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Mr Churchill, Mr Keynes and the UK's Re-Entry to and Exit from the Gold Standard

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ABSTRACT
The UK reestablished the gold value of sterling at its pre-WW1 level in April 1925, and Keynes wrote his pamphlet of the Economic Consequence of Mr Churchill, then Chancellor of the Exchequer. The paper begins with the UK's suspension of the gold standard in two stages during World War 1, and the intended path to lifting that suspension after the end of World War 1. The involvement of Keynes in debates over the gold standard starting in 1916 and the evolving contributions of Keynes over the return leading to the events of 1925 are considered. The question of in whose interests the return was is then discussed. The paper finishes with a brief discussion of the economic circumstances in the UK in 1925–31 which fed into the abrupt departure of the UK from the gold standard and were welcomed by Keynes.

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1. Introduction

The UK suspended the fixed exchange rate of sterling with gold (and thereby the dollar) in early 1917, having previously, in 1914, withdrawn from the backing of central bank notes by gold. In this paper, the route back to a return to the gold standard in the form of a fixed rate with gold (but not gold in circulation) and the involvement of Keynes in debates over tole of gold leading to his *Economic Consequences of Mr Churchill* are discussed. Section Two is a brief discussion of aspects of the suspension of that backing and the lead-up to the decision on the exchange rate, and Keynes' arguments for the retention of the \$4.86 exchange rate for sterling. In Section Three, the route back to the gold standard is indicated with a six-year build-up to the return, focusing on the general political consensus for the return to the gold standard, the role of Churchill in that return and the rather lone voice of Keynes warning against it. Section Four moves on to the return to the fixed rate of sterling vis-à-vis gold, and indicates the correspondence between Keynes' critique and the economic events of the second half of the 1920s. In Section Five there is consideration of the issue of in whose interests there was a return to gold. The departure of sterling from the \$4.86 exchange rate was a sudden occurrence in August/September, and this is examined in Section Six, followed by a

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brief indication of the relative success of the UK economy after departure. Section Seven offers some concluding remarks.

2. World War 1 and the Suspension of Gold

The UK (and the rest of the British Empire) had long operated a gold specie standard with gold sovereigns in circulation until the outbreak of World War I (WW1). At the start of WW1, the circulation of gold coins was brought to an end with increased issue of Bank of England bank notes and the introduction of bank notes issued by the Treasury. The Treasury notes explicitly declared that they 'are Legal Tender for the payment of any amount'. 'The UK's banks came to accept the notes in lieu of gold, and few questioned whether they would remain as good as gold in the future. The public also took to using the notes — and to calling them "Bradburys" [after the name of Joint Permanent Secretary at the Treasury]' (Morrison 2021). By 1918, there were £184 million of Bradburys in circulation, against which the Treasury held just £28.5 million of gold in reserve. The Bank of England increased its note issue, from £57 million to £75.6 million, during the war, though it had increased its gold reserves from £38.5 million to £57.1 million.

Moggridge (1992, pp. 272–273) reports the conflicts between the Bank of England and the Treasury over control of exchange policy, in which Keynes (then at the Treasury) was involved with Walter Cunliffe, then governor of the Bank of England and later chair of the committee on return to the gold standard as mentioned below. 'On 3 July [1917], after a verbal protest, he [Cunliffe] reminded the Prime Minister and the Chancellor of the predecessor's promise: In November 1915 … the late Chancellor … promised me verbally that Mr Keynes should not meddle again in City matters, which promise was, as far as I am aware, kept until Mr McKenna [the former Chancellor of the Exchequer] went out of office. … . Mr Keynes … in commercial circles [is] … not considered to have any knowledge or experience in practical Exchange or business problems, and I am convinced that, short of a miracle, disaster must ensue. … I cannot remain a mere figurehead acting under men in whom I have no faith, unless the Cabinet after this warning is prepared to accept the entire responsibility. In verbal discussion, Cunliffe demands Keynes' and Chalmers' dismissal. Bonar Law refused, saying that the two men were his officials acting on his responsibility' (Moggridge 1992, p. 273).

