Shocking Intellectual Austerity

The Role of Ideas in the Demise of the Gold Standard in Britain

James A Morrison
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Montagu Norman aboard the Duchess of York
15 Aug 1931

=> Norman’s departure from England is key to Britain’s departure from gold
The Demise of Gold in Britain

I. Britain’s Shocking Departure

II. Previous Explanations

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1. Austerity Politics
2. Division within the Bank
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For centuries, Britain had maintained an unparalleled commitment to the fixed metallic standard.

Britain's most powerful interest groups--exporters and the financiers in the City--had come to depend upon the truism that sterling was 'as good as gold'.

As a result, London had become the centre of the international gold standard system.
As Keynes famously put it...

the Bank of England served as 'the conductor of the international orchestra'.
Yet, on 19 September 1931... 

the Bank of England unilaterally took Britain off the gold standard.
And when the 'conductor' of the gold standard symphony abruptly quit the concert hall...

the international orchestra quickly fell into disharmony.
This departure was shocking...
Britain did leave in the midst of a financial crisis, but this particular crisis was no worse than the previous crises of the interwar period.
Moreover, it seemed that the Bank of England had scarcely begun to fight...
Primary Weapon Remained Sheathed

Interest Rate ("Bank rate") was just 4.5%

- 10% in Austria; 15% in Germany
- 6.5% during sterling’s 1929 crisis

==> Post-hoc models suggest that just 2% interest rate hike may have been enough to save sterling
Other Unused Weapons

• Refused £50 million loan from French
• Didn’t exhaust gold reserves or overseas assets
• Eschewed capital controls
Relative to the fundamentals of other countries, Britain left gold “early”...

“when the economic conditions did not necessarily warrant such a move.”

(Wandschneider 2008)
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This is one of the most significant shifts in foreign economic policy in the 20th Century.

And there has been no shortage of attempts to explain it.
Virtually all of them follow in the tradition of Karl Polanyi…

The “locus classicus of political-economy analysis of the gold standard.”
(Eichengreen & Flandreau 1997)
The Polanyi Thesis

(1) Disintegrating international system--and Britain's declining position within it--raised the cost of defending sterling.

(2) Britain's evolving domestic politics limited the Bank's capacity to impose the austerity necessary to make the defence.

**Rationalists:** Expansion of franchise & rise of unions

(Simmons 1994; Eichengreen 1996; Frieden 2006)

**Constructivists:** Shift in values

(Ruggie 1982; Kunz 1987; Blyth 2002)
The Polanyi Thesis

=> By 1930s, Britons no longer willing to subordinate “questions of social organization...to the needs of the restoration of the currency.”
This assumes:

(1) Britons recognised that leaving gold would alleviate unemployment.

And...

(2) It was obvious how to save the gold standard.
I challenge both assumptions.
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Few Britons believed that suspension would reduce unemployment.

Most did not question the orthodox belief that leaving the gold standard would lead to unstoppable inflation.
Of course, it's no surprise that the Conservatives maintained this view.
But what about Labour?
If Britain left gold, “the situation would rapidly worsen and unemployment would rapidly increase—far more rapidly than we have known it even during this terrible time of depression.”

Ramsay MacDonald
Labour Party Leader
August 1931
Ramsay MacDonald
Prime Minister, National Government
After Suspension
“[R]educing the standard of living of the workmen by 50%...would be the effect of departing from the gold standard.”

Philip Snowden
Labour Chancellor
August 1931
To save the gold standard, even radical trade unionists were willing to swallow substantial impositions on the working class.
(Keynes was exceptional. More on him later!)
The question was not *whether* to save the gold standard.

The question was: *how*?
This was not obvious to the guardians of the gold standard.
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Previous scholars (Sayers 1976; Kunz 1987) maintain that the Bank approached the crisis with one mind.
I disagree.
15 July: Norman warns Americans of “progressive increases in bank rate” up to “7% or 8%”

23 July: Bank Rate ==> 3.5%

29 July: Bank Rate ==> 4.5%

But...then Norman suffered a nervous breakdown
This provided Harvey with an opportunity to radically alter the Bank’s strategy...
“The crisis had been one of confidence.”

Interest rate hikes might “stimulate the lack of confidence.”

Instead, sterling’s “future prospects must...depend upon the course of political developments.”

--- Statement to Government
September 1931
Despite being ill, Norman continued trying to influence policy...
...particularly via secret discussions with NY Fed Governor Harrison.

Norman *en route* to North America
15 August 1931
Norman became increasingly incensed as Harrison relayed the details of Harvey’s manoeuvres.

By mid-September, Norman knew that he had to return to the Bank.
that if that were true they themselves would have to decide which was the least disturbing form of election. He then stated that he had to appear before his government tomorrow morning to give the benefit of his judgment as to the effects of different procedures upon the present disturbing exchange situation; that he was inclined to express his opinion along the lines that he had mentioned to me. In conclusion he asked specifically what he said was in the minds of a great many over there, that is, whether there was any prospect of helping the British situation from Washington. I asked what he meant and got no very satisfactory answer. I rather gathered that he and they are wondering whether there is any likelihood, as the press has been indicating in the past several days, of Washington taking any affirmative position regarding inter-allied debts and reparations. I hinted that I did not think it was possible to expect Washington to take any further initiative in this matter. It was left that way.

During the course of my conversation with Harvey I told him that I had just seen Norman, that he was much disturbed about the way the exchange situation was handled and he agreed with us that it was most important not to peg it, that every peg in past history had proved disastrous, that he saw no occasion for it at this time and that the chief reason he was hurrying home before he was quite ready to do so was to see if he could not make some headway in handling the exchange situation more satisfactorily.
This threatened disaster for Harvey.
He knew that Norman would resume raising interest rates.

