Britain and the Gold Standard

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By T. E. Gregory

SINCE Great Britain's departure from the gold standard on September 21, 1931, the course of the dollar sterling exchange has revealed three major movements. It fell almost continuously till December, the average daily rate for that month being $3.37 to the pound. From thence onwards it rose to a new maximum in April 1932, the average rate for that month being $3.72. By July the rate had sunk to $3.56. In August, September and during the first three weeks of October the rate showed considerable stability, the average for the whole of this period being about $3.46. As this article is being written, late in October, the downward tendency has again been renewed.

Toward the end of the week ending October 22, Sir Hilton Young, a distinguished parliamentarian who was formerly a brilliant financial journalist, speaking as deputy for the Chancellor of the Exchequer at the Annual Bankers' Dinner, vaunted the intrinsic stability of the pound sterling and put an end to any hopes or fears that might have been entertained that the British Government contemplated an early return to the gold standard. His speech may have contributed to the subsequent weakness of the sterling exchange, in so far as it may have encouraged Continental speculators to sell short and Continental bankers to withdraw balances. It has certainly not met with even the shadow of criticism in the British press; on the contrary, it is certain that, in the present state of public opinion, a return to the gold standard would be highly unpopular. When, a year ago, sterling was falling there were certainly some voices demanding that "something should be done about it." It is significant that it was the rise rather than the fall of sterling which produced alarm in the spring.

To appreciate this state of public opinion, it must be related to the past, both near and remote. Great Britain had been a gold standard country for a century before the war; it was, and is, the center of international financial operations; the Bank of England had rendered yeoman service in restoring the gold standard in Europe in the period 1925-1929, and only recently supported a resolution in favor of the international gold standard at a meeting of the directorate of the Bank for International Settlements; finally, the present National Government was originally formed to
save the pound from destruction and played upon the fear of inflation in the autumn of last year—in the opinion of many somewhat shamelessly. Any discussion of the possibility of Great Britain returning to the gold standard requires that account be taken not only of those factors in the domestic and world situation which may well make even a convinced supporter of the gold standard hesitant, but of those intangible, perhaps partly irrational elements of public opinion which no government can afford to neglect. I shall begin with these wider elements of opinion, because, at a distance, they are in danger of being overlooked.

The gold standard is unpopular, to begin with, because to it it is attributed both the world depression and the peculiar difficulties to which Great Britain was exposed in the period 1925–1929; and in the formation of opinion the special difficulties of this country have played perhaps the greater rôle. When the gold standard was restored, the opponents of the step then taken (and particularly Mr. Keynes) pointed out that, if the old parity of exchange were restored, the gold cost of British goods to the foreigner would rise unless the level of British costs fell, and that there was grave reason to fear that British costs would not fall. In a word, there was a danger that the pound sterling would be permanently overvalued, unless either world prices rose (without a corresponding rise in British internal prices taking place) or the forces of rigidity within the British economic system were overcome. If world prices neither rose nor British costs fell, the result would be a more or less permanent depression in the British exporting industries. In my opinion, whilst it would be unwise to say that the whole of the difficulties of, say, the British coal trade in the last decade are due directly to the reimposition of the old parity, undoubtedly the currency situation contributed to the difficulties actually experienced by exporters. The trade unions feel that they were asked to consent to a wage reduction merely because of a currency policy forced on them by "financial interests." Employers feel that they had to consent to a fall in their export prices and, under the conditions of the case, a deduction of profits on the same grounds. A large part of British industry is therefore disinclined to return to the gold standard because it fears a repetition of the same difficulties in the future. As for the general public, it has appreciated the line of argument advanced in 1925 and subsequently sufficiently well to have the impression that it was the supporters, rather than the opponents, of the gold standard who
failed in their predictions; and consequently it is unsympathetic to restoration of gold.