The fixed price of sterling in terms of gold and thereby the dollar and a number of currencies was maintained at $4.86 until a 'run on the pound' with a 'fixed' exchange rate dropped in February 1917. Within the Treasury, there was some opposition to this move. 'Bradbury mobilised a clique of like-minded Treasury officials and external advisers, working almost ceaselessly, to make the intellectual case against suspending the gold standard. The foremost among them was John Maynard Keynes' (Morrison 2021). Keynes wrote his 'Memorandum on the Probable Consequences of Abandoning the Gold Standard', dated 17 January 1917 (reproduced in Keynes' Collected Writings, vol. XV1). Keynes argued that the right to turn sterling into gold for export had in effect already been withdrawn with the last withdrawal of gold from the Bank of England's reserves for export on private account having been in June 1916. 'Its place is now taken by the official sale of dollars in exchange for sterling, *to all comers* at a minimum rate which has been fixed for many months past at 4.76 7/16.' (Keynes 1917, p. 215). Hence, 'in practice, therefore, to abandon the gold standard means to abandon the present policy of selling dollars to all comers at a fixed price not far removed from the parity'. Keynes summarised his arguments: 'The abandonment of the gold standard does not afford the means to discharge a single liability; it does not furnish a new instrument of economy except through the consternation it creates; it diminishes our assets by involving the abdication of our position as the world's banker; it is gravely injurious to our credit; and it affords encouragement to our enemies. It is not so much a possible policy for deliberate adoption, as the symptom, if it occurs, of a grave disease.' (Keynes 1917, p. 222).

Burk (1979) notes that Keynes' views changed with the change of circumstances when the United States entered the war in April 1917, and hence this memorandum may not represent Keynes' attitude for the last years of WW1. The pound was slightly devalued in February 1917 to the rate of $4.6714. Later, on 1 April 1919, the gold standard was temporally abandoned, and the value of the pound was unpegged and subsequently experienced a marked decline, and by February 1920, it had reached its lowest point of $3.18.

3. Charting the Return to Gold 1918–25

As the First World War drew to an end, the British Government commissioned a report on the war's consequences for the currency and foreign exchange markets. As governor of the Bank of England, Cunliffe chaired the committee to recommend on the postwar transition of the British economy. The interim report of the Cunliffe Committee (1918) reflected 'the consensus opinion of British financial and commercial sectors, unanimously recommended a return to the gold standard, the reduction of government debt and borrowing, and the accumulation of sufficient reserves to underpin the system' (Duckenfield 2004, p. 109). Ingham (1984, p. 172) argued that Bank of England and the Treasury had by its actions during WW1 preserved the institutional conditions for the gold standard and 'in a very real sense the "decision" to return to gold was taken in 1914' (Ingham 1984, p. 172). Indeed, the Cunliffe Committee (1918) argued 'it is imperative that after the war, the conditions necessary for the maintenance of an effective gold standard (https://en.wikipedia.org/wiki/Gold_standard) should be restored without delay'. It argued that before the outbreak of war, the UK had 'possessed a complete and effective gold standard. The provisions of the Bank Act 1844, operated automatically to correct unfavourable exchanges and to check undue expansions of credit. During the war the conditions necessary to the maintenance of that standard have ceased to exist.'

The Cunliffe Committee (1918) postulated three prerequisites for the restoration of an effective gold standard. The first was the cessation of government borrowing as soon as possible and hence a balanced budget. Second, the effective use of the Bank of England discount rate to check a foreign drain of gold and the speculative expansion of credit in this country. Third, 'the issue of fiduciary notes should, as soon as practicable, once more be limited by law'. The deflationary aspects of return to the gold standard are evident in the first requirement, and the use of bank discount rate for foreign reserve purposes in the second.

An Act of Parliament of 1919 suspended the gold standard for six years, and the return to the gold standard (in the sense of setting price of sterling relative to gold) in 1925 came about from not renewing the act of 1919. It set out the objective of 'return to gold'. Morrison (2021) argues in the debates on 'return to gold' that there were differences of view on what 'return to gold' would entail, and he also argues that before WW1, there were distinct versions of 'the gold standard' which were in operation within the United

Kingdom, with Scotland and Ireland having their own laws regulating the emission and convertibility of currency, and 'considerable variation in the norms and practices in London and those that prevailed elsewhere around England and Wales' … 'There was not even a single gold standard *ideal*'. The Cunliffe Committee defined 'the essence of' the UK's 'complete and effective gold standard' as the reality that 'notes … always stand at absolute parity with gold coins of equivalent face value, and that both notes and gold coins stand at absolute parity with gold bullion'.

There was widespread political consensus on the return to gold. It was strongly supported by the financial sector and also received strong support from trade unions and the Labour Party and (perhaps to a lesser degree) business. As Ingham (1984) wrote, 'the City, Bank and Treasury were in accord in wanting to reconstruct the prewar liberal system, and that the Bank and Treasury ultimately served the City's vowed "interests", but the strength of the force for the return to gold lay also in the independent practices of both Bank and Treasury. The Bank's pre-eminence in the monetary and banking system stemmed from its discretionary management of the gold standard and the Treasury's political dominance within the state system was, in part, based upon its ability to apply stringent budgetary controls within the external constraint of the gold standard regime' (p. 173). Collins (1990) argued that the profits of the City of London were 'closely dependent on sterling's international role and devaluation could undermine confidence and threaten this role. It is not surprising, therefore, that the City sought a return to pre-war conditions at the old exchange rate' (Collins, pp. 280–281).

