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Japan and the British Gold Standard, ca. 1715–1885

As it came to Japan in 1897, the gold standard was a Western, originally British institution, and its institutional life story reflects the long rise to worldwide economic ascendancy of Great Britain and its more sudden fall. Japan's engagement with the gold standard was from beginning to end a story about international hegemony, integrally connected to the many questions of Japan's relationship to Britain and to the United States. To understand that story, it is necessary to begin with the prior monetary history of both Britain and Japan.

At its most basic level, the "classical" British-style gold standard consisted of two linked practices. First, a nation's standard money was given a fixed value in terms of gold. Thus, both paper money and subsidiary bronze and silver coins were denominated in terms of gold. The issuing authorities were committed to convert these representatives of gold, on demand by the bearer, into gold coins. Second, private individuals had the right freely to import and export gold. In practice, national gold standards were operated by national treasuries or central banks of issue, which held a stock of gold as a reserve for convertibility and issued paper money backed by that gold. This set of monetary practices, in a variety of national permutations, spread to most of the world in the late nineteenth and early twentieth centuries, and its use had profound economic, social, and political consequences.[1]

These two aspects of the gold standard—unification of the national currency in terms of gold, and free cross-border gold flows—have distinct origins, and their development reveals, respectively, a state-centered and a market-centered aspect of the gold-standard system. These elements came together in Britain over the course of the eighteenth century and formed a complete system, fixed in British law, in 1816. With the companion doctrines of free trade and laissez-faire, the gold standard became a central pillar of classical British liberalism. This latter story has received ample attention from historians. It is less well known that at the same time, Japan's Tokugawa shogunate also developed essential elements of its own national gold standard. The most immediate effect of open trade between Japan and the West was the sudden ruination of Japan's gold-based monetary system.

THE BAKUFU GOLD STANDARD

For several centuries, Japan's monetary circulation depended mainly on the import of Chinese bronze coins, making Japan a peripheral zone in a China-centered monetary sphere that extended across East and Southeast Asia. In the Tokugawa period (1600–1867), a nationally independent monetary system was created, as the shogunal government (Bakufu) issued its own bronze, silver, and gold coinages. Up to the 1770s, the Tokugawa coinage system functioned as a triple monetary standard. Each of the metallic coinages had its own system of denominations, and despite Bakufu efforts to fix rates between them, the gold, silver, and copper coinages in effect floated against each other in the exchange markets. Like other aspects of the Tokugawa order, the currency system was highly segmented socially and geographically; and in its multifariousness, complexity, and lack of overall rationalization into a single system, the Tokugawa currency was typical of early modern currency systems, including that of Britain in the eighteenth century and that of China until 1935.[2]

At the outset of the Tokugawa period, when Japanese society was very incompletely monetized, Japanese mines produced gold, silver, and copper in abundance. Much of it was shipped to China to pay for the import of manufactured goods. In one sense, Japan as a nation was simply trading locally produced commodities—metal for monetary use—for foreign goods. However, as rapid commercialization and monetization demanded an increasing volume of money, this trade of bullion for goods came to be viewed as a national loss for Japan—as a trade deficit, even if that conception itself was not yet available. Thus, by the early eighteenth century, the Tokugawa government's famous restriction of foreign trade had come to be motivated mainly by the fear that foreign trade was causing the loss of irreplaceable gold, silver, and copper. These trade restrictions became increasingly effective after the specie export embargo imposed by shogunal adviser Arai Hakuseki in 1715. At different points in the eighteenth century, they were combined with conscious import-substitution and export-promotion policies, as Japan moved toward an increasingly managed monetary system.[3]

