takeover of the hitherto independent Bank of Poland in 1931-1932, and the military's abrupt shift from a pro-gold to an anti-gold stance following the remilitarisation of the Rhineland in 1936 was the pivotal factor in securing the imposition of exchange controls. Domestic economic considerations played a decidedly secondary role in Poland's exit from gold.

II. Data Sources and Approach

The present study brings together three previously disjunct data sources—archival documentation from the files of the Bank of Poland, Bank of England, and Polish Cabinet of Ministers; high-frequency financial and economic data from the bulletins of the Bank of Poland and the Polish Central Statistical Office (GUS); and a comprehensive survey of economic and political news reports concerning Poland during its time on the gold standard (and slightly afterward, through July 1936) from two mainstays of the London financial press, *The Economist* and *The Times*. The archival research encompassed the complete minutes of the Polish Cabinet from 1930-31 and 1935-36; the minutes of the Bank of Poland's governing bodies and the majority of their subcommittees from 1927 to 1936; and a comprehensive survey of the files relevant to Poland in the Bank of England archives. The data drawn from the London press includes about 3,582 news items from *The Times* and 3,443 from *The Economist*, as well as daily-frequency exchange-rate and bond-price quotations (the latter totalling 43,111 observations), collected for two other chapters of my thesis, but, as will be shown, highly relevant to understanding Poland's exit from gold.

The primary quantitative contribution of this paper is in digitising and bringing together two entirely new data sources. The first of these consists of the balance sheet returns of the Bank of Poland, giving the main positions of the Bank's balances at ten-day frequency from the Bank's foundation in 1924 to July 1936. Though taken in the first instance from *The Economist*, the public returns appear consistent with the figures prepared by the Bank's bookkeeping department for internal use. The data provide aggregate information on the Bank's holdings of gold and foreign exchange, bill discounts, loan portfolio, deposits, and notes in circulation, which allows for the calculation of the Bank's ratio of reserves to monetary issue for the whole period as a consistent series for the whole period (despite the transition from a gold-exchange standard to a gold-bullion standard in 1933). The other major new data source represents the first fruits of the present author's long-term project to digitise and make available the quantitative publications of GUS for the interwar period. From the GUS statistical newsletter (*Wiadomości Statystyczne*), I assemble a panel of approximately 300 "headline" economic variables, for Poland and four major economies, at monthly frequency between 1925 and 1936.

This wealth of hand-collected material provides rich opportunities for sophisticated quantitative analysis on the interaction of Poland's economy and the world economy in the Depression, something about which the existing literature is almost silent. The purpose of the present paper, particularly in its abridged form, is more modest: to adjudicate between the two proposed explanations of Poland's exit from gold—'explosive decompression' (per Leszczyńska, Landau, and Tomaszewski) or strategic withdrawal (Wolf, Allen) in the light of hard data and an initial statistical analysis.

III. Results

Taken together, the quantitative series, contemporary financial press, and archival evidence reveal that the Polish imposition of exchange controls on 27 April 1936 was neither preceded by an adverse shift in fundamentals nor anticipated by the investing public. Figure 1 shows the gold cover of the Bank of Poland under three possible definitions between May 1924 and July 1936. As can be seen, while the early years of the Great Depression saw a steady erosion of the backing of the currency, the situation even toward the end of the period was radically different than in 1924-27, during the first, failed attempt to establish the Złoty on gold. As late as 20 April 1936, the Złoty's gold cover remains nearly 10 points above the statutory minimum of 30% (black line), and even on 30 April, following the suspension, there remains a modest safety margin.

Leszczyńska (2013) argues that the reported gold cover figures are misleading, as they fail to declare the extent of French credit support for the Bank of Poland via the Banque de France. According to her own data (reproduced as Figure 2), however, the Bank of Poland's reserves net of credits were beneath the statutory minimum already in 1932, and had reached its alarmingly low level of 20.3% already in 1935.[5] (The minimum reserve ratio in 1932 was 40%; this was reduced to 30% at the time of the shift to a gold-bullion standard in 1933.) If net reserves were the deciding factor, Poland should have left gold in 1932: indeed, it was the Bank's attempt to leave the gold standard in May 1932, justified on grounds of low reserves, that was the direct cause of the government's subordination of the Bank's governing structures under political loyalists. Instead, the government-controlled Bank resolutely pursued the contractionary line against which the independent Bank, with its body of shareholders drawn largely from among the large manufacturers who would be harmed by further tightening, had baulked.

