Causes and Effects of the Britain's Return to the Gold Standard

Yufan Ke*

Wuhan Wanwuyouchang Culture Technology Co., Ltd, Wuhan 430000, China

*wwyc2020@foxmail.com

Abstract. This essay examines the economic policies implemented in Britain during 1925 to 1931. It covers distinct aspects of the British economy post-World War I and pre-Great Depression, including the confidence of the British, and classical economics theories. It discuss the effects after the policy and the disadvantages that prevented the pound from becoming the global currency. This essay focuses on analyzing the British policy of returning to the gold standard from two perspectives: causes and effects of the Britain and the world economic system. It is hoped that valuable information can be obtained from the research in order to accurately and objectively evaluate the impact of this policy on the future world economic landscape. By doing so, we can gain a deeper understanding of the complex interactions between the economy, policies, and society during times of crisis.

Keywords: Gold Standard, British Economy, Economic Policy

1 Introduction

The world war I period was a time of significant economic upheaval and experimentation for many nations, and Britain was no exception. The decision to return to the gold standard in 1925, after a temporary suspension during World War I, was a pivotal moment in British economic history [1]. This policy was not merely a financial maneuver but a reflection of the nation's desire to restore its pre-war economic prestige and stability [2]. However, the consequences of this decision were far-reaching and complex, affecting not only Britain but also the global economy. The gold standard, a monetary system where currency is backed by a fixed amount of gold, was seen as a symbol of economic discipline and stability [3]. For Britain, it was a means to re-establish its role as a financial powerhouse and to maintain its status as a global trading nation. Yet, the rigid adherence to this standard during a time of economic recovery and fluctuating gold reserves proved to be a double-edged sword. This essay aims to dissect the multifaceted implications of Britain's return to the gold standard [4]. It will explore the reasons behind the policy's adoption, the immediate and long-term effects on Britain's economy, and the broader repercussions for the world economic system.

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2 Causes of the Return of the Gold Standard

The return of the gold standard in Britain was not an isolated decision but rather a product of a complex interplay of economic, political, and social factors. To fully understand the motivations behind this policy, it is essential to examine the prevailing economic theories of the time, the political climate, and the societal pressures that influenced policymakers [5].

2.1 Influences on Classical Economics Theory

Firstly, the economic theories of the early 20th century placed a significant emphasis on the gold standard as a cornerstone of financial stability. One of the core theories behind the growth of the British economy is the classical economy and, specifically, the Cambridge School. Alfred Marshall, the founder of Cambridge School, believed that the core of the economy was equilibrium, similar to the theories of physics. This was what exactly happened one year after World War I when the government of Britain lightened control of economics [6]. In short, most people and government officials believed that traditional theories and policies were applicable, which continued even during the great depression when they thought the policy was strongly related to stabilizing currencies [7]. As a result of classical economics theory, the Chancellor of the Exchequer, Mr. Churchill, officially announced Britain's change of the gold standard.

2.2 Political Background of Britain in 1920s

Secondly, the political context cannot be overlooked. The British government was under considerable pressure to re-establish the country's pre-war economic dominance. The gold standard was seen as a means to signal to the world that Britain was committed to fiscal responsibility and economic recovery. Moreover, the government faced internal political pressures, as there was a strong desire among the populace and political elites to return to the perceived stability of the pre-war era.This is not only to maintain exchange rate stability, promote trade and financial development, but also to regain the former glory of the British Empire [8].

2.3 Societal Pressures after World War I

Lastly, societal pressures also played a crucial role in the decision to reinstate the gold standard. Most British people remember the glorious life before World War I, surrounded by the prospered economy and production of materials. Before World War I, Britain was the most powerful country in the world, known as the Empire that Never Set. However After World War I, the British economy started to suffer setbacks [9]. The people have experienced the turbulence of World War I and post-war economic instability, and are eager to return to a more stable and predictable economic environment. The gold standard is seen as a mechanism that can provide this stability. In addition, the society at that time generally believed that a currency system pegged to gold could prevent excessive government spending and inflation, thereby protecting the savings and purchasing power of ordinary people [10].

In conclusion, the return to the gold standard in Britain was a decision driven by a combination of economic theories, political imperatives, and societal desires for stability. Understanding these factors provides a deeper insight into why policymakers believed this was the best course of action at the time, despite the challenges it would later pose [11]. The following sections will explore the immediate and long-term economic impacts of this policy on Britain and its global repercussions, offering a comprehensive analysis of its consequences.

3 Effects of the Return of the Gold Standard

The immediate effects of Britain's return to the gold standard in 1925 were mixed. On one hand, there was a sense of relief and confidence among businesses and investors who appreciated the predictability and stability that the gold standard promised. The fixed exchange rate was intended to bolster international trade by ensuring that the value of the British pound would not fluctuate wildly, which was seen as a necessary step to restore Britain's position as a global financial center. However, the return to the gold standard also had significant drawbacks. The pre-war exchange rate was set at a level that was no longer reflective of Britain's post-war economic reality. The high value of the pound sterling made British exports less competitive on the international market, as they became more expensive for foreign buyers. This led to a decline in demand for British goods abroad, which in turn slowed down the recovery of British industries.