National closure allowed the development of an independent monetary regime with some very modern features. Among the most striking innovations was the creation of a system of token (or fiduciary) silver coins denominated in terms of gold. This principle of monetary leverage—"overvalued" token coins whose face value exceeds the market value of the metal that they contain—is the essential principle of every modern system of coinage. Thus, for example, the metal contained in a quarter-dollar U.S. coin must have a market value of less than twenty-five cents, or else quarters would be minted at a loss and would end up being melted for other uses and vanishing from circulation. Simple as it appears in retrospect, this principle was only arrived at after centuries of monetary experience. It is usually regarded as a principle that was first instituted in England with the full enactment of the gold standard in 1816.[4]

In Japan such a principle was first implemented in 1772 by the government of Bakufu minister Tanuma Okitsugu, which began to issue overvalued silver coins—valued not by the weight in silver that they contained, but given a face value (an exchange value) in terms of gold *ryō*. Seen by generations of Japanese historians as a matter of straightforward debasement of the coinage motivated by simple cupidity, Tanuma's reform was in retrospect a monetary revolution: fifty years before the world's first unitary gold standard was fully realized in Britain—the very definition of monetary modernity for most specialists—the Tanuma administration independently created a partial gold standard in Japan.[5] Tanuma's "gold standard" remained partial in that these gold-denominated silver coins circulated side by side with the old silver-by-weight currency. However, over the final ninety-six years of Tokugawa rule, the new gold-denominated silver coinage occupied a progressively more dominant place in the national stock of currency.[6]

A primary dynamic of general monetary evolution was at work here. Abstractly, economic growth and commercialization demanded a greater circulation of money, but the national stock of specie was more or less fixed. As monetary historian Angela Redish has described it, a specie standard is like a ship on a finite anchor chain in rising seas.[7] More concretely, the difference between the face value of the token coins and their intrinsic metallic value constituted a source of seigniorage—a lord's profit. Such monetary leverage was a wellspring of state power, as seigniorage profits came to constitute a great part of Bakufu revenues.

Thus the "anchor chain" was lengthened—or, to employ a second metaphor, a given national stock of silver was leveraged into an even greater volume of "gold." The result was two distinct sets of gold-to-silver ratios. If Tokugawa gold coins were exchanged for the old-style silver-by-weight coinage, the market rate in 1858 was around 1:10. By contrast, if the actual silver contained in the Bakufu's widely used token coins were compared to their face value in gold, the ratio would have been as low as 1:5. As this difference provided an important source of seigniorage revenues to the Bakufu, it likewise tempted counterfeiters, who, as Takahashi Korekiyo wrote as a young student of English, "used to be crucified but now they are hanged." Outside Japan, gold-to-silver ratios in the world market were 1:15 or 1:16, and this difference would prove a temptation to foreign merchants.

Japan's closed, leveraged monetary system was shattered by the treaties imposed by the Western powers. In 1858, while Britain and France jointly warred against China to extend their economic rights there, U.S. consul Townshend Harris took advantage of the occasion to induce the Bakufu to accept a commercial treaty that required free trade and free monetary flows. Britain and the other European powers signed similar treaties soon after. Applying as a model the system that the powers had forced on China,[8] these treaties opened designated ports to foreign trade and residence, fixed Japanese tariffs at relatively low levels, and provided that the volume of trade should be unlimited. Thus, the Japanese government lost control over both tariffs and foreign exchange.

Many things have changed since 1858, but the respective economic policy positions of the U.S. and Japanese governments have shown some surprising continuities. In August 1929 Finance Minister Inoue Junnosuke, also responding to U.S. pressure, prepared to lift the embargo on gold exports that the Japanese government had imposed during World War I. In this connection he warned the Japanese people: "If we were to lift the gold embargo with things as they now stand, Japan's gold coins would at once go out to foreign countries, exactly like a great flood when a dam breaks." Before the monetary door could be opened, Inoue explained, Japan's foreign-trade accounts must be brought more nearly into balance.[9] Inoue's *kin kaikin,* the lifting of the gold export embargo, was an effort to restore Japan's economic equilibrium by relinking the country to the international gold-standard system. But his warning could have applied equally well to the Tokugawa Bakufu's predicament seven decades earlier. Under the terms of the 1858 Treaty of Amity and Commerce, "all foreign coin shall be current in Japan and pass for its corresponding weight of Japanese coin of the same description. . . . Coins of all description (with the exception of Japanese copper coin) may be exported from Japan."[10] The acceptance of these American demands meant the lifting of the specie export embargo that had been emplaced after 1715. It also meant that foreign silver dollars must be accepted weight-for-weight for the Bakufu's gold-denominated silver coins, as if the latter were a straight silver bullion coinage.