Nor did Poland's balance-of-payments position take a sharp turn for the worse in early 1936; indeed, quite the opposite seems to be the case. The trade balance in goods (Figure 3) had been consistently exhibiting a modest surplus since summer 1935; the budgetary reforms of the new finance minister Eugeniusz Kwiatkowski had managed to bring expenditures in line with revenues for the first time since the Depression began (Figure 4). Even the wave of strikes cited in the early Communist-era historiography as the main reason for the government's change of course appears to have been rather over-rated as a causal factor: while there is a local peak in strike activity in March 1936 (Figure 5), it is neither the most intense nor the longest-lasting strike wave of the Great Depression, and despite a few much-publicised incidents of lethal police suppression of demonstrations, in terms of working time lost to industrial action April 1936 appears entirely unremarkable.

Perhaps the ultimate test of the 'explosive decompression' hypothesis is to consider whether professional investors anticipated Poland's exit from gold in April 1936. Data from both the foreign-exchange (Figure 6) and bond markets (Figure 7) reveals no adverse movements in Polish assets from the start of January 1936 to late April, followed by a sharp deterioration beginning April 27, the day of the suspension of convertibility. This finding is formally demonstrated by a Bai-Perron analysis of structural breaks in the daily Polish bond-price series, which reveals a break-point in the final week of April in both the London and New York series.[6] (A useful placebo is October 1935, another structural break, when an intention to exit gold was *announced* by a reshuffled Polish Cabinet but not implemented due to opposition from the Army and Foreign Ministry. Foreign markets responded to the announcement by slashing the price of Polish bonds.) In other words, at least on the international financial markets where Polish government bonds were thickly traded, the Polish exit from gold in 1936 was an unanticipated event.

If neither economic deterioration at home nor speculative attack by foreign investors was responsible for the Polish exit from gold, what was? Archival evidence points to the Polish loss of faith in the military alliance with France as the prime motive. The intimate link between Poland's geopolitically motivated desire to remain committed to the French alliance, a position made necessary by Poland's precarious position between two revanchist rivals and bereft of a territorial guarantee by Germany under the Treaty of Locarno, and the conduct of Polish monetary policy, is revealed in the reasoning behind the Polish government's rebuff of the independent Bank of Poland's urgent request to impose exchange controls in May 1932. The government stressed that nothing could be done without the French: 'on grounds of broader national policy' the decision had to 'await the results of the Lausanne Conference and explanations as to the financial policy of the new French government'.[7]

---

[5] Leszczyńska (2013), p. 339. A more detailed set of figures exists in the minutes of the Bank of Poland's Exchange Commission, but could not be sourced owing to the pandemic.

[6] Don-Siemion (2021). Working draft in preparation.

[7] Archiwum Akt Nowych – Bank Polski t. 25 (Minutes of Bank Policy Council, 9 June 1932)

This statement came within the context of a Polish scheme, pursued consistently until 1934, to attract French private capital to the western border regions and thereby create inducements for the French government to intervene in the event of war.[8] With the French acquiescence in Hitler's military reoccupation of the Rhineland in March 1936, however, the strategic calculus abruptly changed.

At the emergency government meeting held the evening of Hitler's coup, once it had become clear that the French would not act, Marshal Rydz-Śmigły, who just the previous month had personally vetoed an attempt by the Bank of Poland's President to convince President Mościcki to abandon gold, now demanded an immediate and radical expansion of the military budget. The dominoes fell quickly after that: on April 9, the Cabinet approved the establishment of a National Defence Fund, which by 1937 had swelled to nearly half of the annual budget; between April 17 and April 21, the government removed the hard-money advocates Matuszewski and Koc from their remaining positions of influence; and on the evening of the 21st the Bank of Poland received marching orders to prepare for an imminent suspension of convertibility. As the Bank of Poland's balance sheets, fortuitously released on the 20th, show, the limited run on the Złoty that occurred domestically occurred only after the removal of Koc and Matuszewski leaked to the press. While Kwiatkowski and Mościcki may have *wished* to abandon gold already in the autumn of 1935, the veto of the diplomatic establishment and especially the military, whose influence in government following Marshal Piłsudski's coup of 1926 was assured, blocked their attempts to do so.

Until, that is, the strategic calculus changed.

