Andrew Bailey: Revisiting the Norman Conquest of $4.86. Thoughts for the world today

Speech by Mr Andrew Bailey, Governor of the Bank of England, at Britain's return to the Gold Standard in 1925 revisited, hosted by the Bank of England, London, 24 June 2025.

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It is a great pleasure to have the opportunity to open this conference. You could say that it is an example of the endearing British sense of humour that we organise a conference on what is commonly regarded as one of the less good economic decisions in the country's history. You may add that what I have just said demonstrates another British characteristic, the calculated British sense of understatement. Actually, as I hope to show, there remain lessons to be learned from the events. And, I do follow the wise advice of Ken Arrow, that "It will always be true that practical understanding of the present will require knowledge of the past." [1]

Two other things before I get properly started. First, my title is unashamedly a lift from the sub-title of Donald Moggridge's book on British monetary policy in the period[2], which – as Adam Tooze has recently commented – is one of the best such sub-titles. On this, can I also say how nice it is that Susan will participate in the panel session today. It wouldn't be the same if we could not personally record the major contribution of Susan and Don in this field. And, it is of course sad that Don isn't with us.

The second point is to mention something that I find amusing about the events around the return to gold. Montagu Norman kept a diary, which is available on-line on the Bank's website. On the day it was announced by Winston Churchill at 4.30pm in the House of Commons, Norman wrote in large capitals in his diary, "GOLD STANDARD". In this day and age, I think we can describe it as putting the caps lock on and going full Trump.

On to more serious stuff. I am not going to give a full account of the events of 1925, I am going to be selective to illustrate a few points. One way to look at the episode is as a clash between domestic and international priorities. Norman took an international view – I will come on to describe it more fully. His biographer Andrew Boyle commented that he ardently believed that Europe could only begin to count on lasting peace and prosperity once Britain reinstated the gold standard[3].

In contrast, Don concluded forcefully that Norman failed to understand the domestic context, and showed very little apparent interest in doing so. The wild card in this is the position of Keynes. I will come onto this, but I do think the most pithy observation here came from Don when he observed that over time Keynes advocated almost every possible form of exchange rate arrangement.

I am going to set out very briefly, and rather selectively, some of the arguments on the international versus domestic cases, and then use these to draw out a few points that I think are of relevance today.

There are a number of strands to the international argument, but they come together in the conviction that the gold standard was the best form of monetary anchor at the time, that it was an open economy anchor in the sense that it had anchored across countries in a world of large capital and trade flows, and that in doing so before the First World War it had worked. It provided certainty on the terms of international trade and thus lowered transaction costs. Douglas Irwin has concluded that studies have attributed up to 20% of the growth of world trade between 1880 and 1910 to the benefits of greater certainty and lower transactions costs[4]. Allied to this is the argument that before the First World War adherence to the gold standard was an effective signal of credibility which had beneficial consequences for a country's external borrowing cost. Estimates put this benefit as up to 30 basis points[5].

I would add two further elements of the broad international argument for returning at the pre-war parity. The first is the view that the experience of hyper-inflation in a number of European economies after the First World War heightened the attraction of sticking to the pre-war anchor. The second is that returning to gold at the established parity, and lowering transactions costs by doing so, would benefit the City of London as a financial centre, and most particularly if the UK led the way in doing so.

The problem was of course that by returning in this way the burden of adjustment fell on domestic wages and prices. These had been sufficiently flexible in the late nineteenth century, but in the face of smaller economic shocks than were to emerge after 1925.

But at the pre-war parity sterling was overvalued – domestic prices were now higher relative to other countries. This was the essence of the Keynes critique, namely that a central bank with the objective of fixing the value of its currency in terms of gold could not use monetary policy to stabilise domestic prices, which should be the objective[6]. In stable times, the gold standard worked because there was no conflict between a fixed exchange rate and stable domestic prices. But that was not the case when the economic shocks were larger, and because domestic prices were relatively higher the impact was to force deflation. We can add to this that in terms of the impact on borrowing costs noted earlier, the actual evidence suggests that while countries returning to gold at pre-war parities did lower their costs of borrowing, those who devalued on return gained somewhat more, though the evidence is open to some interpretation[7].