With this, the dam burst. Western traders rushed to convert foreign silver dollars weight-for-weight into the token silver coinage of Japan. They then tripled their money by converting these token coins at their face value into Japanese gold coins and shipping the gold out of the country. Once it began to operate, this circuit worked very quickly, as every available ship was pressed into service for the Yokohama-to-Shanghai run. An estimated 4 million *ryō* of gold coins flooded out of Japan in 1860, and gold rapidly began to disappear from circulation. The Bakufu responded by radically debasing the gold coinage, reducing its gold content by two-thirds in order to match the value of the actual silver content of the subsidiary coinage, at the international gold-to-silver ratio.[11] This "lifting of the gold embargo" in 1859 thus delivered a shock that destroyed Japan's native gold standard and forced the Tokugawa Bakufu to return its coinage to a straight bullion standard based on international rates of exchange. In the process, the Bakufu lost its freedom to finance itself by recoinages and finally resorted to issuing unbacked paper money. A great inflation also got underway, which did much to wash away the Tokugawa social order and make ready the way for the Meiji revolution of 1867.

THE PARLIAMENTARY GOLD STANDARD

The origins of Britain's gold standard are conventionally dated to 1717. Then, just as Bakufu policy makers were attempting to stanch the outflow of bullion from Japan to China, British policy makers were also trying to stem the flow of silver from Britain to the European continent (and thence on to India and China), and Sir Isaac Newton, master of the mint, refixed the mint price of silver in an attempt to keep silver in circulation. Gold, however, remained relatively overvalued in England. Silver continued to flow out and gold to flow in, and thus, England became the first country in modern times to have a gold-centered coinage.[12] The result may have been accidental, but as the virtues of a monometallic standard later came to be consciously regarded, Newton's name did provide a convenient authority for the new doctrine. And in fact there was something Newtonian about the equilibrium conception of the gold standard as it came to be imagined by British philosophers like David Hume in the course of the eighteenth century.

In his 1752 essay "Of the Balance of Trade," Hume likened the power of trade to that of gravity: "All water, wherever it communicates, remains always at a level." In a like way, when countries traded freely with one another and did not attempt to dam the free outflow of gold and silver, then money and prices should remain at a common international level.[13] Here, in an ideal form, is the second core element of the classical British gold standard: free international gold flows.

Following Hume's conception, the self-equilibrating mechanism of the gold standard was supposed to keep a nation's trade in automatic balance, as represented in figure 1. In short, if a nation imported more than it exported, it would have to settle its international debts in gold. As gold flowed out of the country, the domestic money supply would contract, which would raise the domestic value of money (gold) relative to goods. To put it another way, the money price of domestically made goods would fall. Domestic goods would thus become cheaper compared to foreign goods, discouraging imports and promoting exports, thus correcting the original trade imbalance. Conversely,

FIG. 1. Idealized operation of the gold standard in adjusting a nation's trade balance.

a country with an export surplus would receive gold inflows, enlarging the domestic money supply and causing the value of money (gold) to fall relative to goods. This inflation of domestic prices would make domestically produced goods less competitive internationally, thus ending the trade surplus. In modern times, Hume thought, the one thing capable of disrupting this natural balancing mechanism was the issue of paper money and credit. In actuality, even in its late-nineteenth-century heyday the international gold standard never worked in the automatic way that many of its proponents imagined.[14] Nevertheless, the grand simplicity of Hume's naturalistic conception retained a power to convince, and in arguing for a return to gold convertibility in the 1920s, Ishibashi Tanzan, Inoue Junnosuke, and many others presented this theory in its classic, idealized form.