[8] AAN – Bezpartyjny Blok Współpracy z Rządem, t. 115, k. 56

Figure 1: Bank of Poland Gold Cover (Three Definitions), 1924-1936

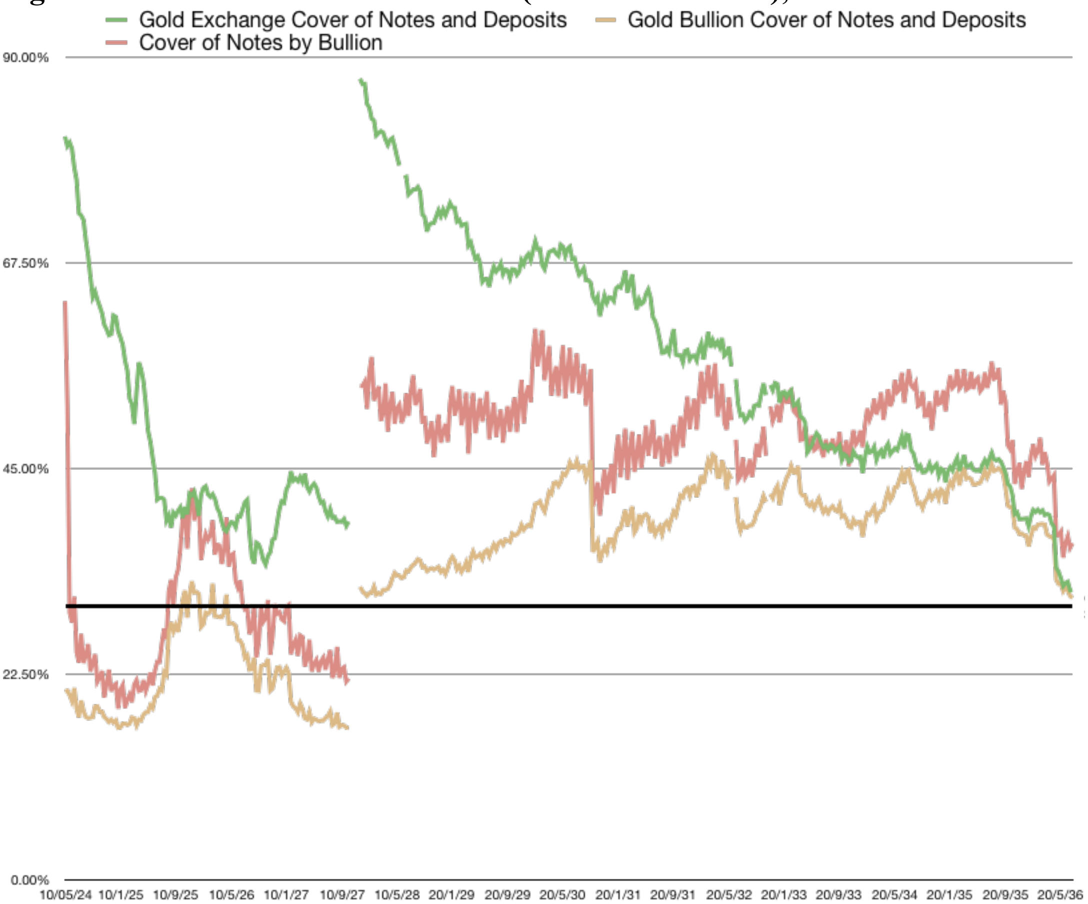


Figure 2: Gold Cover Net of Stabilisation Credits, 1930-1936

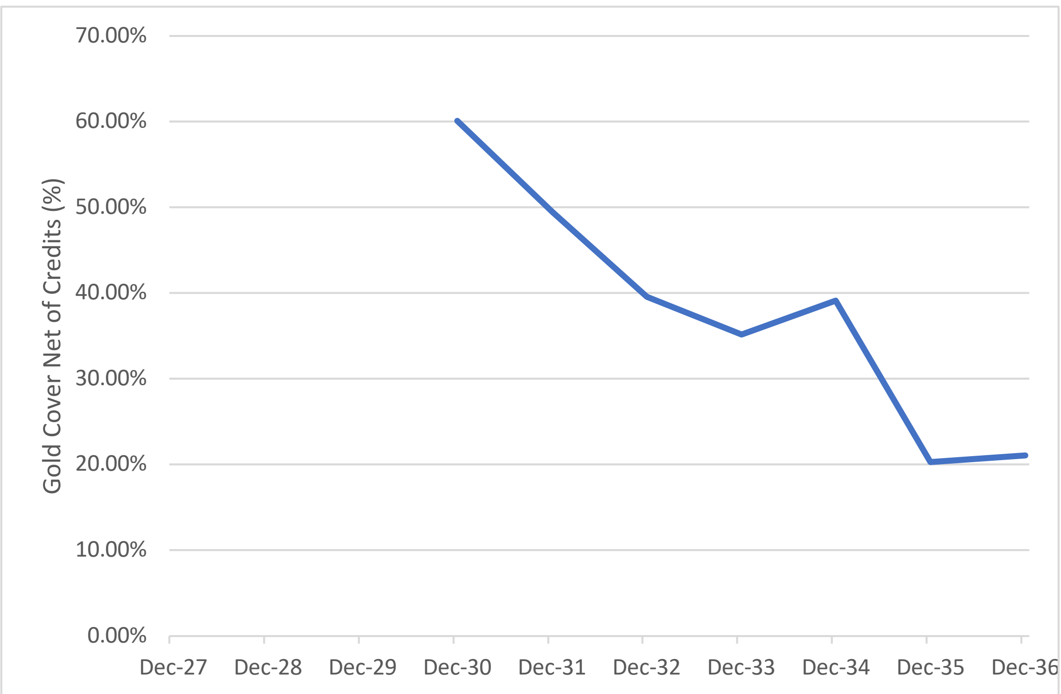