There appears to have been considerable support for return to the gold standard from the Labour Party and trade unions, as can be seen by their full support for return to gold in 1925 and the Labour government striving to maintain the gold standard in 1931.[1] Morrison (2021) argued that the support of Labour came from a view that there was no better alternative. 'Their lives (they believed) had improved markedly over the last several centuries, and the gold standard (they concluded) was the cornerstone of this development. Moreover, they saw the gold standard as curbing increases in the cost of living. They were convinced that inflation allowed 'profiteering,' that prices tended to rise faster than wages.' (Morrison 2021, p. 20).

On the industry side, Hume (1963) argued that the relatively recently formed Federation of British Industry 'never achieved a policy on the gold standard to which it stuck unwaveringly or which summed up the views of all its members'. In a 1921 memorandum, the Federation 'was willing to say categorically neither that any attempt to restore the gold standard ought to be postponed or abandoned, nor that deflation was responsible for the existing slump' (p. 238).

Hume (1963) noted a marked shift in emphasis in July 1924. From then on, the Federation was 'committed to the gold standard as an ultimate objective and was no longer prepared to argue … that the pre-war parity ought to be rejected as a goal' (p. 240). By March 1925, it was admitting that 'return of the pound sterling to parity with the dollar is an essential preliminary to a return to a gold standard by this country'. The

[1]In a Parliamentary debate in 1948, Churchill remarked that he acted on advice. 'Indeed I did, on the advice of a Committee appointed by Lord Snowden, the Chancellor in the Socialist Government in 1924 … What did Lord Snowden say about our return to the Gold Standard? On the Second Reading of the Gold Standard Bill he said that while the Government had acted with undue precipitancy he and his Socialist colleagues were in favour of a return to the Gold Standard at the earliest possible moment' (Gilbert 1991, p. 469).

gap between prices in the two countries was assessed at about 10 per cent. The FBI argued that attempting to eliminate the price gap would be 'severe industrial friction and dislocation, brought about by the fact that, in order that goods may be produced at the new lower level, all the items entering into the cost of production, including wages and salaries, must be adjusted to this level' (FBI Bulletin, 15 July 1924, p. 406, quoted in Hume 1963, p. 241). The Federation of British Industry 'took strong exception [to possible increase in interest rates and credit restrictions in connection with return to gold] and urged a waiting policy in the hope and belief that gold accumulation in America would inevitably force American prices up, and make British deflation necessary' (Adams Brown Jnr [1929] 1970, p. 51)

These remarks are intended to give some flavour of the consensus behind the UK's return to the exchange rate of $4.86, with some doubts over the particular exchange rate but with a perspective of the general benefits of return to the gold standard. There were some departures from the consensus, and Hume (1963, pp. 226–227) argues that 'the criticism of orthodoxy may have been proportionately small but in absolute terms it was not inconsiderable. Keynes might, indeed, be more appropriately regarded as having been, before 1925, in the vanguard of a movement rather than as a voice in the wilderness'.

4. Churchill's Decision

Churchill re-entered Parliament having stood as an independent candidate, under the label of a Constitutionalist with Conservative backing, in the general election of 29 October 1924. He immediately took the Conservative Party whip. He had previously been a Liberal member of parliament, losing his seat in 1922 as a Liberal, and had been unsuccessful in the 1923 general election. Incoming Prime Minister Stanley Baldwin appointed Winston Churchill as Chancellor of the Exchequer on 6 November.[2]

The role and responsibility of Churchill for the return to the gold standard have been variously assessed. One line of argument is that Churchill was swept along by the prevailing economic and political orthodoxies. 'There were two episodes where Churchill could, with some plausibility, be represented as an unwilling dupe of the authorities: the decision to return to the Gold Standard in 1925 and the promulgation of the Treasury view on loan-financed public works in 1929. In both cases, Churchill became the mouthpiece for an unflinching reassertion of the established orthodoxy, in the face of provocative challenges from John Maynard Keynes. … Churchill became a disillusioned agnostic in his economic ideas, dealing with issues of economic policy in a purely pragmatic way' (Clarke 1996). Churchill was not an economist, though Chancellors rarely are. He depended on advisers. The banker Sir Henry Strakosch wrote that 'none of the witch-doctors sees eye to eye and Winston cannot make up his mind from day to day whether he is a gold bug or a pure inflationist'.

