Contrasting Challenges:
The 1930s Chatham House Study Group on ‘The International Gold Problem’ and the 2011 Chatham House Taskforce on ‘Gold and the International Monetary System’

Catherine R. Schenk
University of Glasgow

September 2011

The views expressed in this document are the sole responsibility of the author(s) and do not necessarily reflect the view of Chatham House, its staff, associates or Council. Chatham House is independent and owes no allegiance to any government or to any political body. It does not take institutional positions on policy issues. This document is issued on the understanding that if any extract is used, the author(s)/speaker(s) and Chatham House should be credited, preferably with the date of the publication or details of the event. Where this document refers to or reports statements made by speakers at an event every effort has been made to provide a fair representation of their views and opinions, but the ultimate responsibility for accuracy lies with this document’s author(s). The published text of speeches and presentations may differ from delivery.
The economic context of the 1930s Chatham House Study Group was in many ways very different from the modern-day Chatham House Taskforce, of which I am a member, but the focus was the same: the role of gold and the international monetary system. Eighty years ago the international economy was reeling from an international financial crisis that contracted liquidity in domestic and international credit markets, shrank growth rates and led to unemployment at record levels. Despite some superficial similarities with today’s economic environment, the differences are important.

In 1931 the UK economy was constrained by the gold standard, which made it impossible to allow the exchange rate of the pound to take the strain of adjustment. After struggling through three years of intense crisis, in September 1931 the pound finally broke from its fixed gold parity and depreciated. Exports became more competitive, credit became cheaper and the British economy began its recovery from depression. A similar effect can be observed today in relation to the case of Ireland and Greece, which suffer from the ultimate fixed exchange rate of the Euro and have limited room for manoeuvre to absorb shocks. One of the immediate outcomes of the crisis of 2007/8 was the depreciation of the pound, which supported exports, protected services and industry from international competition and allowed lower interest rates.

In 1929, R G Hawtrey, Chatham House Study Group Member on the International Gold Problem, claimed that ‘the command of the central banks over the market in gold is absolute’ and the Study Group sought ways to make the gold price ‘behave’ to ensure stable prices. The crisis of September 1931 showed that this assumption was wrong – but it underpinned a lot of the Study Group’s discussions. Its members also worried that gold could not be mined fast enough to match the growth of the world economy and that the United States and France held most of the world’s gold, so they addressed proposals for ways of ‘economizing’ on gold (i.e. operating a gold standard without central banks actually holding much gold). For John Maynard Keynes, the ‘vital thing’ for the ‘present emergency’ was to sustain international lending to prevent a global liquidity crisis, and he looked to France and the United States, as large gold holders, to lend more – a situation with some analogies to the global imbalances and reserve hoarding today. We must also remember that the Study Group was meeting during a period of falling prices and with no historical experience of volatile gold prices.
(for 100 years to 1930 the price had only risen from $19 per ounce to $21 per ounce). In contrast, we are now in a period of rising inflationary expectations, reserve rich countries tend to have lower GDP per capita and the price of gold has become highly volatile.

After the monetary expansion of the First World War, the direct link between gold and the money supply could not be restored to the system that had operated for 30 years before 1914. What emerged was a ‘gold exchange standard’ where most countries held foreign currencies (sterling or the US dollar) as their reserve assets instead of gold. In the maelstrom of the European financial crisis in the summer of 1931, the publication in July of the low ratio between the UK’s gold holdings and the amount of short-term obligations that could potentially draw on these reserves triggered the final collapse of Britain’s ability to defend the fixed value of gold. Meanwhile, the fixed exchange rate system had spread the US monetary contraction of 1929–30 across the world as other countries struggled to match their rising interest rates in an environment of falling demand and slowing growth.

Today, the huge quantity of outstanding US dollar assets held by global central banks, instability in the dollar exchange rate and doubts about the worth of such an exceptionally large amount of US debt have all revived interest in replacing the US dollar as a primary reserve asset. Central bankers, particularly in emerging economies, have responded to the dramatic surge in the gold price by accumulating gold in their reserve portfolios. This has prompted some speculation about the potential for a new role for gold in the international monetary system, and a new Chatham House Taskforce is examining the issues.

There have been two experiences of the gold standard and both were accompanied by depression – in the 1890s and in the 1930s – so there are few serious advocates of a return to a gold standard today. Nevertheless gold’s use as a hedge against inflation and the inverse relationship with the value of the dollar suggest that there may be ways in which it could produce some offsetting (and possibly stabilizing) pressures in the international system. Suggestions include inserting a small amount of gold into the valuation of the SDR, using the gold price as a trigger for an array of policy interventions, or accumulating gold in official reserves. The challenge is that the gold price is most volatile at times of general international economic uncertainty (which makes it an unlikely anchor), the market tends to be prone

---

1 Royal Institute of International Affairs (1931) The International Gold Problem: Collected Papers. A Record of the Discussions of the Chatham House Study Group of Members of the Royal
to speculation and the supply of gold does not grow as fast as the international economy, leading to deflationary bias if the price is fixed.

The 1929–31 Chatham House Study Group was rather ill served by historical timing it concluded just two months before the unexpected abandonment of the gold standard. Perhaps its most lasting area of consensus was the need for international cooperation to promote prosperity in a stable economic environment and the importance of public engagement in current economic problems. These principles also underlie the current Chatham House Gold Taskforce as it seeks to promote a broad and open discussion of gold’s role in the international monetary system.
ABOUT THE AUTHOR

Catherine Schenk is a Professor of International Economic History at the University of Glasgow and a member of the 2011 Chatham House Taskforce on gold and the international monetary system.