

International Finance, Econ 3331

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International finance in history

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Topic 9

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Overview

Three distinct episodes

- 1870–1913 (first wave of modern globalization)
- 1919–1939 (interwar years)
- 1944–1971 (Bretton-Woods era)

Organizing principle: [Policy Trilemma](#)

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Bimetallism

- Parity between two metals fixed at the mint; e.g., 15.5 silver/gold
- Both are legal tender and coined at the mint; e.g., Sweden copper and silver

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Gold-exchange standard

- Parity between the currency and gold fixed at the central bank/treasury
- History
 - 1717: Sir Isaac Newton adjusts silver/gold parity in England
 - 1774: silver becomes legal tender for small denominations only
 - 1821: gold becomes the only legal tender
 - circa 1870: gold becomes international standard

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Newton's legacy

Mint ratio of silver/gold = 15.5, but market relative price = 16

- Exchange 15.5 oz. silver coins at the mint for 1 oz. gold coin
- Export the gold for 16 oz. silver: 'Wizard of Oz'
→ Silver disappears from circulation

R. Dighe, 2002. *The Historian's Wizard of Oz: Reading L. Frank Baum's Classic as a Political and Economic Allegory*. Westport, CT: Praeger Publishers.

Current account adjustments

Specie-flow mechanism (David Hume)

- surplus countries import, deficit countries export gold
- money supply increases in surplus, and decreases in deficit countries
- inflation in surplus, deflation in deficit countries
- real appreciation of currency in surplus countries; real depreciation in deficit countries

World trade: 1830–1870

- Low tariffs
- Growth rate of world trade: 4.2% per annum

Driving forces

- Demand for raw materials (not food)
- Declining transportation costs (steamship)
- Imperialist colonialism

Policy pillars: 1870–1913

- Convertibility and capital mobility
 - currency into gold
 - domestic currency into foreign currency
 - deposits into currency
- Exchange rate stability
- Little consideration for independent monetary policy

Gold old days: 1870–1913

- gold standard
- gold-exchange standard, pegged exchange rates
- some restrictions on gold exports, convertibility
- international capital movements of a “disturbing sort”

Direction of merchandize trade: 1876–1880

- Industrial countries
 - 71% of world exports
 - 97% of world manufactures exports
- Exports from (% of total world exports)
 - industrial to industrial 45%
 - industrial to non-industrial 26%
 - non-industrial to industrial 25%
 - non-industrial to non-industrial 4%

Source: Yates (1959, Tables 29 and 30). Industrial countries: USA, UK, Belgium, France, Germany, Austria-Hungary, Netherlands, Italy, Sweden, Switzerland, Japan

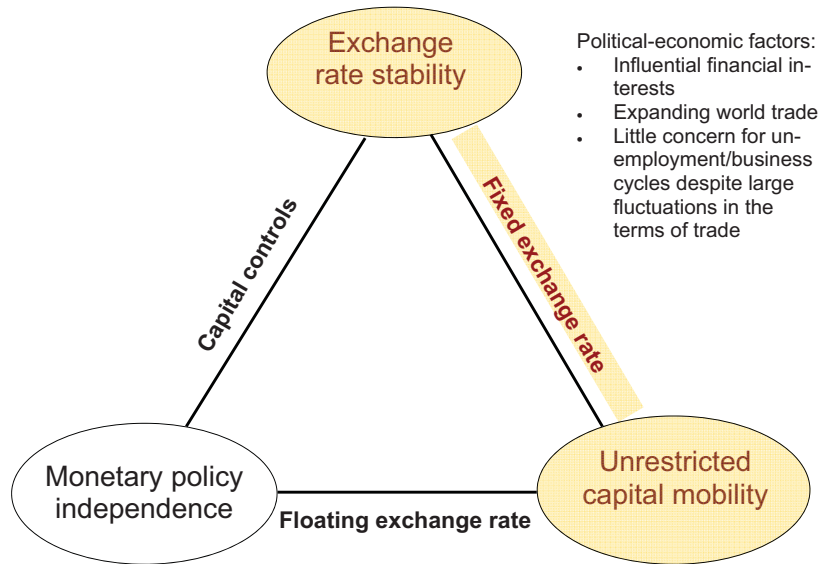
World trade: 1870–1913

- Low but rising tariffs
- Growth rate of world trade
 - 1870–1899: 3.0% per annum
 - 1900–1913: 3.8% per annum
 - driving force: food and manufactures

Emerging constraints

- Bank runs, financial panics (1907), currency crises
 - demand for provision of liquidity
- Political economy
 - demand for employment and income policies
- ‘The clash between stability and progress’
 - demand for restrictions on immigration
 - demand for tariffs

Policy trilemma in history, 1870-1913



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Interwar chaos

- 1919–1926: Experimenting with the float
- Chaotic outcomes I
 - hyperinflations and exchange rate instability
- 1926–1931: Back to gold
- Chaotic outcomes II
 - Great Depression
- 1931–1939: competitive devaluations, back to float

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Direction of merchandise trade: 1928

- Industrial countries 62% of world exports
- Exports from (% of total world exports)
 - industrial to industrial 40%
 - industrial to non-industrial 22%
 - non-industrial to industrial 27%
 - non-industrial to non-industrial 11%

Source: Yates (1959, Table 29). Industrial: USA, UK, Belgium, France, Germany, Austria, Czecho-Slovakia, Canada, Formosa, Netherlands, Italy, Sweden, Switzerland, Japan, Korea