But the state of business opinion is also in part influenced by the somewhat irrational idea that a fall in the international value of the pound is necessarily favorable to British exporting interests, whilst a rise in the value of the pound is unfavorable: the alarm which was felt at the rise in the dollar value of sterling in the spring was due in part to this feeling. In other words, business opinion feels that the existence of a falling exchange also implies the existence of an "export bonus," whilst a rising exchange involves a tax upon exports. Now, in so far as the falling exchange merely registers the extent to which world prices are falling more quickly than British prices, and accurately measures the extent of the difference, a falling exchange does not yield a bonus, any more than a rising pound due to world prices rising more rapidly than British implies any impediment to export. It so happens that the pound sterling probably has been "undervalued," i.e., the international value of the pound has been below its true value on a comparison of price-levels, because in the case of Great Britain the exchange has been, and is, greatly influenced by financial movements which have only remote (if any) connection with the state of prices. There has therefore been a bonus on exports, which a rise in the exchange would imperil. Opinion in Great Britain does not recognize that the continuance of such an undervalued exchange, given a free exchange, is intrinsically unlikely, or that its existence is in itself one of the reasons for the continuous increase in the import "quota" and "anti-dumping" legislation of other countries. Public opinion confuses the advantages resulting from a free exchange with those resulting from a temporary position of the exchanges, and its desire to retain these temporary benefits leads it to refuse to assent to the disappearance of a régime under which they are possible, even if only temporary.

Thirdly, public opinion has learnt to associate the world depression with the existence of the international gold standard. I have to refer here to arguments which must be familiar to American readers: the two theses that the fall of prices is due to gold shortage and that it is due to gold maldistribution have become commonplaces even to the general public. It would be easy to exaggerate the direct influence of experts such as Gustav Cassel and Sir Henry Strakosch upon the movement of opinion, though their views have been given wide prominence in the press. Where-
as the trained economist is inclined to describe the depression as a cyclical decline in activity, accentuated by abnormal political and economic factors, the “man in the street” now believes that the fall of prices is due to the fact that “there isn’t enough gold to go round” and that what gold there is has been locked away by France and the United States. This maldistribution of gold, he has been taught to believe, is due to a failure on the part of other countries to “play the rules of the gold standard game.” Under these circumstances, he is naturally inclined to ask himself whether it is not better to stay where he is rather than risk any further disasters by linking up again with gold. In a more sophisticated form, this view is shared by many whose knowledge of the technical position is much greater. In any event, the position in the United States (which the public believes to be much worse than it is in Great Britain), and the growing difficulties of France (which have not failed to be advertised by the press), are negative reasons for refusing to budge. The retention of the gold standard in these countries has certainly not prevented the accentuation of local difficulties in the period during which Great Britain has been off gold.

Moreover, the country finds itself in good company. It is not as if Great Britain had been driven off gold whilst the rest of the world remained unaffected by the British action. On the contrary, a large part of the world is in the same plight as Great Britain, and the number of paper standard countries has been added to since last September. In the spring of this year, when the great gold drain from New York was taking place, there were not wanting voices in the City of London prepared to argue that by the autumn the pound would be worth six dollars. The wish was no doubt father to the thought: it is certain that there has been no general conviction that the gold standard will maintain itself even in those areas where it is still ruling. Moreover, although the Ottawa Conference did nothing to further the hopes of those who saw in it the formal instrument for creating an Imperial Currency Union (to which other countries might perhaps be eventually admitted), the public knows that the “Sterling Club” is coextensive with a large part of the Empire. The public also sees that the maintenance of the gold standard on the European Continent has been accompanied by an ever-growing volume of exchange regulation and it is not convinced that other countries—for instance, Germany—may not ultimately be forced
off. For these reasons, there is an under-current of feeling that the flowing tide is with the paper standard rather than with gold, and opinion is not prepared to risk a return to gold unless there is more evidence than is at present available that Great Britain's return would be followed by Scandinavia, for instance, or by those dominions, e.g. Australia, whose immediate interest it is to see that the gold and commodity value of sterling should be kept low.