The specie flow system thus appeared as a closed hydraulic system, except for irregular "injections" of newly mined gold and "leakages" of gold lost to circulation. To the extent that adjustment was unobstructed and rapid, the entire mechanism should never be far out of balance. In the common conception of the gold standard, the value of gold itself was held not to fluctuate: gold was the standard relative to which all else fluctuated. Thus, a nation's currency, if held constant relative to gold, should neither appreciate nor depreciate, although the price of goods might—indeed must—fluctuate. The important point here is that under such a regime, the whole burden of trade adjustment falls on domestic prices: net inflows of gold should bring domestic inflation, net outflows should bring deflation. An alternative but presumably temporary way to balance a trade deficit—which would be central to the actual operation of Japan's gold standard—was to borrow money from abroad.

In its actual operation, the gold standard has historically been associated with price deflation. At the most fundamental level, the sheer fact of limited world gold stocks, relative to the long-run expansion of the gold bloc and the rapid economic growth of its member economies, created a pronounced deflationary bias—a finite anchor chain in a rising sea. The fact that creditors thoroughly dominated Britain's political economy and that Britain, the historic center of the gold-standard system, was the world's great creditor nation was not incidental to this arrangement: creditors preferred to be repaid in "heavier" rather than "lighter" money. In the 1920s the United States inherited the role of global creditor, and American bankers became the world's leading promoters of the revived, deflationary gold standard.

In the eighteenth century, however, the neat symmetries of Hume's system remained a kind of utopia, and despite the new centrality of gold, British coinage remained extraordinarily chaotic. It was only after 1821 that Britain became the first European country fully to solve the old problem of keeping gold, silver, and copper coins all in circulation. The solution was the creation of a truly token (that is, overvalued) silver and copper coinage denominated in terms of a single gold standard.[15] This unification of the coinage under a single standard was the essence of the modern monetary revolution. The gold standard thus represented a grand simplification and, in the reckoning of most monetary theorists, a great step forward in monetary progress. Like paper money and like the token silver coins issued by the Tokugawa Bakufu, the value of Britain's new token coins was determined not by their intrinsic metallic content but by their face value as denominated in gold—they were "banknotes printed on silver," to paraphrase J. M. Keynes.[16] Indeed, the logic of paper money and fractional-reserve banking—the creation of banknotes or deposit money in excess of currency reserves—could be thought to be the mental model for this system.

This line of thinking leads finally to a consideration of the central-banking aspect of the gold standard. At the same time that Britain's metallic coinage was being unified, a related development was by stages reducing metallic coinage itself to the trivial monetary importance it has today, for Britain also led the way in the use of cheques and paper banknotes, convertible into gold. In fact, from the beginning, the British gold standard was a gold-and-paper system, as the unitary gold standard and modern paper money took form together, linked by the institution of modern central banking, which also received its first great development in Britain. As central banking evolved in Britain, an ideology developed as well—of the central bank as the guardian of the currency, neutral, expert, above politics, and largely hidden from view.

The specific conjunctural context of Britain's original enactment of the modern gold standard is also relevant to Japan's experience after World War I. In the first instance, the British government was forced to suspend the convertibility of bank notes into specie during the costly and inflationary world war to contain revolutionary France. With the war's end in 1815, the British parliament voted to terminate the wartime fiat currency and to institute gold monometallism formally into law. Britain's gold standard was thus legislatively instituted as a *restoration,* both moral and economic, and as a reaction to the experience of a wartime paper-money inflation.[17] The gold standard guaranteed that the paper banknotes issued by the Bank of England would be backed by "real" money—gold. It also rendered the creation of this real money into a completed fact dating back to the third day of biblical creation—a fact well beyond the reach of secular authorities who might be inclined to inflate the currency. The new gold standard was also highly deflationary.