With the general election now weeks away, Harvey believed that this would promote a political backlash that could deliver Parliament to the radicals.
Fearing that the budget would get unbalanced, Harvey decided to “temporarily” suspend the gold standard...

in order to delay the election...

and keep the gold standard coalition in power.
Britain did not leave the gold standard because the Left had gained control.

Ernest Harvey suspended convertibility in order to prevent the Left from gaining control.
Norman stormed back into the Bank...
ELUSIVE FINANCE KING ENDS MYSTERY TRIP

NORMAN IN LONDON; PUBLIC HELD BACK

Police Guard Head of Bank of England From Interviewers After Canadian Trip.

MET BY SIR JOSIAH STAMP

Financier, Traveling Incognito, Quits Liner by Special Tender Before His Boat Reaches Dock.


LONDON, Sept. 23.—Montagu Norman, governor of the Bank of England, landed at Liverpool on the liner Duchess of Bedford today after a trip to Canada which is shrouded in mystery, although he insists it was made solely for reasons of health. The air of mystery was maintained on his return to England. While he was recognized aboard the steamer, his name was not on the passenger list; he did not participate in the liner’s social life and he took meals alone.

BANK CHIEF’S BODYGUARD.

Police Cordon For Mr. Montagu Norman.

Mr. Montagu Norman, the Governor of the Bank of England, who has been on a visit to Canada, returned to London yesterday.

He was met at Euston Station by Sir Josiah Stamp, the chairman of the London Midland and Scottish Railway and a director of the Bank of England, and by one police inspector, two sergeants and eight constables. The police took extraordinary care that no one, other than Sir Josiah Stamp should be allowed to speak to Mr. Norman when he arrived at Euston.

A large crowd had gathered, but was kept well down the platform.

DODGED THE CROWD.

A cordon was drawn round Mr. Norman’s waiting motor-car.

Sir Josiah engaged him in serious conversation as soon as he stepped on to the platform, and the two drove away at once to the Bank of England. Mr. Norman bade at Liverpool from the Canadian Pacific liner Duchess of Bedford early in the morning.

He had wirelessed for a tender to put him into the river to take him from the liner, and in this way he dodged the crowd waiting at the quayside. He drove to the railway station at Liverpool just before the train was due to leave, locked himself into a first-class compartment, and at once began dictating letters to his secretary.

Bank of England Mum on Norman

LONDON, Sept. 24.—Rumors that Montagu Norman, governor of the Bank of England, would resign were current in financial circles today, but it was said at the bank that nothing was known there of such reports.

Mr. Norman, who returned here from Canada yesterday, was at his desk in the bank.
...but the Old Lady was already off.

Norman could only hope to drive Britain back onto gold.
Why didn’t that happen?
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Remember that the economic orthodoxy had been at pains to insist that suspending the gold standard would inevitably lead to 'uncontrollable inflation'.
Yet, after Britain left…

the hyperinflation never came.

The pound slid about 30% and then stabilised.

The British economy didn't collapse.
In fact, it grew.
Following the Bank’s unexpected suspension, policymakers learned that a managed float was a viable, desirable equilibrium...
deal with our own currency first. I cannot say more than that it is our intention to take the steps which will most surely tend to stabilise the pound on a definite basis as soon as the necessary conditions are fulfilled. These conditions are not all of our making nor are they all within our power to secure. We cannot forget that our return to the gold standard in 1915 was followed almost immediately by the beginning of the long decline in world prices which has been so calamitous to productive industry all over the world. It would clearly be foolish to repeat that experience and before definitely binding the country by obligations we shall examine the position from every point of view to assure ourselves that there is no doubt as to our permanent ability to maintain the position taken up.
“First and foremost the Bank rate should be reduced as rapidly as may be to say 3 per cent...we want cheap money and plenty of it to stimulate industry.”

“These considerations suggest that a (relatively) low value of the pound is desirable...because it seems the only way to prevent sterling prices following gold prices down.”

Frederick Phillips
Principal Assistant Secretary
HM Treasury
What About Keynes?

• Sharpest critic of gold standard
• But...Bank left *in spite of* JMK
• Shaped policy following suspension
  – Treasury & Bank open dialogue with JMK
  – Theories guide monetary policy for fiat currency
  – Endorses Exchange Equalisation Account & managed float
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Conventional models focus on power, interests, and institutions.
I argue that we cannot understand the demise of the gold standard in Britain without reconstructing actors’ mental models.
This weekend, we've been talking about how we do (and ought to) do history.

(And I hope that this study provides an example of at least one way to do this.)

But there are two larger points about history here...
(1) History can be highly contingent.
What if Norman hadn't collapsed?

What if Keynes had?
(2) The actors we study depended on specific views of history.
Britain has always been on gold.

The 1920s European experience demonstrates that leaving gold always leads to hyperinflation.

Leaving gold has proven to be quite good!
Thank You!

“The Lady of the Bank”
By Charles Wheeler (1930)
Could Norman have saved gold if he hadn’t collapsed?

**Consensus:** No!

- Political division sapped confidence (Eichengreen; Simmons)
- Balance of payments was deteriorating (Moggridge; Howson)

**My Response:**

- Banks expected rate hikes. Early, strong, consistent response would have bolstered confidence
- 2% rate increase might have reversed capital account (Cairncross & Eichengreen)
Dear Prime Minister,

I do not intend to publish anything about the Report of the Economy Committee, because my views are not fit for publication; they are not even fit for circulation to the public. But I welcome the chance of expressing in your letter, received this morning, to tell you personally what is in my mind.

One could criticize the Committee's recommendations in detail, but I would prefer to consider them on a very broad line, because their recommendations are the quite logical outcome of a general point of view which many responsible and authoritative people hold - or have held up to recently.