Sayers took a more sympathetic view on Churchill's expertise. 'Despite the overwhelming pressure of opinion in favour of restoration, the whole subject and all possible

[2]In Liberal government, Churchill was president of the Board of Trade and later Home Secretary, and then First Lord of the Admiralty and in the Coalition government (1916–22) successively Minister of Munitions, Secretary of State for War, Secretary of State for Air and Secretary of State for the Colonies.

courses of action were thoroughly argued out in official circles and put before the Chancellor both in written memoranda and in oral discussions. In these discussions there were no concessions of the pains of adjustment.' (Sayers [1960] 1970, pp. 88–89).

Gilbert (1991) takes the view that 'Churchill was uneasy at the Treasury's decision to return to the Gold Standard. … Churchill told his officials on January 29 [1925] that return to gold "favoured the special interests of finance at the expense of the interests of production". On February 22 he tried to influence them once more, "I would rather see Finance less proud and Industry more content".'

Churchill gave a dinner on 17 March 1925 for Keynes and his own officials. 'But Baldwin, with his authority both as Prime Minister and a former Chancellor of the Exchequer, urged Churchill not to rock the boat which was already virtually launched, and to which the Bank of England was committed' (Gilbert 1991, p. 469). Niemeyer and Bradbury invited to represent the Ayes and McKenna and Keynes the Noes. Based on record by Grigg, the Chancellor's Private Secretary, 'plenty was said about the risks of unemployment, falling wages, prolonged strikes and the contraction of some heavy industries. I suspect that Keynes was not at his most effective: he did not in those days carry his later weight, and he was always liable to have an "off-day". Churchill in effect asked McKenna: "This is a political decision; you have been a politician, indeed you have been Chancellor of the Exchequer. If the decision were yours, what would it be? McKenna, after wobbling to the end, replied, 'There's no escape, you have to go back; but it will be hell".'[3]

Boyce (2004) argues that Churchill 'was impressed by the likely impact upon the export industries, which were already struggling and could not easily adjust to further deflationary pressures' (p. 222). But after the dinner on 17 March just mentioned, 'within three days, Churchill surrendered and prepared to announce the return to gold in his forthcoming budget speech'. However, 'even after agreeing to act, he displayed considerable misgivings'. (p. 223)

Churchill is reported as later saying, 'The biggest blunder in his life had been the return to the gold standard' [recorded by Lord Moran, Churchill's personal doctor recorded Churchill in 1945]. 'Montagu Norman had spread his blandishments before him till it was done, and had then left him severally alone.' (Clarke 1996, p. 82)

'At the time the authorities accepted that £1:$4.86 might overvalue the currency but they believed any necessary adjustment to British prices and costs would be slight and may well be rendered unnecessary by inflation overseas, especially in America. … . The decision to return to gold was seen as a return to normalcy: the actual rate chosen was not an important policy issue' (Collins, pp. 279–80).

By April, the value of sterling was only a little below par, and on 28 April 1925, Winston Churchill, Chancellor of the Exchequer, restored the pound to gold.

The decision to rejoin the gold standard at the pre-1914 rate was formally announced by Churchill in his budget statement of 28 April 1925. Churchill (1925a) announced that the Gold and Silver (Export Control) Act 1920, which prohibited that export of gold coin and bullion except under licence, expired at the end of 1925. In effect, this was with immediate effect, since a general licence was given to Bank of England for the export

[3]Footnote to this quote reads: 'This is reported by Grigg as the substance of Churchill's question and McKenna's reply: naturally no verbatim record was made of the discussion.'

of gold bullion. The exchange rate of sterling in terms of gold (and thereby the dollar) was returned to pre-war value. Bank of England and Treasury notes were to be convertible into coin only at the option of the Bank of England. Churchill stated that 'a return to an effective gold standard has long been the settled and declared policy of this country. Every Expert Conference since the War … every expert Committee in this country, has urged the principle of a return to the gold standard. No responsible authority has advocated any other policy. No British government — and every party has held office — no political party, no holder of the Office of Chancellor of the Exchequer has challenged … the principle of a reversion to the gold standard in international affairs at the earliest possible moment.' (Churchill 1925a). 'We are often told that the gold standard will shackle us to the United States'. Instead he argued that 'It will shackle us [UK] to reality. For good or for ill, it will shackle us to reality. … The foundation of Great Britain's economic policy must be, as far as possible, based upon reality.' Later in the speech he acknowledged that the strength of the USA and that return to the gold standard would be in the interests of the USA, but in effect argued also in the interests of the UK. 'It is not a question of whether the return to a gold standard makes us dependent on the United States, but whether it makes us more dependent or dependent in an unhealthy and a subservient manner.' (Churchill 1925b).