Herein lies a great difference between the partial Tokugawa gold standard and the unitary gold standard established by the British parliament. The Tokugawa gold standard instituted by Tanuma Okitsugu was essentially an inflationary institution and a step in the direction of a fiat currency. Initially resisted by merchants, it reflected the increased monetary capacity of the Tokugawa state. The British gold standard likewise represented the increased capacity of the British state-bank complex, and notably, it was fully realized only after a successful, if inflationary, wartime experiment in paper money. But it was also conceived, like British constitutionalism in general, as a *limitation* of state power. As such, it reflected the power of the private, creditor interests who dominated the British state.[18]

Britain's unitary gold standard came to have a nearly religious hold on British financial circles. There was, after all, a natural economy and symmetry to the system: there were exactly as many standards of absolute value as there were gods in heaven; Gold was God with a fungible "£" in the middle. These were alike treasures that neither rust nor moths could destroy, and the spiritual dangers inherent in serving two masters were resolved by making them one. Bimetallism, continuing on the Continent until the 1870s, came to appear in Britain as a foolish and dangerous heresy, immoral and unscientific. By the 1840s, support for a "double standard of value" had simply become inconceivable to most British economists and lawmakers, the monetary issue being regarded as settled once and for all.[19] In Japan such quasi-religious monetary convictions were lacking, but in the early 1870s, as Japan's new leaders grappled with the problem of establishing a new monetary standard, Britain's example became influential. Japan's first attempt to join the London-centered gold zone in 1871 failed, and after a wrenching process of deflation and depression, currency stabilization was achieved on a second-best silver-standard basis in 1885.

POSTREVOLUTIONARY MONETARY STABILIZATION IN MEIJI JAPAN

At the same time that Japan was being incorporated into the Western system of trade and diplomacy, Britain's monometallic gold standard was gaining a position of primacy in a world economy that had traded since the sixteenth century primarily on the basis of an international silver-dollar standard.[20] Like the diffusion of the British factory system and the British notion of constitutional government, this was an epochal transformation. And like the popularity of eating beef, wearing neckties, and erecting public buildings in the lumpy Victorian style, this diffusion was not merely a matter of the efficacy of the gold standard as an institution but also a matter of adopting the civilizational markers of prestige and first-class status that attended national wealth and power. It was also a question of linking Japan economically with Europe or with Asia.

As the new Meiji government debated how to unify and modernize Japan's currency system, opinion at first leaned toward a system based on the silver dollar, the de facto trade standard of East Asia. In 1868 the Japanese government purchased the equipment of the British mint at Hong Kong and in 1871 began minting its own version of the silver dollar.[21] Itō Hirobumi, vice minister of finance, was then studying fiscal and monetary systems in America. He swung back and forth between favoring a bimetallic standard and a gold standard, finally recommending the latter "in accordance with the best teachings of modern times."[22] Following Itō's advice, the New Currency Law of May 1871 created the yen (*en*) and made it equal to 1.5 grams of pure gold. This action made Japan one of the very first countries, after Britain, to legally enact a gold standard. The value chosen made the gold yen nearly identical in value to the Mexican silver dollar, the standard trade dollar of the day, which was also the model for the U.S. dollar.[23] At the same time, however, the Meiji government also minted a full-weight silver yen modeled on the Mexican dollar for foreign-trade purposes, giving Japan in practice a bimetallic currency system.

Foreshadowing the wave of foreign borrowing after 1897, the new government also approached the London capital markets for a loan. The Meiji government's first foreign loan, raised in London in April 1870, was for £1 million at 9 percent, to construct Japan's first railroad, an eighteen-mile line from the newly renamed capital, Tokyo, to the new treaty port of Yokohama. With the success of this enterprise, the government took out a second loan of £2.4 million in January 1873, also in London, for the commutation of samurai stipends into interest-bearing government bonds. Thus, the new government borrowed money from British capitalists for the purpose of dissolving feudal obligations at home (very literally, for capitalizing them). Many former samurai in turn used their bonds as capital for founding Japan's first national banks.