To these more remote considerations must be added the tangible facts of the situation. The immediate consequences of the departure from the gold standard have been on balance favorable and are certainly far removed from those which were predicted in the summer of 1931, when the struggle to maintain parity with gold was going on. At that time it was freely predicted that the abandonment of gold would lead to a drastic fall in the purchasing power of sterling, and the politicians, at any rate, played upon the fear of inflation with very considerable effect. But, for various reasons, the unfavorable consequences which might have been expected to accompany the departure from the gold standard did not materialize, whilst some of the favorable consequences did manifest themselves, though to a smaller extent than the optimists had hoped for. The fundamental reasons for the non-appearance of unfavorable reactions upon the cost of living were the continued fall in gold prices and the steady decline in the number of gold standard countries. Great Britain was in fact in a position to exert a deflationary effect upon the prices of all those commodities for which she represented an important market, especially at a time when import and exchange restrictions of all kinds were narrowing the world market to an unprecedented extent. Moreover, public opinion took no account of such price changes as actually occurred. Between September 1931 and October 1932 the Economist index number (September 18, 1931 = 100) show two maxima. On February 24 the general index stood at 111 approximately, and on September 7 at 107; the index of primary products on the two dates in question stood at 121 and 120 approximately. But the cost of living index barely moved and on balance has been falling; thus, the Board of Trade general index number was the same in August of this year as it was in August 1931. It must further be borne in mind that for a time at least unemployment ceased to increase, though this favorable symptom ceased after December 1931. The fall in the exchange undoubtedly
benefited certain industries, primarily textiles; for a time the
growing depression in shipbuilding and iron and steel was checked;
and there was a sharp rise (partly seasonal, however) in the index
of production. Moreover, the combined effect of tariff measures
and a falling exchange was to cause (after a preliminary period of
rising imports, due to anticipation of the duties which were later
to be imposed) a sharp drop in the volume of manufactured im-
ports: exports of manufactures maintained their position at a time
when the general decline in world trade would have warranted
one in expecting a decline. Thus the visible adverse balance of
trade moved in a direction favorable to the country — and the
fact that a cutting of imports must be accompanied by increasing
pressure on such countries as Germany was overlooked in the
general rejoicing.

These favorable symptoms lasted long enough to give renewed
confidence in the outlook at home. After unemployment began to
increase again (in May) other counterbalancing elements of sat-
isfaction made their appearance. The creation of the Exchange
Equalization Fund, coinciding as it did with the flight from the
dollar, gave sterling an appearance of stability which was a neces-
ary preliminary to the great conversion operations of the gov-
ernment. In estimating the situation, the fact that there has been
in progress a great boom in gilt-edged securities must not be over-
looked. In September of last year the index of gilt-edged securities
stood at 97.9; it fell to 92.6 in October and has since recovered to
126.8\(^1\). Thus the rentier class and the bankers, those sections of the
population most likely to be scared by a falling external value of
sterling, have seen their security holdings appreciate some 40
percent, and if this result has been in part achieved by official
propaganda and an embargo on competing issues, a saving to the
Exchequer of £23 millions net and a sense that the “old country
is not played out yet,” as well as very handsome profits on current
purchases of gilt-edged stocks, are ample compensation. The fact
that bankers’ deposits at the Bank of England are up some £18
millions and bank deposits are up by some £150 millions —
in other words, the circumstance that there has been some infla-
tion which must sooner or later affect prices — is either disre-
garded or welcomed. Certainly it does not diminish satisfaction
with the way in which events have moved.

I come now to the more narrowly technical reasons which pre-
\(^1\) Basis 1924 = 100: London and Cambridge Economic Service Index.
vent any great enthusiasm being displayed for an immediate return to gold, or even a return within a foreseeable time.

The first is the perfectly understandable reluctance to risk a return to gold unless it is certain that, if the return is decided upon, a new wave of international unrest will not drive the country off again. This issue is, of course, a different one from the quite narrow question of the choice of parity. There is universal agreement that, failing a drastic rise of world prices in which Great Britain does not share, a return to the old parity of $4.86\frac{3}{4}$ to the £ sterling is impossible — and there are not wanting distinguished authorities, such as Emeritus Professor Edwin Cannan, who assert that the very fact that we are not likely to be able to return to gold at the old parity is a decisive reason for not returning at all, since public opinion abroad will regard a devaluation of the pound as itself a reason for not trusting our intentions as fully as before. So far as the factors internal to Great Britain are concerned, the possibility of remaining upon gold, once the return is decided upon, is of course affected by the choice of parity, but this is not the factor which looms largest in the British mind. What does loom large is the possibility of a new run upon sterling in consequence of circumstances over which the country has no control whatever. A decline in sterling, due to removal of balances, is by no means to be welcomed; but at least the shock to confidence due to the gold standard having to be abandoned is not, under these present conditions, one of the elements to be taken into account. So long as the volume of international short-term balances remains as great as it is, adherence to an international standard does undoubtedly involve dangers which are not contemplated by orthodox gold standard theory. The fear of being driven off gold by some sudden panic is a very real element in causing hesitation on this side.

