From Robert Peel to J. P. Morgan: what is a British-style gold standard?

by Richard Freeman

As admitted by most of the professional economists cited below, the model for all the gold proposals on the table other than the LaRouche plan is the British gold standard. We outline here how this system worked to cripple credit, industry, trade and national sovereignty.

The British gold standard was presented in germinal form at the 1810 bullion debates, by David Ricardo of the East India Company, under the standard principle of that company to "buy cheap, sell dear." The idea was that by backing the pound sterling with gold to make the money supply contract, the rest of the world would have to pay back its debt to Britain—the world's leading "pursestrings"—in "heavy pounds."

Through its control over world trade, Britain controlled the world's gold supply. By 1844, the Bank of England had accumulated £15 million of gold—an enormous sum in those days. And the bullion houses, led by N. M. Rothschilds had a huge hoard. If a country had no gold, if it were thrown into deficit, it could not settle its trade accounts and therefore was at the mercy of the terms of the British gold bullion traders.

Gold was fully established in 1844 by a Bank of England committee headed by Ricardo's lieutenant Sir Robert Peel.

The 1844 Reform established the following rule: £12 million of British bank notes could be circulated against an equal amount of securities held in private British banks; another £2 million of British bank notes could be circulated against "unemployable deposits." But not a British half-penny more could be circulated above this initial startup level of £14 million unless the currency was backed up on a strict one-for-one basis with gold by either British private banks or the Bank of England.

John Stuart Mill observed that if Britain ran short of gold, the Bank of England might have no alternative, except to "stop payment on British notes," thus creating a liquidity crunch. In a moment of candor, the May 3, 1845 London *Economist* stated that if the object of the British gold standard had been to "increase the intensity of a . . . crisis," then no "more certain plan" could have been adopted to achieve that aim.

The plan conformed to Ricardo's dictum, uttered several decades before during the 1810 bullion debate that "England, in consequence of having a bad harvest, would come under the case of a country having been deprived of a part of its commodities." The only way to adapt to a situation of reduced commodities on a permanent basis, was to "diminish the amount of circulating medium," through the contractionary gold standard.

The American System

To appreciate fully the implications of the British gold standard, it should be compared to the credit policies of the American System of Treasury Secretary Alexander Hamilton.

The purpose of a gold system, properly conceived, is to increase, not to contract credit. But to avoid speculation and inflation, the gold system must specify that credit created against gold be funneled into new productive investments in mining, manufacturing, construction, agriculture, and transportation. This increases the real-wealth base of the economy, and thus the rate of goods output expands faster than the growth of gold-based currency notes.

To limit the amount of credit creation to the amount of a yellow metal that can be dug out of the ground is the height of absurdity. There is no economic causality between the level of desired and potential economic output and the level of gold mining that could possibly be established. Such an assumption, however, is a cornerstone of a British gold standard.

With the amount of credit now firmly in the control of a small group—the Bank of England, the big British merchant banks, and the gold bullion houses—they used it for purposes of economic warfare, first against British industry. The regional banks that supplied the great quantity of credit to the so-called British industrial revolution, were collapsed. British industry, built on

© 1981 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

taking patents from France and Germany, soon began its long downhill course.

The same private cabal brought the world economy to its knees. Peru, in the mid-19th century, was extended a loan that was discounted—i.e., interest was taken out in advance, and Peru got only 65 percent of the loan. Peru was then told that it had to keep another 20 percent of the original loan as an immobilized compensating balance at a British bank. This left Peru with cash equal to 45 percent of the value of the loan; but interest had to be paid on the full 100-percent value of the loan. Moreover, if Peru ran a trade deficit with Britain, it had to acquire gold from a British bullion house, at huge expense, to pay the deficit. Most nations were thus reduced to labor-intensive agriculture and raw materials extraction. Perhaps the country got a railroad—to ship the commodities.