Itō's gold-standard plan, however, did not work. First, the government lacked the gold reserves necessary to back up a gold standard. Further, the policy of minting both full-weight gold and silver yen coins, at a time when silver prices were beginning to drop, encouraged foreign traders to exchange their silver yen for gold ones, and thus Japan, like other bimetallic countries, experienced an outflow of gold and was pushed onto a de facto silver standard.[24] Western criticism of Japan's failed gold-standard aspirations is also revealing of the status dynamics of international monetary relations. "So long as silver is and remains the great medium of exchange throughout the East, Japan is only placing herself in an entirely false position in adopting a gold standard," opined the *Japan Mail,* a newspaper of Japan's treaty port community in 1876.

> Doubtless the Finance Minister of the time thought that what England and America had done, could not be wrong; and his successor has been fortified in that belief by the example of Germany and Holland [in adopting the gold standard]. And if Japan were an European country, they might have done well in thus deciding. But it is an Oriental country, and—in all probability—will remain so. Many curious things are and may be done in countries despotically governed, but it might have been better to realize once for all that Japan, whatever else it may do in the future, is obstinately a geographical fixture. . . . Japan was, we fear, too much influenced by the desire to do what England and America had done because she wished to place herself on some imaginary footing with England and America.[25]

In a hierarchically ranked world of colonizers and colonized, Japan thus entered the European world order with a peripheral, nearly semicolonial status. It became the great mission of the statesmen of the new Japan to remove the disabilities of that status and gain parity with the Western imperial powers. Domestically, the new Meiji government also issued its own paper money, which became increasingly disconnected from the worlds of either silver or gold. In effect, inconvertible paper money was used internally, and international money—silver dollars—was used for external payments.[26]

At this point, there occurred a monetary cycle of a sort that would be repeated after the Sino-Japanese War, after the Russo-Japanese War, and—on an international scale—after World War I. In 1877 the government financed the "Southwest War" against rebellious former samurai in Kyushu by a further issue of inconvertible paper money. The national banks, recently established on the U.S. model, also increased the issue of their own private banknotes, helping to fuel an inflationary boom. A debate arose within the government over how to adjust the inflated paper currency and restore specie convertibility. Finance Minister Ōkuma Shigenobu (1838–1922), drawing on the ideas of the Westernizing intellectual Fukuzawa Yukichi, proposed in late 1879 to establish a "specie bank" that would purchase silver coins and bullion and issue silver certificates in their place, thereby concentrating Japan's specie resources in the hands of the government. The semigovernmental Yokohama Specie Bank was accordingly established in February 1880.[27] Ōkuma also proposed a positive policy of raising foreign loans to finance industrial development, which would in turn strengthen exports and balance Japan's foreign-trade accounts. In the early part of 1880, he proposed to stabilize the currency by raising a gigantic loan of ¥50 million in London (at a time when the entire national budget was ¥63 million).

Ōkuma's foreign-loan plan was rejected as dangerous to national independence. This was not an idle fear: British creditors, backed by military force, were just at the moment seizing control of Egypt under the pretext of collecting the debts owed them, most of which had accrued as part of a disastrous deal to underwrite the construction of the Suez Canal. As a youthful Sakatani Yoshio saw it in 1881, if Japan's government by some financial mismanagement were to fail to repay foreign loans, "then we [would] have no alternative but to be the Turks or Egyptians."[28] Thus, after the 1873 loan, Japan did not borrow abroad again until 1897. By that time Japan was itself undertaking a campaign of financial imperialism—on the Egyptian model—in Korea.

