Overview of the Golden Age

<u>Lecture Outline</u>

1. From Mercantilism to Laissez-faire
   - Laissez-faire: Specialization, division of labor, limited government
2. Spread of Free Trade
   - Events: Repeal of the Corn Laws (1846), End of Navigation Acts (1852), Cobden-Chevalier Treaty (1860)
   - Causes: <u>International</u> and <u>Domestic</u>
3. The Gold Standard
   - Benefits and Costs
   - Political controversy
   - BOP adjustment mechanism
   - Wizard of OZ: allegory for the gold standard?

From Mercantilism to Laissez-faire

Features of Laissez-faire

1. Division of labor
   - Adam Smith's example of a "pin factory"
2. Specialization
   - related to comparative advantage
3. Limited government
   - role limited to providing public goods: national defense, rule of law, and regulation of monopolies.
     - Public goods have two characteristics: non-excludability and non-rivalry in consumption. These characteristics explain why markets fail to provide public goods, creating a legitimate role for government.

Spread of Free Trade

Important Events:

1. Repeal of the Corn Laws in England in 1846
    - Navigation Acts repealed in 1849
2. Cobden-Chevalier Treaty (1860) and the spread of free trade
    - bilateral treaties containing the Most-Favored-Nation (MFN) clause

Causes of freer trade: International Factors

1. **Political Condition: Pax Britannica**
    - Defeat of the French at Waterloo leaves Britain dominant; colonialism and mercantilism are no longer essential for security.
    - Britain's navel power means sea lanes are safe and open for business
2. **Political Condition: Hundred Years' Peace** (1815-1914)
    - Peace was conducive to negotiating freer trade with other countries
    - With peace, governments no longer needed taxes on trade to pay for costly wars - a very high proportion of revenues came from tariffs on imports.

Rise of Free Trade (cont.)

3. Global technological innovations

- Iron hulls, steam, refrigeration in transoceanic shipping
  - Trade expands to basic commodities, raw materials, and heavy manufactured items
  - Allows for specialization and division of labor (manufactured goods from Europe for agricultural products and raw materials from US, Canada, Australia, Argentina).
- Railroads move raw materials to ports (Table 1)
  - Hinterlands linked to ports cities by rail ⇒ mineral/agricultural products more cheaply extracted and traded.
  - Europe specializes in manufactures while the developing world specializes in the primary product, that new rail infrastructure allowed it to export
- Telegraph: “Victorian Internet”

Table 1: Railway Mileage, 1850-1910

Country	***1850***	***1870***	***1890***	***1910***
Austria-Hungary	954	5,949	16,489	26,834
Australia	--	953	9,524	17,429
Argentina	--	637	5,434	17,381
Canada	66	2,617	13,368	26,462
France	1,714	11,142	22,911	30, 643
Germany	3,367	11,729	25,411	36,152
India	--	4,771	16,401	32,099
Italy	265	3,845	8,163	10,573
Russia	310	7,098	18,059	34,990
United Kingdom	6,621	15,537	20,073	23,387
United States	9,021	52,922	116,703	249,902

Rise of Free Trade (cont.)

<u>Domestic Factors</u> in Great Britain – the first free trade nation

1. *Endowments*
   - GB abundant in capital, skilled labor, scare in land. HO theorem: GB should have specialized in manufactured goods and imported food and raw materials.
   - Corn Laws worked against comparative advantage
2. *Interests*
   - Corn Laws supported by the landed classes and agricultural interests: the aristocracy, the gentry. With their base in landed wealth, the Tories (Conservatives) supported Corn Laws
   - Corn Laws opposed by urban capitalists, financiers, merchants and skilled workers. Whigs (Liberals) the party of Free Trade
3. *Institutions*:
   - British electoral system traditionally overrepresented landed elite
   - <u>Reform Act of 1832</u> enfranchised free traders. New industrial districts and towns, which were chiefly Whig, had far greater representation after 1832, weakening the grip of landlords.

The Gold Standard

- What was it? A fixed exchange rate regime in which a nation pegged, not to another country's currency, but to gold.
  - Govts pledged to exchange currencies for gold at a certain rate (£100 note got you 22 oz. of gold in GB while a $100 bill got you 4.5 oz of gold in the US)
  - Once you had the exchange rate in gold, could easily figure the exchange rate between currencies: 22/4.5=4.88 so £100 = $488 or £1 = $4.88.
  - Since the £/$ rate strayed very little from $4.88, the GS was simply another case of a fixed exchange rate system.