5. Keynes' Involvement

Hume (1963) argues that during the early years of the 1920s, 'there was persistent criticism — a good deal of it coming from industry and some of it from the City — of the Cunliffe Report and of the approach which it had recommended and which formed the official policy of successive Governments from 1919 onwards'. He acknowledges that the criticism of orthodoxy may have been proportionately small but that in absolute terms it was not inconsiderable. Keynes might, indeed, be more appropriately regarded as having been, before 1925, in the vanguard of a movement rather than as a voice in the wilderness. (Hume 1963, pp. 226–227).

(Sayers [1960] 1970, p. 86) notes 'the only real opposition came from a small group around Keynes, and there were critical noises in the Beaverbrook Press', which (in the form of the *Sunday Express* and the *Evening Standard*) printed a number of Keynes' significant pieces on the gold standard.

In 1925, Keynes was highly critical of the UK's return to a sterling exchange rate of $4.86 and the likely consequences. In the first half of the 1920s, Keynes made a variety of proposals with regard to the exchange rate. He also made substantial arguments on the desirability of the return of the UK and other countries to the gold standard.

Keynes proposed a number of variations on the return to gold at $4.86. At the end of WW1, 'Keynes had proposed a scheme where sterling would be pegged at 10–15 per cent pre-war par through a tax on gold exports and left the possibility through Order in Council of reducing the tax to work sterling back towards pre-war par' (Moggridge 1992, p. 414), though nothing came of the scheme. At conference in Genoa, he advocated pegging sterling to gold at the existing exchange rate, $4.20, again leaving open the possibility of its appreciation to pre-war parity, this time over a period of at least 20 months. In December 1922, in a lecture to the Institute of Banks, he still supported stabilisation at a devalued rate, this time between $4 and $4.50, but he was already less enthusiastic about taking sterling back to pre-war par (Moggridge 1992, p. 414).

In a piece headed 'Alternative aims in monetary policy' (first published as chapter 2 of A Tract on Monetary Reform, Keynes 1923), Keynes finished by stating that he regarded the stability of prices, credit and employment as of paramount importance, and that he had no confidence that the restoration of the pre-war gold standard would give the stability that it used to give. Hence, he rejected the policy of restoring the pre-war gold standard. He had previously concluded that 'the gold standard is already a barbarous relic' and that already 'a regulated non-metallic standard has slipped in unnoticed' (Keynes 1923, p.168).

Keynes remarked that the success of the gold standard in maintaining its stability of value in the 19th century was 'certainly remarkable' but that the conditions of the future did not match the past conditions. The shift of financial and political power towards the United States would mean that 'confidence in the future stability of the value of gold depends therefore on the United States being foolish enough to go on accepting gold which it does not want, and wise enough, having accepted it, to maintain it at a fixed value'. He expressed 'grave objections to reinstating gold in the pious hope that international co-operation will keep it in order. With the existing distribution of the world's gold the reinstatement of the gold standard means, inevitably, that we surrender the regulation of our price level and the handling of the credit cycle to the Federal Reserve Board of the United States.' (Keynes 1923, p. 169).

Keynes had indicated that it would be neither desirable nor indeed possible for many European currencies to be restored to their pre-war parity with gold, and asked what forces or arguments pressed for this 'undesirable impossibility'. These forces and arguments related to the low level of the gold value of a country's currency 'is an injustice to the rentier class and to others whose income is fixed in terms of currency, and practically a breach of contract; whilst to restore its value would meet debt of honour' (Keynes 1923, p. 149). In a later writing, Keynes argued that 'The City of London considered that it was under an obligation of *honour* to make every possible effort to maintain the value of money in terms of which it had accepted large deposits from foreigners, even though the result of this was to place an intolerable strain on British industry' (Keynes 1931b). This argument was largely dismissed. Keynes considered the argument that the 'The restoration of a currency to its pre-war gold value enhances a country's financial prestige and promotes future confidence' (Keynes 1923, p. 150). Keynes appears to have accepted this argument for a range of countries where the gold value of currency is 'within (say) 5–10 per cent of their former value'. A further argument that 'If the gold value of a country's currency can be increased, labour will profit by a reduced cost of living, foreign goods will be obtainable cheaper, and foreign debts fixed in terms of gold (e.g., to the United States) will be discharged with less effort' was dismissed as 'pure delusion' (Keynes 1923, p. 151).