The agricultural sector, which was a significant part of the British economy at the time, was particularly hard hit. Farmers found it difficult to compete with cheaper imports from countries that did not have the same high exchange rate. This led to falling incomes and a wave of rural distress, which further contributed to the overall economic malaise. The government's commitment to the gold standard also meant that it had to maintain a tight monetary policy to keep inflation low and defend the currency's value. This policy, however, came at the cost of economic growth. With interest rates kept high to attract foreign capital and maintain the gold parity, domestic investment was stifled, and the economy struggled to gain momentum.

In the long term, the return to the gold standard had profound implications for British society. The economic stagnation that resulted from the policy contributed to the social unrest and political upheaval of the 1920s and 1930s. The working class, in particular, felt the pinch of the economic downturn, with rising unemployment and wage cuts. This led to increased labor militancy and a series of strikes that further destabilized the economy. The global repercussions of Britain's decision were also significant. As the world's leading economy, Britain's adherence to the gold standard had a domino effect, influencing other nations to follow suit. This created a rigid global financial system that was ill-equipped to deal with the economic shocks of the Great Depression. Countries that remained on the gold standard found it increasingly difficult to respond to the economic downturn, as they were constrained from using monetary policy to stimulate their economies.

4 Policy Analysis

During the implementation of the policy, Britain forfeited its opportunity for devaluation, a potential enhancement for economic development and improvement of international trade competitiveness, which meant that Britain had lost the potential to re-achieve its global currency position, as it held in the last century. Though currency devaluation was considered positive, its protectionism against trade tanked a 65% decline in global trade.

The aftermath of Britain's adherence to the gold standard during the economic turmoil of the late 1920s was a stark illustration of the limitations of traditional monetary policies in the face of systemic financial shocks. The decision to maintain the gold standard, despite the evident strain it placed on the domestic economy, was a testament to the prevailing economic orthodoxy of the time, which held that fixed exchange rates provided a stable framework for international trade and investment. However, the global economic landscape was rapidly changing, and the rigid commitment to the gold standard proved to be a double-edged sword. As the economic crisis deepened, the British government found itself caught between the Scylla and Charybdis of economic theory and practical exigencies. The policy's inflexibility meant that the Bank of England could not adjust interest rates to stimulate the economy without risking a run on gold reserves. This created a situation where the domestic economy was held hostage to the whims of international financial markets.

The eventual abandonment of the gold standard in September 1931 marked a pivotal moment in British economic history. It allowed the government the necessary monetary autonomy to implement policies that could address the domestic economic downturn. The devaluation of the pound sterling that followed made British exports more competitive on the global market, which was a crucial step towards recovery. The devaluation, while initially painful, paved the way for a gradual economic revival and a shift in the country's economic strategy. The policy analysis reveals that while the gold standard had provided a semblance of stability in the pre-war era, it was ill-suited to the dynamic and interconnected global economy that emerged in the 20th century. The inflexibility of the gold standard meant that it could not accommodate the necessary adjustments in response to economic shocks, thereby exacerbating the downturn.

In the wake of the crisis, economists like Keynes advocated for a more pragmatic approach to economic management, one that recognized the importance of active government intervention in stabilizing the economy. The lessons learned from the adherence to the gold standard during the economic crisis of the late 1920s and early 1930s informed the development of more flexible monetary policies in the post-war period, which allowed for greater autonomy in managing domestic economic conditions.

The British experience during this period underscores the importance of adaptability in economic policy-making. While the gold standard had its merits in providing a stable currency and predictable exchange rates, it was ultimately too rigid to cope with the complexities of a modern, global economy. The transition away from the gold standard marked a significant evolution in economic thought and practice, paving the way for a more nuanced understanding of the role of central banks and the importance of maintaining a balance between internal and external economic objectives.

5 Conclusion

The abandonment of the gold standard by Britain in 1931 had far-reaching implications beyond the immediate economic turmoil. It marked a significant shift in the global financial order, as other nations began to reevaluate their own monetary policies in response to the changing economic landscape. The ripple effects of this decision contributed to the eventual reshaping of international trade and finance, paving the way for the emergence of new economic powers and the decline of others.

The policy's impact on the British psyche was profound. The loss of the pound's status as a global currency was not merely an economic setback but also a blow to national pride and identity. The British public's faith in the government's economic stewardship was shaken, leading to a period of introspection and debate about the role of the state in managing the economy.

In the years that followed, the British government adopted a more pragmatic approach to economic management, one that was less dogmatic about classical economic theories and more open to interventionist policies. This shift laid the groundwork for the Keynesian revolution in economic thought, which would dominate economic policy-making for much of the twentieth century.

Further research into the aftermath of Britain's departure from the gold standard could explore the social and political consequences of this economic upheaval. For instance, the rise of extremist political movements in the 1930s can be partly attributed to the economic despair and uncertainty that followed the Great Depression. Understanding how economic policies intersect with social stability and political dynamics is crucial for comprehending the broader implications of financial decisions.

Moreover, a comparative analysis of other countries that maintained or abandoned the gold standard during this period could provide valuable insights into the effectiveness of different economic strategies. For example, the United States' adherence to the gold standard until 1933 had its own set of consequences, which can be contrasted with Britain's experience.

In conclusion, while the return to the gold standard was intended to restore economic stability and the former glory of the British Empire, it ultimately had the opposite effect. The policy contributed to economic stagnation, social unrest, and a rigid global financial system that was ill-prepared for the economic challenges of the 1930s. The legacy of this decision serves as a cautionary tale about the dangers of adhering to economic policies that are out of touch with the realities of a changing world.

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