In place of Ōkuma's scheme the government adopted an alternative plan put forward by Inoue Kaoru, who called for the government to cut spending and promote exports. Contained within Inoue's proposal was a call, similar in intent to Ōkuma's intentions for the Yokohama Specie Bank, to establish a "Bank of Japan," which would promote exports and attract specie by lending money in paper yen to exporters and then taking payment in the specie they received from the sale of their goods abroad.[29] As Ōkuma was forced by stages from his position of influence, the Specie Bank itself became, in line with a proposal of Maeda Masana, an institution for promoting exports and dealing in foreign exchange, which had previously been controlled by foreign banks. In this it was successful. The Specie Bank immediately began to create an international branch network by setting up offices in Japan's New York and London consulates in 1880 and 1881. The government lent paper money to the Specie Bank, which lent it in turn to exporters on the security of their exported goods. The bank returned the specie received in payment to the government.[30]

Ōkuma was calling at the same time for the immediate establishment of British-style constitutional government, and in October 1881 the Chōshū and Satsuma oligarchs forced him from the government.[31] Matsukata Masayoshi was appointed finance minister, thereafter retaining the finance portfolio for most of the next nineteen years—by far the longest tenure of any cabinet minister in Japan's modern history. Matsukata also completed the policy turn from inflation to deflation by implementing a currency stabilization policy and returning Japan to a hard-money standard, at the cost of a severe depression.

To address Japan's lack of capital and the efflux of specie due to the trade deficit, Matsukata proposed in March 1882 to establish a Bank of Japan, to act as a sole bank of issue and to coordinate and oversee the private banking system, "somewhat in the same way as a head office looks upon its branch offices." That is, the Bank of Japan would take direction from the Ministry of Finance, and the Specie Bank and all other banks would take direction from the Bank of Japan. Matsukata's vision of the function of central banks was also distinctly bullionist: the Bank of Japan would follow the example of "foreign governments," which "are all the time making very strong efforts through their Central Banks to absorb the specie that might otherwise never return."[32] This concern to concentrate specie (that is, foreign exchange) goes back to the original "statist" side of the gold-standard system; and while finding no place in the orthodox market-oriented theory of automaticity and free gold flows, it has historically been at the heart of the story. In June 1882 the Bank of Japan was established by imperial ordinance, and it opened for business in October.

By withdrawing the existing paper money from circulation, Matsukata forced down domestic prices and restored the value of the paper yen to a par with silver. Matsukata officially placed the yen on a silver-standard basis in May 1885, when the Bank of Japan began to issue banknotes, redeemable in silver.[33] The "Matsukata deflation" ended, and a renewed, moderate inflation got underway. In 1893 Finance Minister Matsukata took the first steps to prepare for a transition to the gold standard. In 1897, as the culmination of years of financial institution building, he completed the project, following a German precedent.

DEFLATION IN THE GOLD BLOC

The historiography of the Western economies in the late nineteenth century presents dueling images. On one hand, there is the long-established idea of the "Great Depression," which before it came to signify the global crisis of the 1930s, referred to the period from 1873 to 1896, an age of almost continual price deflation and deep, intractable depressions.[34] On the other hand, many economic historians tend instead to take as a unit the age of the "classical" gold standard from circa 1870 to 1914, foregrounding high levels of international trade, free capital flows across international boundaries, and a smoothly working system for settling international payments, to yield an image of a golden age of globalism and stability, irreparably shattered by the tragic "exogenous shock" of 1914. Partly, the difference of view depends on one's choice of periodization: depression set the international tone for much of the period from 1873 to 1895, and prosperity from 1896 to 1913.[35] The view also depends on whether one looks at things from the standpoint of the metropolitan financial hubs of the global system or from its agrarian peripheries. But remarkably, at the center of both of these opposed views is the fact of the generalization of Britain's gold standard during this period.

Britain adopted a unitary gold standard in 1816, and the eighty years that followed were an age of systemic deflation in the increasingly British-centered world economy.[36] Major gold discoveries in the late 1840s and in the 1890s interrupted this long-run tendency, and World War I, when the gold standard was universally suspended, brought another great inflation, comparable to that of the Napoleonic Wars. With the general restoration of the gold standard in the 1920s came renewed deflation. In this sense as in others, the "restoration" of the 1920s was the final, jangled reprise of the long nineteenth century.