The second element which leads to hesitation is the future behavior of the price level. So long as Great Britain remains upon paper, a fall in the world level of prices will lead, in so far as British monetary policy is directed towards maintaining the pre-existent level of British prices, to a further fall in the external value of sterling. If the fall is not accentuated by speculative or financial pressure, the cost of British imports will not, therefore, rise and the foreigner will pay the same amount as before, in the aggregate, for British exports. Great Britain cannot, of course, expect to “contract out” of the direct consequences of a fall of
prices on the volume of world trade and production, but she can escape the necessity of making the adjustments which other countries might have to be making to adjust the level of costs to the new level of prices. Without question, it is a fact that it is easier, in view of the traditions and the economic structure of the country, to allow the exchange to fall than it is to bring pressure to bear upon the level of costs. If, then, world prices were to go on falling and Great Britain were to return to gold immediately, the effect would be to cause the reinaugurated gold standard régime to be exceedingly unpopular both with the broad mass of the population and with the business world. For the return to gold would involve the necessity for further wage reductions and hence would provoke new labor conflicts — at any rate in the exporting industries. Owing to the rigidity of the British economic structure, such a fall of wage rates would not necessarily communicate itself to the “sheltered” trades — those protected by the nature of the case from foreign competition, or those working primarily for the home market. But the disparity between wages in the export industries and those in the sheltered trades is itself a cause of labor unrest. Having had experience of just such a situation between 1925 and 1929, business opinion would naturally be hostile to a resumption of the gold standard if it were to imply the recurrence of a similar situation. The fact that Great Britain’s retention of a paper standard might in itself act as a deflationary factor, and that a return to gold might act as an element strengthening confidence and so lead to a rise of world prices, is of course overlooked by those who put forward this line of argument.

The third element in the situation is the position of the debt question. There can be no doubt that Great Britain’s capacity to pay has been influenced by the decisions taken at Lausanne: nobody supposes that Germany will ever resume payments or that the former Allied Powers are in a position to constrain her to do so. The resumption of payments to the United States would involve in any event a serious additional strain upon the budget, and might easily involve serious transfer difficulties. These difficulties have only a slight connection with those which popular opinion imagines are comprehended under the term: a country upon a paper standard which is allowed to fluctuate freely must, in the end, be capable of transfer, by allowing the exchange to fall sufficiently to encourage further exports and at the same time drastically check imports. But in a world in which tariff and quota
restrictions are of great and growing importance, the fall in the rate of exchange necessary to force exports to a sufficient degree may well have to be very considerable, and such a fall—even allowing for a decline in world prices due to the pressure which Great Britain can exert upon the areas supplying food and raw materials—might then have very undesirable repercussions upon the internal cost of living and standard of life. Opinion within Great Britain might not be greatly upset; but London is still a great international center, and a rapidly falling exchange might lead to renewed distrust of sterling. From this point of view, the creation of the Exchange Equalization Fund has made things worse rather than better. For, whilst British opinion primarily regards the Fund as a means of preventing an undue appreciation of sterling, Continental opinion pays equal attention to the use of the pound as a means of preventing undue depreciation of sterling. The removal of the “peg” in October is one of the causes of the magnitude of the fall in the external value of the pound which followed. It is natural that it should lead to rumors that the Fund is exhausted and to attempts to force sterling down by bear sales. The resumption of debt payments to the United States—assuming that nothing else happens—must exert a depressing influence upon exchange and make it in any case impossible to fix a parity-point here and now. In any event, so long as we do not even know whether we shall have to keep on paying, and, if we do, what the immediate and more remote results are likely to be, the public and the government will not seriously consider the possibility of a return to gold.