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Policy pillars: 1944–1971

- Exchange rate stability
- Demand for independent monetary policy
- Capital mobility for reconstruction and growth

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Bretton Woods, 1944

Search for a good fix

- U.S. dollar on gold standard
- other major currencies pegged to the dollar (adjustable)
- controls on capital mobility
- policy coordination
 - current account deficit targeting – sterilization

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Direction of merchandise trade: 1953–55

- Industrial countries
 - 63% of world exports
 - 91% of world manufactures exports
- Exports from (% of total world exports)
 - industrial to industrial 36.5%
 - industrial to non-industrial 26.5%
 - non-industrial to industrial 26.5%
 - non-industrial to non-industrial 10.5%

Source: Yates (Tables 29, 30). Industrial: USA, UK, Canada, Belgium, France, Germany, Austria, Netherlands, Italy, Sweden, Switzerland, Japan, Denmark, Greece, Norway, Portugal, Turkey

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World trade: 1950–1971

- Low and falling tariffs
- Growth rate of world trade $> 5\%$ per annum
 - driving force: manufactures and nonagricultural primary products (fuel, minerals, metals)

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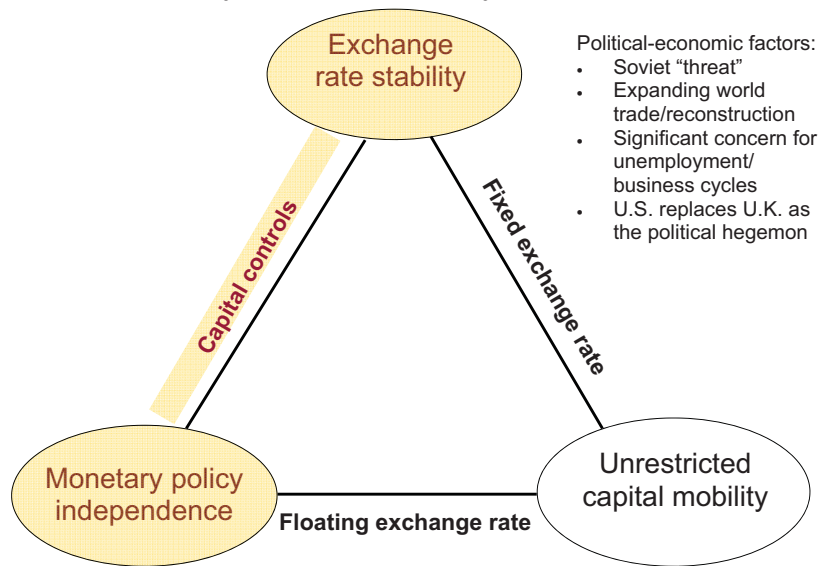
Emerging constraints and collapse, 1971

- chronic under (mark) and over-valued (pound) currencies
- chronic high i (mark) and low i (pound) currencies
- demand for more independent monetary policy
- increased global capital mobility
- US dollar decouples from gold – gold sales by central banks

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Policy trilemma in history, 1944-1971



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Canadian dollar in the post-WWII

- July 1946: parity with the U.S. dollar
- July 1947: devaluation and exchange controls
 - 9 % devaluation
 - U.S. dollar receipts from U.S. exports to be sold to Foreign Exchange Control Board

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Signs of indecisiveness

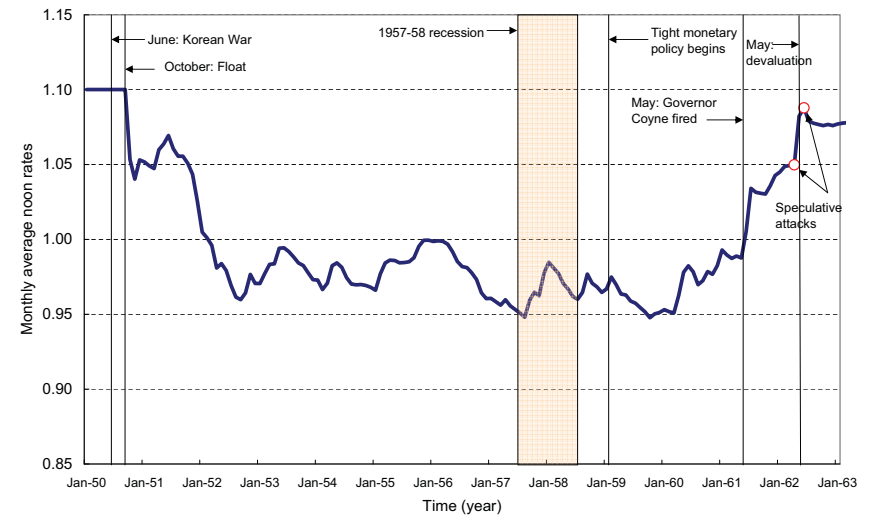
- September 1950: withdrawal from the Bretton Woods
 - December 1951: lifting of capital controls
- May 1962: back to pegging to the U.S. dollar
 - April-June speculative attacks + IMF rescue

See Bordo, Dib, Schembri (2008) for an analysis of the 1950–62 episode
- May 1970: back to (dirty) float
- October 2007: parity with the U.S. dollar

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Canadian dollars per U.S. dollar



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Further readings

- Nurkse (1945). Conditions of International Monetary Equilibrium.
- Bloomfield (1963). Short-term Capital Movements under the Pre-1914 Gold Standard.
- Obstfeld and Taylor (2004). Global Capital Markets.
- Frieden (2006). Global Capitalism.
- Powell (2005). A History of the Canadian Dollar.