Gold Standard: Benefits and Costs

Benefits

1. Price and exchange-rate stability (promotes global economic integration).
2. Automatic adjustment to BOP imbalances via the “price-specie-flow” mechanism
3. No discretion in monetary policy

Costs

1. Price levels arbitrarily set by global supply and demand for gold
2. Domestic economy is subservient to maintaining external balance
3. No discretion in monetary policy

Gold Standard (cont)

- Why was the Gold Std important to globalization?
  1. Reduced foreign exchange risk
  2. Signaled financial rectitude of govts that adopted it and thus improved their creditworthiness
- Why was the gold std politically controversial?
  1. Cost #1 (above): price level arbitrarily determined (Figures 1 and 2).
  2. Cost #2 and #3 (above). No room for domestic macroeconomic policy. This related to the BOP adjustment mechanism…

Gold Standard (cont)

- BOP adjustment under the Gold Std
  - BOP adjustment mechanism was “automatic” (unlike today's pegs, the Gold Std required no intervention or macroeconomic policy changes)
  - Philosopher (and Director of the Mint in England) David Hume called this automatic process the <u>Price-Specie-Flow</u> mechanism:
  - **BOP deficit (M>X) ⇒ gold outflow ⇒ domestic prices fall ⇒ Demand for X increase; Demand for M fall ⇒ BOP Balance (X=M)**

Figures 1 and 2: Price level arbitrarily set by global supply and demand for gold (deflation to 1896; then reflation)

Figure 1: wholesale price indices (1880=100)

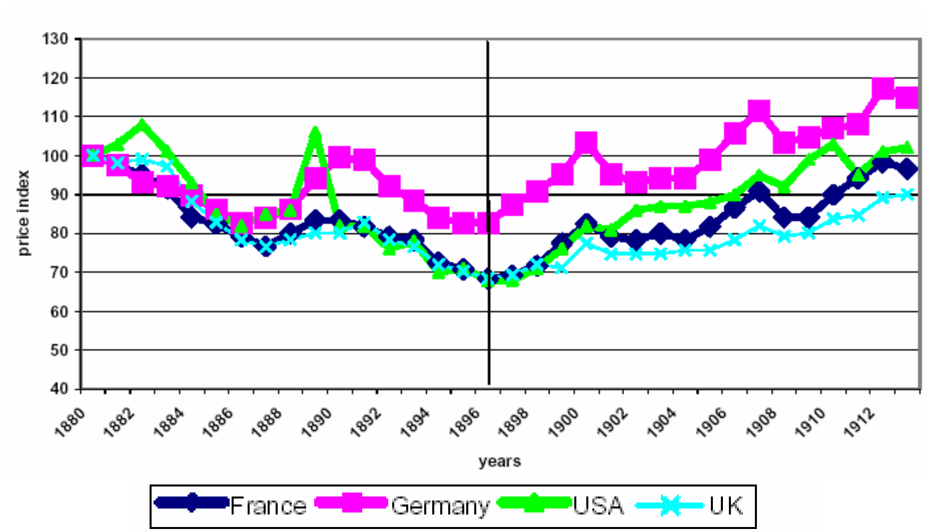
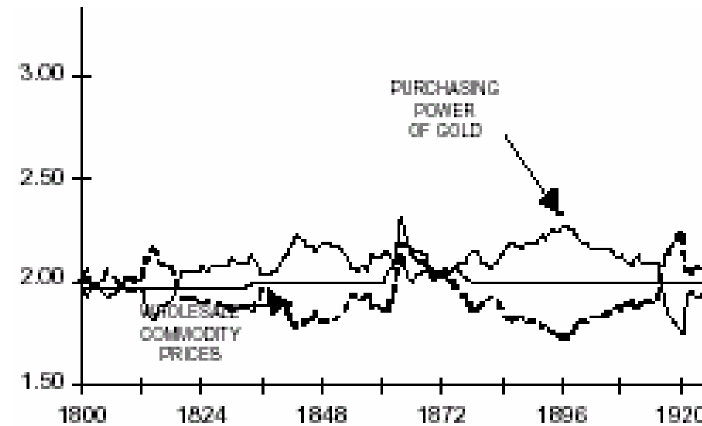


Figure 2: Purchasing power of gold currencies



Between 1873-1896, prices fell (Figure 1) with <u>farm prices</u> falling the most. Under the gold standard, the gold supply determined the money supply and so the price level (Figure 2). This was a major problem.

Cost #1: Wizard of Oz as an Allegory for the politics of the Gold Std

- <u>Gold Std Opponents</u> (interests with stakes in the domestic economy) advocated free coinage of silver, which would increase the money supply and thus raise prices
  - Farmers of the West
  - Debtors (farmers, railroads)
  - Labor (harmed by "discipline" of gold std)
  - Silver mine owners
- <u>Gold Std Supporters</u> (interests with stakes in the int'l economy) supported maintaining the gold std at all costs
  - NY bankers (e.g., Belmont, J. P. Morgan)
  - International merchants
  - foreign investors

- **Yellow Brick Road** = Gold Standard
- **Oz** = Ounce of gold. Also, Washington D.C (emerald green, like money)
- **Slippers** = Silver standard (changed to "ruby" for film to maximize effect of color

- **Dorothy** = traditional values; Mary "raise less corn and more hell" Lease?
- **Scarecrow** = Farmers: outwardly dim but very shrewd
- **Tin man** = Industrial workers: rendered heartless by factory work
- **Cowardly Lion** = William J. Bryan. Lots of hot air but little success
- **Wicked Witch of the East** = New York bankers, int'l merchants
- **Munchkins** = citizens of the east
- **Wizard** = McKinley or perhaps Marcus Hanna, Republican party chair
- **Toto** = Prohibitionist Party (Teetotalers)
- **Poppy fields** = imperialism (Opium Wars?)