Figure 3: Trade Balance in Goods (millions PLZ), 1935-1936

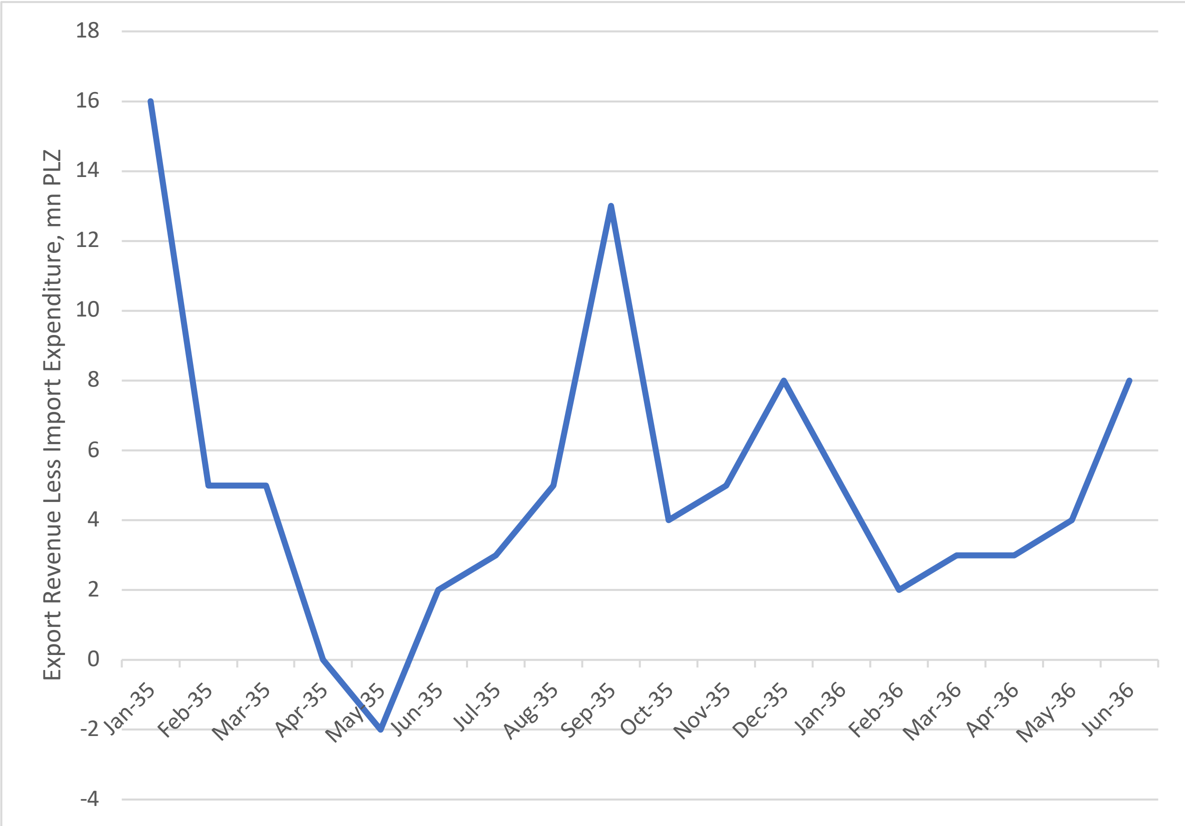


Figure 4: Budget Deficit/Surplus (millions PLZ), 1935-36