Simultaneously this tended to brake the industrial-expansion capabilities of the industrialized sector, by limiting the amount of surplus they could create and export, in the form of capital goods, to the third world.

The only way the major nations at that period—Germany, Japan, the United States, Russia—could grow, was to break free of the British world gold standard, creating their own sources of credit.

The Specie Resumption Act

In the late 1870s, Britain moved with its Anglophile associates on Wall Street to attempt to put the United States under the same gold standard that Britain was on. By linking the U.S. credit system directly to Britain by the gold mechanism, U.S. credit was doled out according to the wishes of the City of London.

The United States was the fastest-growing "developing-sector" nation during the second half of the 19th century, specifically because of American moves to keep the U.S. as free as possible of London's gold system.

The United States had opened up its vast potential for economic development by jettisoning the anarchistic Jacksonian banking system of the 1840s and 1850s and replacing it with a Hamiltonian banking system under the reforms of the Lincoln Administration passed by the Congresses of 1861-65. These reforms were part of a package of subsidies and tax breaks for construction of the railroads and industry, the adoption of strict protectionism (not free trade) for manufacturing, and agricultural development.

The key feature of the system is that, along with maintenance of the gold system for international settlements, the banking reforms created $450 million in U.S. Treasury notes, which were called greenbacks, and made legal tender, and circulated through national banks. State banks were practically abolished by the impositon of a tax upon them.

Thus Lincoln, acting on the advice of his great economic adviser Henry Carey, worked to dirigistically direct the private banking system to funnel credit to productive industrial-agricultural purposes.

The U.S. economy responded by taking off on an industrial surge, starting in 1861 and not ending, effectively until 1900.

As the economy produced tangible wealth, federal tax revenue and other ordinary government receipts outstripped expenditures every year from 1866 through 1879; there was a budget surplus each year, because of the Lincolnian government-dirigistic policy. Inflation, which had shot up during the war—largely because of speculators attempting to undermine the dollar—started to decline immediately after the Civil War's end.

The passage of the Specie Resumption Act followed a rigged financial crisis, the Overend-Gurney crisis of 1866. The collapse of one of the largest British merchant banks of that name spilled over into a liquidation in 1871 by British holders of U.S. Treasury and stock securities to get ready cash. This liquidation took the specific form of an attempt by key Anglophile banks in the U.S. like the Drexel, Morgan bank of Philadelphia, to bring down the leading American investment house of Jay Cooke.

The Act specified that only the amount of U.S. government notes—the greenbacks—were convertible into gold. It said no new greenbacks could be issued, and therefore the only new credit that could be issued was private bank notes. Thus, credit was concentrated in private hands—mostly Wall Street's—and the volume of these notes was linked to the U.S. gold hoard.

The gold standard meant that each time the British overextended themselves, the United States went into severe recessions. This included, in addition to the 1873-79 crisis, an 1883-86 crisis, the 1893-97 severe panic and the 1905-07 crisis. U.S. financial markets became attached like a yo-yo to the boom-bust cycle of British gold-based monetarism.

For example, the U.S. held $100 million in reserve at the Treasury, deemed the minimum level that must be maintained at all times. As the London-Latin American crisis of 1891-92, which included the near bankruptcy of the Barings, played itself into the U.S. in 1893, the house of J. P. Morgan led a raiding expedition on the U.S. Treasury. Morgan would redeem U.S. legal tender greenback notes, drawing the gold supply at the Treasury below $100 million. The Treasury would then have to purchase gold abroad, through a London gold-selling house. The U.S. paid exorbitant interest rates on the borrowings to get the gold; Morgan intermediated and took a cut on the U.S. purchase of gold from London. Once the gold was parked in the U.S. Treasury, Morgan, joined by Jacob Schiff, Ned Harriman, and others, presented the U.S. Treasury with greenbacks for redemption and drew the level of gold at the Treasury below the critical $100 million once again. And U.S. industry went into collapse.