It was during the final phase of the long nineteenth-century deflation, from 1873 to 1896, that the fall of prices in the gold bloc became most continuous and systematic. What happened then was in several ways a preplay of the final deflationary crisis of the global gold-standard system in the 1920s and early 1930s.

At the beginning of the 1870s, most of the core countries had bimetallic standards, and Britain was the only large country to use a monometallic gold standard. By the end of the decade, all of the core industrial countries operated unitary gold standards. Prussia's defeat of France and establishment of the German empire in 1871 set in train a sequence of monetary events. Seizing the chance presented by victory, Germany imposed on France a great indemnity of 5 billion francs—about one-third of France's gross national product (GNP) at the time. The German government used these funds to provide the gold reserve needed to switch to the gold standard.[37] This leveraging of military power into financial power became a model for Japan's adoption of the gold standard a quarter century later. It also set off an international economic crisis. In the short run, the inflow of French money fueled a speculative postwar investment boom in Germany and Austria. In May 1873 the bubble burst when the Vienna stock market crashed, and Germany was immediately swept up into the panic. In September, bank failures and financial panic also erupted in New York.[38] This was the abrupt beginning of what later became known as the Great Depression.

Germany's move from silver to gold also depressed silver prices at a time when world silver production was already increasing rapidly, setting off a general move away from the use of silver as a monetary standard. France and the United States both restricted the coinage of silver in 1873. Other countries went onto the gold standard one after another, further intensifying the scramble for gold and reducing the demand for silver.[39]

Thus, the deflation of 1873–96 was specifically a *gold* deflation. In England the purchasing power of gold in terms of real goods increased by more than 80 percent during the twenty-three-year deflation. At the same time, the purchasing power of silver actually fell by 6 percent.[40] Monetary politics accordingly came to the forefront of popular concern in a way that would happen again in the 1920s, and precisely because of its deflationary effects, the gold standard became the target of populist attack and the subject of a vast polemical literature. Farmers were typically the group worst affected by deflation, as crop prices and land prices fell year after year, while mortgages and other debts grew heavier in real terms. By the same token, bondholders saw the real value of their returns increase year by year. Thus, the gold standard, as anti-gold activists such as William Jennings Bryan saw it, squeezed "the struggling masses" to benefit "the idle holders of idle capital."[41] This social dynamic was recapitulated at the international level, with England appearing as the world's great creditor power.

Silver-standard Japan, however, was insulated from the gold-bloc deflation: instead of Japanese domestic prices deflating, the value of the silver yen depreciated for twenty-three years relative to the gold-backed Western currencies.[42] Thus, the yen began life in 1871 at a level of ¥1 = US$1. By 1896 the yen had lost one-half of its value relative to the U.S. dollar (which returned to gold convertibility in 1879). Japan's adoption of the gold standard in 1897 then fixed yen-dollar rates at a new level of nearly fifty U.S. cents to the yen would be maintained, with interruptions, until the final crisis of Japan's gold standard in December 1931.

As the silver yen depreciated, Japanese domestic prices increased by almost 40 percent from 1873 to 1896.[43] The increased price of Western goods in Japan provided de facto protection for domestically oriented Japanese producers, and the decreased price of Japanese goods in the gold bloc stimulated Japanese exports. A similar combination of inflation internally and deflation externally would appear again in 1932 and 1933, when Finance Minister Takahashi Korekiyo cut the yen loose from gold and allowed it freely to depreciate, helping Japan to recover early from the world economic crisis.

In 1897, as Japanese luck would have it, the long gold-bloc deflation had come to an end. One reason for the upturn in prices was a series of new gold finds in the 1890s, in South Africa, Australia, and the Yukon. As British luck would have it, these were all within—or about to be within—the British Empire.[44] Another reason was that the form of the gold standard that spread in the 1890s to the peripheral regions of the world—including Japan—was a qualitatively new institution, the *gold-exchange standard,* that represented a new extension of the principle of monetary leverage.