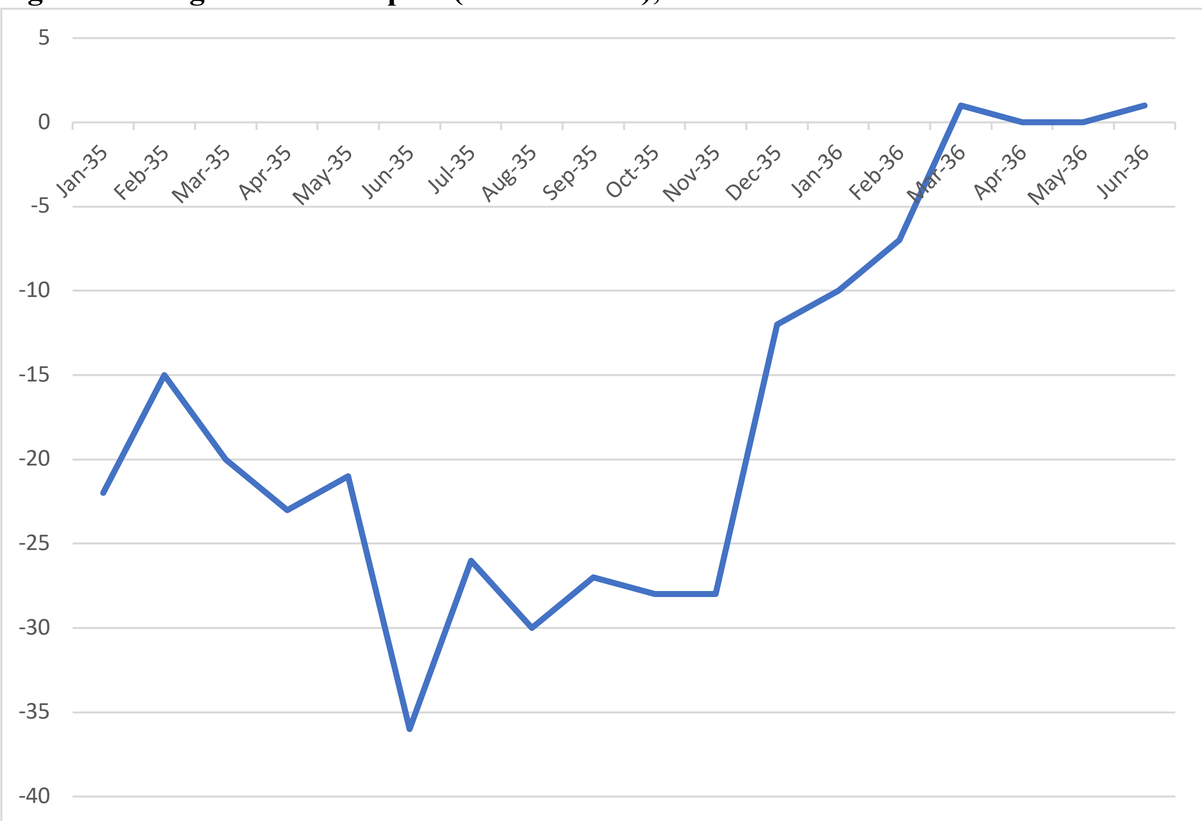


Figure 5: Workdays Lost to Industrial Action (1000s), 1932-1936

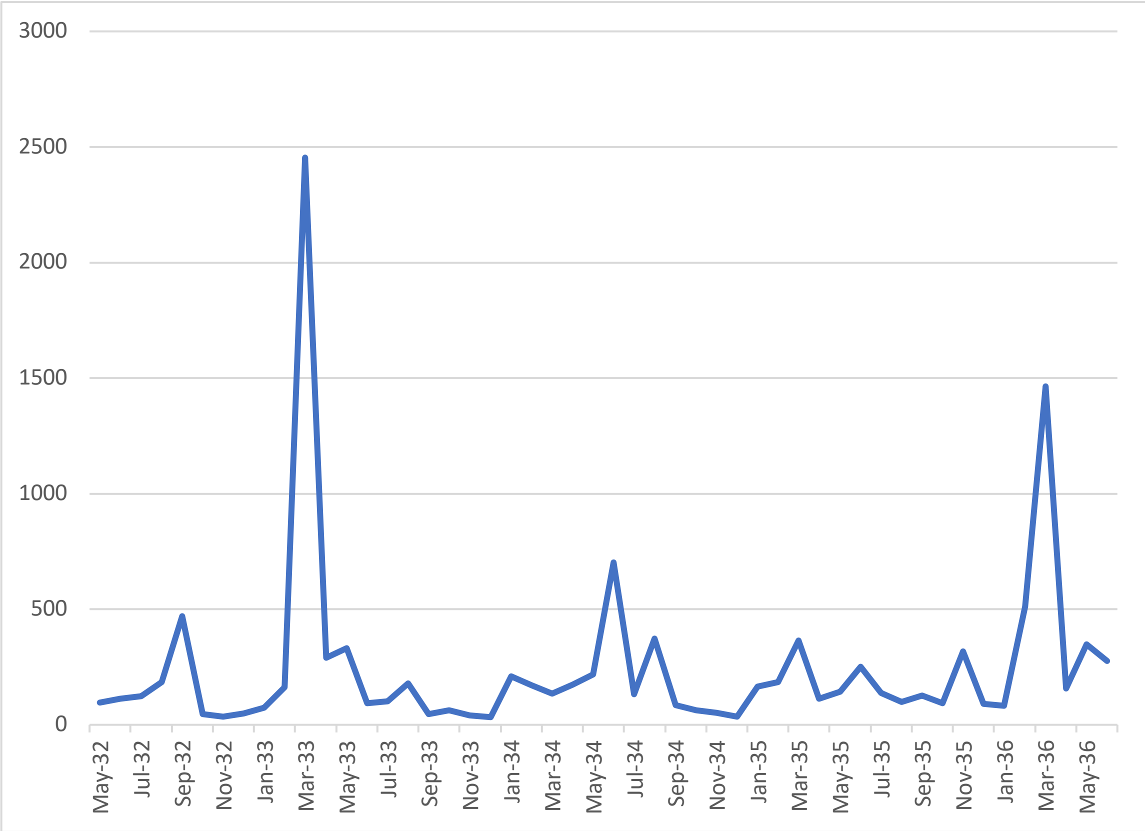