6. The Return to Gold

The decision to return to gold had been widely anticipated, and the rise in the sterling exchange rate during 1923 and 1924 could be ascribed to that anticipation. However, Boyce (2004) notes that in 1924 and into 1925, 'sterling was also strengthened by several temporary factors' including mild inflation in the USA, the expansionary monetary policy of the Federal Reserve Bank of New York and stimulus to UK exports from disruptive effects of the Ruhr crisis.

In January 1925, the value was $4.77, and hence the rise to $4.86 with the return to the gold standard was rather modest, though in the estimation of Keynes and others would represent a significant over-valuation.

Keynes' pamphlet *Economic Consequences of Mr Churchill* was an expanded version of three newspaper articles which appeared in the *Evening Standard*, 22, 23 and 24 July 1925, under the heading 'Unemployment and Monetary Policy'. He noted that the policy of raising sterling's exchange rate by 10 per cent involve a reduction of 10 per cent in the sterling receipts of our export industries. 'Thus Mr Churchill's policy of improving the exchange rate by 10 per cent was, sooner or later, a policy of reducing every one's wages by 2s[hillings] in the £ [that is 10 per cent]. He who wills the end wills the means. What now faces the Government is the ticklish task of carrying out their own dangerous and unnecessary decision.' (Keynes 1925, p. 1)

The pound had risen in value during 1924 and into 1925, which Keynes viewed as a movement away from equilibrium, and brought about by the anticipation of the restoration of gold but not by 'an improvement in the intrinsic value of sterling' (Keynes 1925, p. 1). Keynes discussed issues of how wages would be reduced by 10 per cent and the pain involved until prices fell by comparable amounts. Keynes noted that these 'arguments are not arguments against the gold standard as such. … They are arguments against having restored gold in conditions which required a substantial readjustment of our money values' (p. 3). He viewed this in terms of a commitment by Churchill to forcing down money wages and all money values but with no idea of how that would be done. Keynes, later in this piece, notes the 'deliberate intensification of unemployment' as a means to bring down wages and prices. 'Why did he [Churchill] do such a silly thing?' (p. 3). 'Partly, perhaps, because he has no instinctive judgement to prevent him from making mistakes; partly because, lacking this instinctive judgement, he was deafened by the clamorous voices of conventional finance, and most of all, because he was gravely misled by his experts.' (p. 3). Keynes argued that experts advising Churchill (presumably the Treasury) miscalculated 'the degree of the maladjustment of money values which would result from restoring sterling to its pre-war gold parity'. Further, these experts had misunderstood the technical difficulty of bringing about a general reduction of money values.

The economic performance of the UK economy during the 1920s was relatively poor. The unemployment rate had declined from 12.2 per cent in 1921 to 7.9 per cent in 1924 and then hovered around 8 per cent through to 1929 with a small uptick in 1926. Output (GDP) grew at under 1 per cent per annum during the 1920s. Prices and nominal wages tended to decline in the 1920s though real wages at an average annual rate of 0.6 per cent. Eichengreen (1981) argued that 'Britain did better during the First and Second Word Wars than the European continent … . Its performance compares less favourably with Europe's in the 'twenties, when it persistently lagged its Continental rivals, than in the 'thirties, when it closed much of the gap that had opened up in that earlier decade'. It is suggested that in 'a number of other respects in which Britain's growth record was distinctive – for example, the severity of the post-World War I recession and the relatively mild nature of Britain's post-1929 slump'. The UK did not suffer bank collapses, and while stock market prices declined after 1929, it was mild compared with the Wall

Street experience. Many factors, of course, contributed to such outcomes, and for the UK include the impact of WW1 on its export markets and the decline of 'staple industries', notably coal mining. The drive to 'return to gold' and the deflationary pressures which that generated would be a further contributory factor. The similarity of economic performance in the second half of the 1920s to that in the first half could suggest that the actual 'return to gold' itself did not make a great deal of difference. What can be said is that the promised confidence, etc., did not play any significant role.

