The Basics of Monetary and Currency Arrangements

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The Gold Standard

- Fully in place in the second half of 19the century until 1914
- Arrangement:
  - Definition of national currency in units of gold
  - Determination of money (bank notes) in circulation covered by gold treasure

Gold Standard Mechanism

- Monetary aggregate is determined by the stock of gold that covers circulation
- Credit Position at Central Bank: gold
- Debit Position at Central Bank: notes
- Free convertibility of notes into gold
- Gold serves as international numéraire
- Gold standard implies fixed exchange rates

Domestic effects

- Long-term price level stability
- Restraint on credit expansion
- Restraint on government expenditure
- Incentives to save
- Relatively stable interest rates
- Sometimes severe but usually very short recession (business fluctuations)

International Effects

- Highly stable exchange rates
- Automatic correction of trade imbalances
- Growth of foreign direct investment
- Growth of international trade
- High economic growth
- No significant international spill-overs

International Gold Mechanism I

- Country A has trade surplus, country B has trade deficit
- A obtains excess of foreign monies
- Gold exchange happens between A and B with gold moving from B to A
- In A, gold stock rises, increasing money supply

International Gold Mechanism II

- In B, gold stocks fall, decreasing money supply
- In A, demand expands
- In B, demand falls
- Relative prices change in favor of country B, correcting its trade deficit and eliminating the surplus in A

End of the Gold Standard

- Gold standard ended because of government intervention with the beginning of World War I
- Breakdown of international commercial relations
- Rising nationalism
- 1920s and 1930: Monetary and currency turmoil

Interwar Period

- Hyperinflation in continental Europe
- Stagnation in Britain
- 1920s boom in the US
- 1929 Wall Street Crash
- 1930s Great Depression
- 1939 Begin of World War II

Bretton Woods

- 1944 Bretton Woods Conference
- Creation of IMF and World Bank
- US dollar put into center
- US dollar linked to gold
- Formal establishment of fixed exchange rates (peg)
- Formal IMF guided correction

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