Figure 6: PLZ/GBP Exchange Rate, January-July 1936

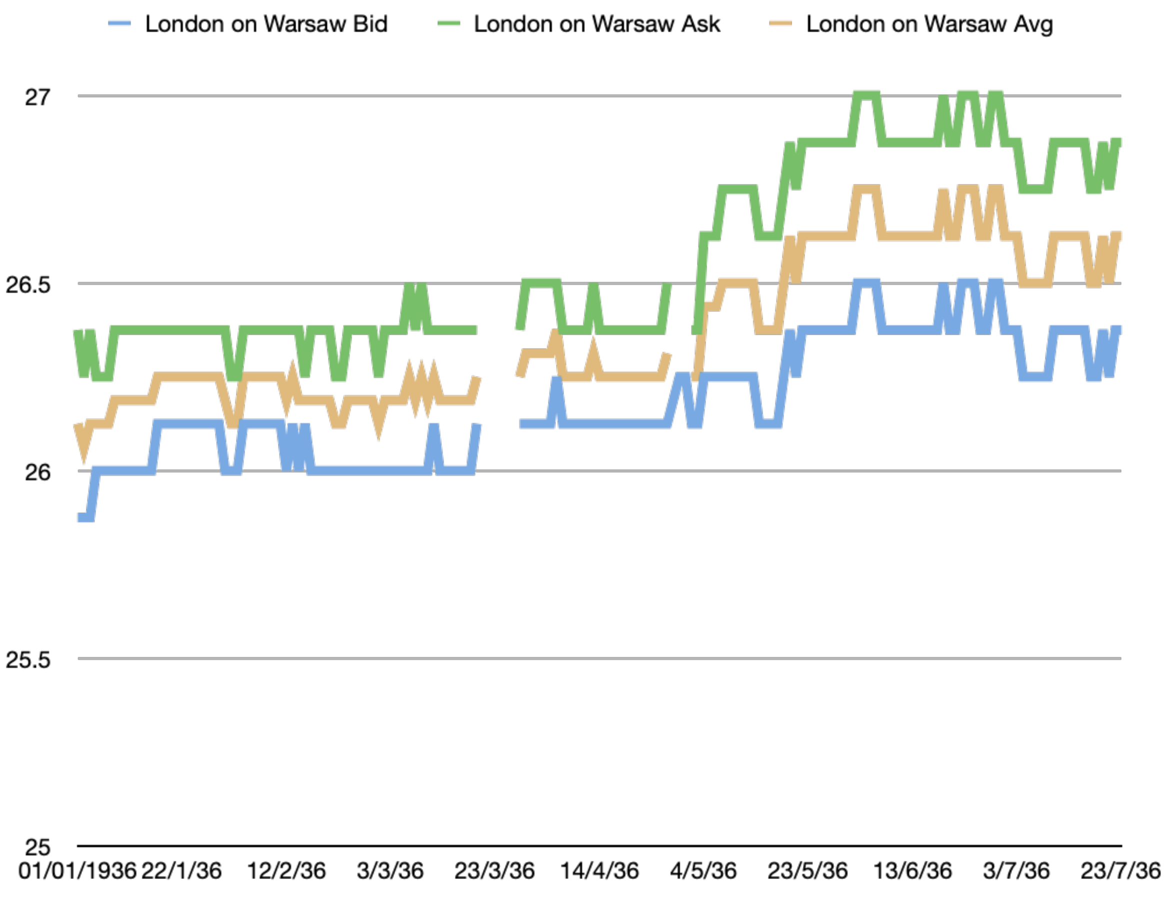
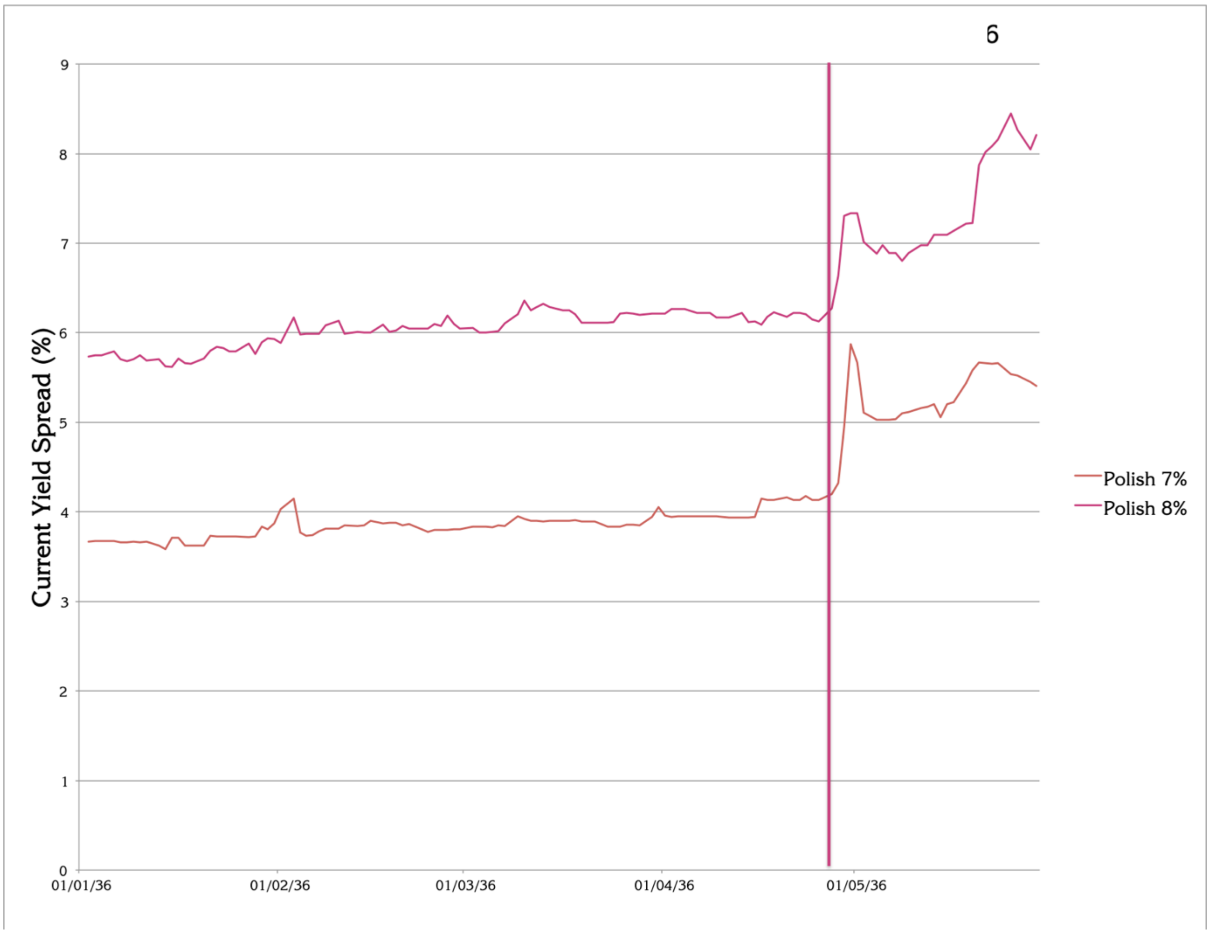


