

# International Monetary System



*Inter-war period  
(1915-1944)*

# Inter-war Period (1915-1944)

- ❖ After WW1, the world powers tried to return to the gold standard at prewar parities (i.e., at the previous exchange rates),
- ❖ But the attempt to restore gold convertibility did not succeed, except momentarily
- ❖ The 1920s-30s were characterised by recessions, banking crises, the Great Depression and the rise of fascism
- ❖ Exchange rates were mostly floating and protectionism increased
- ❖ There was a hegemonic power shift from the UK to the US

# Inter-war Period (1915-1944)

- ❖ The Classical Gold Standard was shattered by the outbreak of WW1
- ❖ The system collapsed not because of an internal dilemma but because of an external violence
- ❖ As soon as the fighting began in Europe, private trade and financial transactions were suspended
- ❖ Gold exports were banned

# “Return to Gold”

- ❖ As international linkage disappeared, each country started to issue bonds and print money to finance the war effort
- ❖ They began to have different inflation rates
- ❖ When WW1 ended, the major countries wished to restore the prewar gold standard, which seemed to offer prosperity and stability
- ❖ "Return to gold" became the national and even global slogan, and it was believed that returning to gold at the prewar parities (i.e., at the previous exchange rates) was the right thing to do

# “Return to Gold”

- ❖ The US returned to gold early, in 1919
- ❖ The UK returned in 1925
- ❖ Most other European states also returned by 1928, so it looked like the gold standard was resurrected
- ❖ But this system lacked leadership and coordination, and turned out to be fragile and short-lived
- ❖ As France demanded only gold for international settlements, a speculative downward pressure on the UK pound emerged

# “Abandonment of Gold”

- ❖ In 1931, the UK abandoned the gold standard again, and the other countries followed
- ❖ In the midst of the Great Depression (1929-), countries began to form trade blocs and protected their internal markets
- ❖ Global trade continued to shrink
- ❖ Militarism and fascism rose
- ❖ Japan returned to the gold standard in January 1930 and abandoned it in December 1931

# Why did the attempt to restore the gold standard in the interwar period fail?

- ❖ First, the 1920s and 30s saw frequent recessions and banking crises (exception: the US economy was booming until 1929)
- ❖ It was thought that governments had first and foremost the responsibility to solve the domestic problems of bankruptcy and unemployment, rather than keeping international commitments

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- ❖ Second, there was a leadership vacuum in the international regime.
- ❖ Third, as a result of this and in the absence of policy cooperation, each country became selfish.
- ❖ Protectionism and competitive devaluation escalated.

# John Maynard Keynes argued against returning to gold

- ❖ During this period, the famous British economist John Maynard Keynes argued against returning to gold (this was in 1925, before he wrote the famous General Theory in 1936)
- ❖ His argument was roughly as follows:
- ❖ At the prewar parity, the pound would be 10% overvalued against the dollar because of the inflation gap between the UK and the US since 1914

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- ❖ If the UK returned to gold at the old exchange rate, the tradable sector (especially the coal industry) would have to suffer severely
- ❖ Moreover, from a historical perspective, the gold standard was a "barbaric relic" (i.e., crude and outdated system) and should be abandoned
- ❖ The value of money should not be subjected to the demand and supply of gold which was uncontrollable
- ❖ The world should move to paper currency managed scientifically and responsibly by central banks

Thank You