Money wages declined in the second half of the 1920s: on one index of weekly earnings, 198 in 1925, 195 in 1929 and then to 189 in 1931 and 185 in 1932 (1913 = 100). Prices declined somewhat more (1913 = 100), from 173 in 1925 to 161 in 1929, then 145 in 1931 and 141 in 1932. These statistics imply real earnings rose 5.8 per cent between 1925 and 1929 and then a remarkable 7.6 per cent between 1929 and 1931. The most notable decline in wages came in the coal mining industry, which had around 1.2 million employees, 12 per cent of the total. A Royal Commission on the Coal Industry insisted that wages had to be lowered and invoked the rhetoric of the gold standard. The Commission argued that 'a disaster is impending over the industry and the immediate reduction in working costs … is essential to save it' (United Kingdom. Parliament, Report of the Royal Commission on the Coal Industry (London: HM Stationery Office, 1926), 236). The mine owners based their wage offer on the Commission's recommendation, insisting on lower wages and longer hours. A miners' strike was called, initially supported by a general strike (which lasted ten days), which ended in defeat for the miners after nine months.

As Boyce (2004, p. 214) remarks, 'implicit in the decision to return to the gold standard at the exchange rate of $4.86 in 1925 was the assumption that it would benefit both the City of London and the government … . In fact, the gold standard had an even broader appeal to the merchants, brokers, insurance underwriters, shipowners, financiers and brokers of the City, which was that, in theory at least, it made redundant other constraints on trade and finance.' 'The City thus seemed certain to gain from the return to gold, but so did the government' (Boyce 2004, p. 215). However 'none of the assumptions [expectations] on which they were based proved well founded' (Boyce 2004, p. 216). 'The City grew impatient at the reluctance of the government to assist in the downward adjustment of wage and price levels, which seemed essential if the gold standard were to be given a chance to work.' (Boyce 2004, p. 216). 'The Bank of England found its operations constrained, and in turn found it necessary to constrain the international activities of the City' (Boyce 2004, p. 217). The statistics on gross trading profits of insurance, banking and finance show little evidence of financial gain for the City of London. The share of that sector's profit in total profits was in the range 11–12 per cent throughout the second half of the 1920s and though the 1930s — with the exception of 1929, when it reached 14.5 per cent.[4]

7. Goodbye to the Gold Standard 1931

The Macmillan (1931) report on finance and industry (which is thought to have been largely written by Keynes) was published in July 1931, i.e., two months before the UK left the gold

[4]Calculations from Feinstein (1972), Table 26. The sector of insurance, banking and finance is the lowest disaggregation I could find.

standard. It remarked that 'unfortunately, the anticipations of those who were responsible for our return to the gold standard in 1925 have to a large extent not been fulfilled … . And the sacrifices which a return to gold at the old parity involved have not been compensated by the advantages of international price stability which we were anticipated' (para 242). The committee, though, rejected the arguments for 'what might have been accomplished with much less difficulty in 1925, namely, to revise the gold-parity of sterling'. Addendum 1 to the report signed by Keynes and some but not all members of the committee advocated a programme of public works and import restrictions.

During 1930 and into 1931, the gap between government expenditure and revenue grew. As Webb (1932)[5] observed, in February 1931, the Chancellor of the Exchequer 'had publicly warned the House of Commons that the decline in revenue combined with the increase in expenditure was creating' (p.4). A three-party commission of six bankers, accountants and manufacturers, under Sir George May, was appointed. It quickly reported at the end of July 1931 a recommendation of reduction in public expenditure of £96 million, equivalent to just over 2 per cent of GDP, and a fifth of current public expenditure with over two-thirds from Unemployment Insurance, and most of the rest by reductions in pay of teachers, police, civil servants, military personnel, etc. Keynes (1931c) attacked the proposals with few in the Economy Programme of the May Report 'which is not certain to increase unemployment, to lower the profits of business, and to diminish the yield of revenue; so much that I have calculated that economies of £100,000,000 may likely reduce the net budget deficit by not more than £50,000,000'.

In July 1931, the Bank of England warned of a large-scale foreign drain of gold, caused by a steady withdrawal of the current balances and short-term deposits previously accumulated in London, later at around £400 million. There was a resulting drawing of gold from the Bank of England, in exchange for currency. The Bank of England borrowed around £50 million in July from New York and Paris. In early August, the Bank of England 'represented that unless the British Government itself borrowed, within a few days, 80 million more in dollars and francs, to maintain the gold reserve, it would be necessary for the Government to declare a moratorium for the whole City of London, with calamitous results to credit, international as well as national, all the world over' (Webb 1932). The continuing grip of the orthodoxy of the gold standard is reflected in Webb's observation that 'No question was raised as to the possibility of going off the gold standard, a step apparently regarded as unthinkable' (p. 7). The government sought to borrow through the Bank of England to borrow from New York. 'The application was met by two requirements stated to be necessary to "restore the confidence" without which, it was stated, no such loan could be obtained. First, that the British Government Budget should be honestly balanced without recourse to other than this merely temporary borrowing with the support in Parliament of the Opposition leaders; and secondly that very substantial economies in Government expenditure should be instantly effected, notably as regards the cost of Unemployment Insurance.' (Webb 1932, p. 7). The Prime Minister and Chancellor of the Exchequer (and a few other government ministers) accepted these conditions and proposed to cut unemployment benefits. Although, the cabinet had already unanimously determined to balance the Budget by immediately