This brings us to two other problems connected with each other and with the issues already discussed. The first of these is the budgetary situation, the second the position of the balance of payments. It is, of course, obvious that the budgetary situation is intimately affected both by the course of prices, the course of exchange and the amount to be paid in principal and interest upon the Anglo-American debt. When the financial statement for the year was presented to Parliament, no account was taken of the possibility of renewed payment upon the debt: on the other hand, the various conversion operations had not then been undertaken. Savings upon the old 5 percent War Loan will amount to a net sum of 23 million pounds, equivalent at rates of exchange current as this is written to some 76 million gold dollars. This is considerably less than half the annual instalment of 189 million
dollars due to the United States. Since the price level has on balance fallen rather than risen, the burden of additional taxation would not be merely a nominal one, but would involve an equivalent real burden upon the tax-payer. There is, fourthly, general agreement that it is out of the question to increase direct taxation upon incomes and upon estates. With a lower exemption limit and a standard rate of tax of 25 percent, and with trade not visibly improving, the position of the government would be politically impossible if it tried to raise the level of the income tax. A recovery in world trade would swell the revenue from customs, now a more important source of taxation than before. Cheap money, if it continues, will help the government by reducing the cost of financing the floating debt. On the other hand, the resentment against the so-called "Means Test," by which an attempt has been made to keep down the cost of unemployment assistance, is growing apace and some concessions will probably have to be made. Apart from further reduction upon armaments — and unilateral disarmament is not really possible — the chances of economies in other directions are not bright. About as much has been accomplished in these other respects as is consistent with efficient government, and a dangerous agitation directed against the whole principle of economy in government expenditure is already under way. It is not to be expected that the government will risk a return to gold until the prospects of being able to balance the budget at the parity chosen become less obscure than they now are.

Finally, there comes the question of the balance of payments. On this subject the public mind has become thoroughly debauched in the course of the agitation preceding the abandonment of gold in the summer of 1931. The real problem in connection with the balance is not the "balancing" of the balance (with a paper standard, the credit and debit items must be adjustable to one another), but the decline in the "invisible" receipts from abroad (interest, shipping earnings, insurance and financial earnings, and the like). The growing disorganization of the world economy (partly, of course, the direct result of British fiscal policy) imperils that proportion of the national income which is represented by receipts from overseas. The improvement in the visible adverse trade balance may in fact merely conceal a reduction in Great Britain's ability to purchase abroad, due to default and absence of dividends upon equities, the laying up of ships and the
like. A decline in these credit items may involve, in order that the balance may be adjusted, a further fall in the rate of exchange. On the other hand, it will be borne in mind that long-period capital issues in the London money market on behalf of foreign countries are almost at a standstill, whilst the prices of foodstuffs and raw materials have fallen. These elements affect favorably both the income and the capital categories entering the total balance of payments. What is not known with any certainty are the movements of short-period capital. Here various items have to be balanced against one another: 1, the repatriation of British funds formerly held abroad; 2, the inflow of foreign monies (speculative and for investment purposes) into London; 3, the outflow of British money to take advantage of low equity prices and high bond yields in New York; 4, outflow of foreign money and speculative sales of sterling due to profit-taking or anticipated further reductions in the external value of sterling. At the moment, the outflow is probably in excess — perhaps largely in excess — of the inflow: and if the New York Stock Market situation should improve in the future the outflow might increase. In any case, it is not yet apparent at what point sterling could be stabilized without the authorities at the Bank of England having constantly to manipulate the bank rate in order to encourage a flow of funds inwards or outwards as the equilibrating item in the balance of payments.

Some of these problems — particularly the problem of the world level of prices — may become more plain as the result of the deliberations of the World Economic Conference. By next spring, also, the budgetary situation will have become clearer and some certainty may have been gained on the subjects both of disarmament and of inter-Allied debts. For the reasons set out above, it is most unlikely that anything positive will be said or done by the British Government in the immediate future on the subject of Great Britain’s returning to gold.