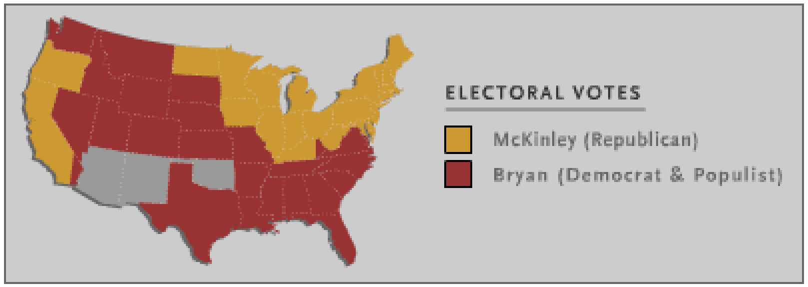
W.J. Bryan's "Cross of Gold" Speech

- **Delivered at the Democratic National Convention in 1896:**

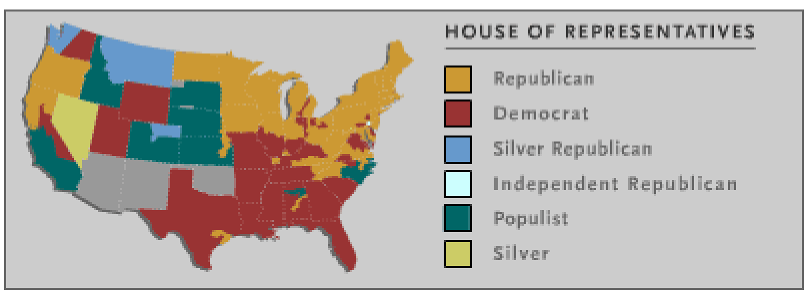
"We have petitioned, and our petitions have been scorned; we have entreated, and our entreaties have been disregarded; we have begged, and they have mocked when our calamity came. We beg no longer; we entreat no more. We defy them ...! Having behind us the producing masses of this nation and the world, supported by the commercial interests, the laboring interests, and the toilers everywhere, we will answer their demand for a gold standard by saying to them: ***You shall not press down upon the brow of labor this crown of thorns, you shall not crucify mankind upon a cross of gold!***"

Figure 3: U.S. Election results, 1896 and 1900

1896

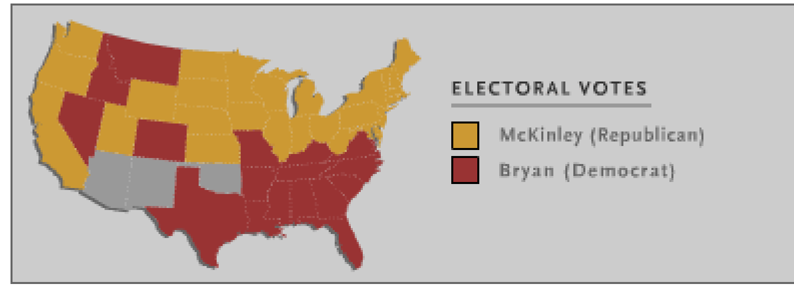


Popular vote: McKinley 51% (7.1 million); Bryan 47% (6.5 million)

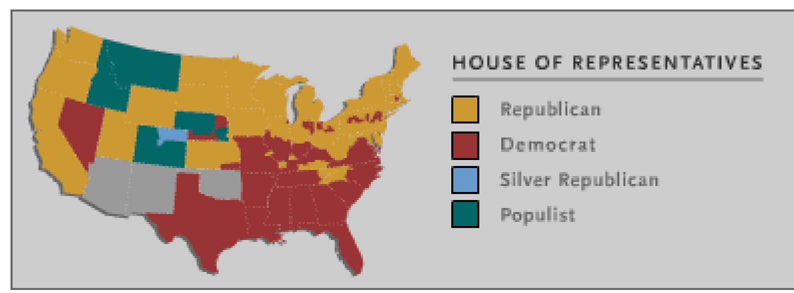


In 1896, Bryan got over 6.5 million votes and nearly won the election.

1900



Popular vote: McKinley 7.2 million; Bryan 6.3 million



Bryan lost again in 1900 as reflation, stemming from the increase in the world's gold supply (Yukon discoveries), undermined the power of his "free silver" appeal.