[5]The author is Sydney Webb, who had served as Labour cabinet minister, and with Beatrice Webb was co-founder of London School of Economics and the Fabian Society.

imposing the necessary additional taxation and by making any prudent economies refused to accept any such 'condition of the borrowing' (Webb 1932). McDonald tended his resignation to the King on 23 August, and the next day, a national government was formed with McDonald as Prime Minister (though now expelled from the Labour Party), dominated by Conservatives with a few Liberals (https://en.wikipedia.org/wiki/Liberal_Party_(UK) and National Labour members (https://en.wikipedia.org/wiki/National_Labour_Organisation; formerly Labour members). These brief remarks can illustrate the continuing commitment to the gold standard, as well as the debates over the scale of government expenditure and deficits, and in particular the pressures arising from the drain of reserves and issues of being able to maintain a fixed exchange rate.

After the change of government 'withdrawals of balances from London, and the drain of gold from the Bank of England continued unabated, and presently became a heavy spate — thus demonstrating that they were caused, not by any lack of confidence in Britain's Government, but by apprehensions of a run on banks in nearly every other country!' (Webb 1932, p. 9).

Keynes (1931c), published in early September 1931, asked 'what are our troubles [of unemployment] fundamentally due to?' after arguing budget deficits were not the cause. He answered that the troubles were attributable 'very largely to the world depression, immediately to the unbelievable rashness of High Finance in the City [of London], and originally to the policy of returning to the Gold Standard without the slightest appreciation of the nature of the difficulties which this involved'. After noting that 'the decision to maintain the gold standard at all costs has been taken', Keynes states his belief that devaluation was the right remedy. At the time of his writing, he saw that the devaluation policy was 'not yet the policy if any organised party in the State', though it did occur within 12 days of his article.

And then, on 21 September, the UK left the gold standard. Webb (1932) argued that 'far from this "terrible calamity" proving instantly ruinous to British credit or British trade, as Mr MacDonald had so recently threatened, the Press welcomed it, and Manchester reported an immediate fillip in the exports of textile goods presently felt in other export markets' (p. 9). Keynes wrote that there were few 'who do not rejoice at the breaking of our gold fetters. … It may seem surprising that a move which had been represented as a disastrous catastrophe should have been received with so much enthusiasm. But the great advantage to British trade and industry of our ceasing artificial efforts to maintain our currency above its real value were quickly realised.' (Keynes, 1931b)

Keynes' critiques of the return to gold were vindicated. The economic performance of the UK in the 1930s compared favourably with that of the 1920s. The unemployment rate peaked in 1932 at 17 per cent and then halved to 8.5 per cent by 1937, though with high unemployment in many regions was 29 per cent higher in 1939 than in 1931, whereas GDP was 9.3 per cent higher in 1931 than in 1921. The bank rate was set at 2 per cent from 1932 onwards. Although the sterling exchange rate initially declined, it then rose and was generally higher than $4.86.

8. Concluding Comments

During WW1, the UK (and other countries) first suspended the gold standard in terms of its bank notes being backed by gold at the central bank. In 1917, the UK suspended the convertibility of sterling into gold at the fixed rate. Keynes, during his time at the Treasury, initially argued against that move. The Cunliffe report of 1918 strongly backed an eventual return to the gold standard, though the export of gold bullion was then suspended until the end of 1925. The value of sterling was then floated. In the first half of the 1920s, there was widespread support across political parties, industry and labour for a return to the gold standard. Churchill, at stages, expressed some doubts about the effects of a return to gold and consulted widely, including with Keynes, but the prevailing orthodoxy prevailed. Keynes was something of a lone voice expressing doubts on the return to the gold standard. His doubts (re-iterated in *Economic Consequences of Mr Churchill*) focused on the consequent over-valuation of the pound sterling and the difficulties which declining nominal wages and prices would encounter. He did, though, question the advisability of the operation of a gold standard even at a lower (for sterling) exchange rate. The return to the gold standard appears a potent mix of the power of ideas (balanced budget, trading benefits of gold standard, sound finance, flexible prices) and the power of vested interests (financial sector interests). The subsequent performance of the UK economy has largely been seen to vindicate Keynes' critique of the return to the pre-war exchange rate.

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