A further problem that was revealed by the larger shocks that occurred after return concerned the asymmetry of adjustment. The gold standard did not provide an explicit remit for monetary policy. It was supposed to work on the basis of the price-specie flow mechanism set out by David Hume, where gold flows were determined by monetary conditions, backed up by central banks following the "rules of the game", with appropriate interest rate and balance sheet policies. In this way, prices would adjust to restore Balance of Payments equilibrium. Whether central banks always followed those rules in the pre-1914 gold standard is debated, but the system seemed to work, at least in in times of smaller shocks. But with the larger shocks of the late 1920s and 1930s, deviating from those rules mattered. The surplus countries (France and the US) sterilised gold inflows and thus prevented the equilibrating mechanism through domestic price adjustment. Irwin estimates that between 1928 and 1930, the US and

France demonetised 11% of the world's gold stock, thereby contributing to further deflation[8].

Before concluding on the relevance for today, I want to draw out a further point. As I noted earlier, it is quite hard to pin down exactly what exchange rate regime Keynes did prefer, as distinct from the ones he did not like. As Irwin notes, by 1925 he was certainly an opponent of the return to the pre-War parity under the gold standard.

But he favoured exchange rate stability and was sceptical that flexible exchange rates could solve Balance of Payments problems[9]. He appreciated therefore that by preferring domestic employment goals and exchange rate management, he was ruling out open capital flows. This put him at odds with Norman. In fact, James Meade - the subject of a new biography by Susan[10] - was one of the few economists of the period whose views were more aligned to the modern preference of free floating exchange rates, free trade and domestic monetary policy goals.

Turning to the relevance of 1925 for today's issues, I want to finish by drawing out three points where there are interesting parallels.

The first concerns the robustness of monetary regimes. The gold standard stood up to the test of the shocks of the nineteenth century, but did not stand up to the much larger shocks of the inter-war period, and particularly the late 1920s and 1930s. Our regime today, based on the nominal anchor of the domestic inflation target, was developed over the decade or so before the financial crisis. In contrast to the gold standard, I think that it has stood up well to the larger shocks of recent years starting with the financial crisis. Our judgement to date is that it has contributed well to reducing inflation persistence following the shocks of recent years.

The second point is closely related. Some countries went back onto gold and introduced flexibility by adjusting their parities from the pre-war level. As I described earlier, this was not the UK approach, and not only was this Norman's strong preference, but returning at the pre-war parity was the conclusion of both committees set up to examine the issue, starting with the Cunliffe Committee of 1918. In the well-known words of former Chancellor Reginald McKenna to Churchill: "There is no escape, you have to go back, but it will be hell". For Churchill, it was a matter of "Shackling ourselves to reality"[11]. But this begs the question, how much flexibility can be included in an anchor without compromising it?

More recent UK history is interesting here. In the days immediately pre-Bank independence, the UK started with an inflation target range, and then switched to a point target.

This strikes me as a sensible limitation of flexibility to promote the credibility of the target. But after the financial crisis and the following recession, the target regime was modified to allow more flexibility in the pace of return to target where there are so-called trade-off conditions between activity and inflation. This "constrained discretion" is limited but useful flexibility. The appropriateness of flexibility therefore remains an important judgement.

The third point concerns international adjustment under the gold standard, and, as I noted earlier, the asymmetry between surplus and deficit countries when it came to so-called equilibrating gold flows.

This meant that surplus countries had the incentive and the ability to put more of the adjustment burden onto the deficit countries, as was the case with France and the US. The adjustment asymmetry point was subsequently built into the Bretton Woods regime. Today, we have another version of this issue when we look at the US-China trade position and the associated imbalances. The asymmetry may not be the same, or indeed present even, but it is reasonable to believe that it might be a feature.

To end, all of this reinforces for me the benefits of going back to review the 1925 decision – there is much to study and learn.

Thank you.

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[1] Kenneth Arrow: History: the View from Economic, in William N. Parker, Economic History and the Modern Economist, Wiley and Sons, 1986.

[2] Donald Moggridge: British Monetary Policy 1924–1931: The Norman Conquest of $4.86, Cambridge University Press, 1972.

[3] Andrew Boyle: Montagu Norman, Cassell and Company Ltd, 1967, P178

[4] Douglas A Irwin: Trade Policy Disaster: Lessons from the 1930s. MIT Press, 2012, P4.

[5] Maurice Obstfeld and Alan. M. Taylor: Global Capital Markets: Integration, Crisis and Growth. Cambridge University Press, 2004, P199

[6] Douglas Irwin: Trade Policy Disaster, P34

[7] Maurice Obstfeld and Alan. M. Taylor: Global Capital Markets, P218

[8] Douglas Irwin: Trade Policy Disaster, P9 & 20

[9] Douglas Irwin: Trade Policy Disaster, P148-9.

[10] Susan Howson (forthcoming) James Meade the Utopian Economist, Cambridge University Press, Cambridge, England.

[11] P.J. Grigg, Prejudice and Judgement, Jonathan Cape, 1948. P184