Figure 7: Polish Sovereign Bond Spreads, New York Market, January-June 1936[9]



[9] Line denotes suspension of Złoty convertibility corresponding to Bai-Perron structural break, 27 April 1936.

Bibliography

Allen, William. 'Poland, the International Monetary System and the Bank of England, 1921–1939'. *NBP Working Paper Series*, no. 328, 2020, https://www.nbp.pl/publikacje/materialy_i_studia/328_en.pdf?v=2.

Bemanke, Ben, and Harold James. 'The Gold Standard, Deflation, and Financial Crisis in the Great Depression: An International Comparison'. *Financial Markets and Financial Crises*, NBER, 1991, pp. 33–68, https://EconPapers.repec.org/RePEc:nbr:nberch:11482.

Don-Siemion, Thea. *Hyperinflation and Stabilisation in Poland, 1919-1927: 'War of Attrition' or Politics by Other Means?* 2019, https://theadonsiemion.com/publications/.

---. *Sovereign Debt and the Great Depression in Central Europe: Evidence from Transatlantic Bond Markets*. 2021.

Drozdowski, Marian. *Polityka Gospodarcza Rządu Polskiego 1936-1939*. Państwowe Wydawnictwo Naukowe, 1963.

Eichengreen, Barry, and Jeffrey Sachs. 'Exchange Rates and Economic Recovery in the 1930s'. *The Journal of Economic History*, vol. 45, no. 4, 1985, pp. 925–46. JSTOR.

Kubiczek, Franciszek, et al. *Zarys historii Polski w liczbach: społeczeństwo, gospodarka*. Zakład Wydawnictw Statystycznych, 2012.

Kwiatkowski, Eugeniusz. *Dysproporcje: Rzecz o Polsce Przeszłej i Obecnej*. Wydawnictwo Towarzystwa Szkoły Ludowej, 1931.

Landau, Zbigniew, and Jerzy Tomaszewski. *Wielki Kryzys (1930-1935)*. Książka i Wiedza, 1983.

Leszczyńska, Cecylia. *Polska Polityka Pieniężna i Walutowa w Latach 1924-1936*. 1st ed., Wydawnictwo Uniwersytetu Warszawskiego, 2013.

Wandschneider, Kirsten. 'The Stability of the Interwar Gold Exchange Standard: Did Politics Matter?' *The Journal of Economic History*, vol. 68, no. 1, Mar. 2008, pp. 151–81. *DOI.org (Crossref)*, doi:10.1017/S0022050708000053.

Wolf, Nikolaus. 'Scylla and Charybdis. Explaining Europe's Exit from Gold, January 1928–December 1936'. *Explorations in Economic History*, vol. 45, no. 4, Sept. 2008, pp. 383–401. *DOI.org (Crossref)*, doi:10.1016/j.eeh.2008.02.003.

---. 'Should I Stay or Should I Go? Understanding Poland's Adherence to Gold, 1928-1936'. *Historical Social Research / Historische Sozialforschung*, vol. 32, Jan. 2007.