

The International Economy Prior to the Great Depression

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The pre-Depression international economic system that collapsed at the end of the 1920s had the following attributes:

- **The Gold Standard.** Gold bullion stood behind the major currencies of the world, with British Pound Sterling as the central currency. In reality, the gold standard held for only a handful of countries that dominated international trade and investment. There simply was not enough gold to monetize an entire globe. Thus, with expanding productivity brought on by the Second Industrial Revolution (from the 1860s), the world vacillated between boom and bust, as societies sought sources of money to accommodate on the demand side the expanding capacity on the supply side. (See the related article on [China Supply Shock](#) that likens the early 21st Century global supply situation to that of the early 20th Century). The gold standard limited monetary expansion to that permitted by discoveries of new gold supplies—which in no way matched the growing industrial and agricultural production capacity of the world. As a result, the US price level dropped by 50% during the 19th Century. This led to experiments to use silver as backing, to use both gold and silver (bimetallism) as backing (remember “Though shalt not crucify mankind on a cross of gold?”), or simply to try relying on the trust of the currency issuer. Many economic historians now believe it was the inability of the gold standard to keep up with industrial and agricultural production capacity added by the Second Industrial Revolution that led to economic collapse in the 1920s.
- **Free International Flows of Goods and Money.** Economic historians are quick to point out that Globalism is not new. Free international flows of people, money, and goods existed before the Great Depression. Of course, trade flows and capital flows occurred primarily between those countries that tried to follow the gold standard. Capital flowed from Europe to North

America to finance the industrialization that occurred between the mid-1800s and the early-1900s. It flowed through the international banking houses of Morgan and Warburg (individuals and companies more powerful than 19th Century governments).

- **Trade & Exchange Rates.** Because major currencies were tied to gold, trade deficits resulted in gold flowing out of country in payment for trade debts. With trade surpluses, on the other hand, gold flowed in. With inflows of gold, Central Banks could issue more domestic money, and domestic purchasing power went up. With gold outflows, domestic money supply and demand went down. With gold in short supply relative to the growing domestic production capacities, intense competition for gold developed. Countries ‘beggared thy neighbors’ by undervaluing their own currencies as each tried to run a trade surplus so that they could expand their own money supplies and create the demand needed to employ all their own people. Obviously, not everyone could run a surplus at the same time. So round after round of competitive devaluation of currencies ensued, followed by tariff protection and an all-out international trade war that spiraled global demand down further and faster in the late-1920s and early-1930s.

A number of things came together in the 1920s to cause a Great Depression to swallow the whole decade of the 1930s—including continuing problems caused by World War I reparations, domestic problems associated with agricultural incomes policies, the ‘stickiness’ of wages resulting from the rise of unionism, and many other factors. And also including the pre-Depression international economic system outlined above. While the Bretton Woods attendees could do little about the other causes of the Depression, they could do something about the exchange rate and capital flows. They tried also to do something about the trade policies; but that that objective ran into the buzz saw of protectionist sentiment and took another half century to achieve (See The Birth of Bretton Woods).