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BRETTON WOODS AND BEYOND: THE DECLINE OF THE GOLD STANDARD AND THE SHIFT TO FIAT MONEY [21]

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Abstract: *The gold standard is one of the most important monetary systems in economic history. It links national currencies to a fixed quantity of gold. This paper investigates the evolution of the gold standard from its origins in ancient civilizations to its institutionalization in the 19th century. Gold served as a medium of exchange and storage of value. Its operation relied on the price–specie flow mechanism. It automatically corrected trade imbalances. Thus, it influenced money supply, inflation and deflation. The study gives the benefits of the gold standard system. Those included long-term price stability, confidence in currency value and restrictions on inflationary policies. There were also limitations such as constrained monetary flexibility, deflationary pressures and the inability of governments to adequately respond to crises. The gold standard collapsed during World War I. The transition to the Bretton Woods system was gradual. It illustrated declining possibility of the gold standard to address the global economic shocks. The eventual abandonment of gold convertibility happened in 1971. This was the start of the modern era of fiat currencies and floating exchange rates. Despite its end, the gold standard continues to create debates on monetary stability and policy design.*

Keywords: *gold standard, monetary policy, Bretton Woods System, fiat currency.*

INTRODUCTION

The gold standard was an important part of the history of international money and finance. It was a system in which the national currencies were related to a specified amount of gold. This brought stability as well as certain restrictions. Trade, investment and economic policy from ancient to the modern times were affected by this standard (Eichengreen, B. 1996). The main characteristic of the system was the price–specie flow mechanism. It adjusted trade imbalances automatically. However, the gold standard had some limitations. It deprived governments of the possibilities to easily respond to economic shocks (Bordo, M.D. 1981). The gold standard developed in different variations. It started in the ancient and medieval economies. Later it grew into the classical gold standard of 1821–1914, passed through the interwar years. Finally, the Bretton Woods system between 1944 and 1971 ended with the abolition of the golden standard. After 1971, a new era began and the world shifted to the use of fiat money. The debates over the benefits and problems of gold-based systems, however, continue with discussions on monetary stability and reform (Obstfeld, M. and Taylor, A.M. 2004).

EXPOSITION

The gold standard is a monetary system which directly ties the value of a national currency to a fixed quantity of gold. Governments guarantee the convertibility of paper money into gold at a predetermined rate. This provides stability in the national currency, but also its convertibility in the international exchange (Eichengreen, B. 1996). The currencies of the countries which participate in the agreement are pegged to gold. This leads to fixed exchange rates between countries.

The gold standard is characterized by the price–specie flow mechanism. The concept was created by David Hume in the eighteenth century. The mechanism operates as a process of an automatic adjustment for the balance of disproportions of payments (Bordo, M.D. 1981). For example, if Country A experiences higher labour productivity and exports more goods to Country B, it would accumulate a trade surplus. At the same time Country B suffers a deficit. Settlement of this imbalance required a transfer of gold from Country B to Country A. The inflow of gold into Country A expanded its money supply. This triggers inflation and a rise of domestic prices. The result is, that exports become less competitive while imports

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increased. This eventually leads to correcting the surplus (Пенчев, 2025).

However, the outflow of gold from Country B reduces its money supply and triggers deflation , which leads to a drop of domestic prices. This makes goods cheaper on international markets, which in turn stimulates exports and the reduction of imports. This eventually restores equilibrium in the balance of payments (Kindleberger, C.P. 1986).

Origins of the gold standard (from ancient civilizations to the 19th century)

The use of gold as a mean of exchange for goods dates back to the beginning of the human civilization. Gold served as a storage of value and was a symbol of wealth. The ancient civilizations of Mesopotamia and Egypt as well as the Roman Empire used gold on a large scale. Other metals like silver were also used for coins and trade (Burns, A. 1927; Redish, A. 1992).

The European economies operated with gold and silver coins for trade started from the Middle Ages up until the 20th century. The value of the coins depended on their metal contents. The coins had different weights and were composed of different metals throughout history (Flandreau, M. 1996). There was no official "gold standard" at the begging. The value of the coin was e mere reflection of the quantity and quality of the metals in it. This made trade easy and facilitated the introduction of the national currency systems that developed in the nineteenth century (Eichengreen, B. 1996).

Classical Gold Standard (1821–1914)

The classical gold standard emerged in the nineteenth century. It was first adopted in the United Kingdom in 1821. The monetary instability created during the Napoleonic Wars forced the authorities to take immediate measures. Britain first suspended its gold convertibility. Later it restored the gold standard (Feavearyear, A.E. 1963) because it needed greater stability and trust in the financial system. The British pound was fixed to a certain weight of gold. The banknotes could be exchanged for gold at a stable rate.

Britain was largely successful with this reform. This, in turn, encouraged other major economies worldwide to follow the example. The United States adopted the standard. It passed the Gold Standard Act of 1900. Germany, France and Japan introduced similar systems in the 1870s. By the end of the nineteenth century, most advanced economies all over the world implemented the standard. The classical gold standard era (1880–1914) (Eichengreen, B. 1996) emerged.

The classical gold standard provided a solid basis for international finance. Exchange rates were fixed by gold parity. This promoted confidence in trade and investment. It also helped to maintain long-term price stability and low inflation. However, it restricted governments with their monetary policy because all the available money was tied to gold reserves. Even so, the period is widely regarded as one of exceptional economic growth and global integration (Gallarotti, G.M. 1995). The gold standard supported the free movement of goods, capital, and labour.

Bretton Woods System (1944–1971)

The Bretton Woods Agreement of 1944 laid the foundation of new international monetary relations after the end of the Second World War. This agreement was nothing similar to the classical gold standard. It was not a pure gold-based system. According to the agreement, the United States dollar was pegged to gold at a fixed rate of 35 USD per ounce. The other international currencies were pegged to gold but only indirectly by being fixed to the dollar. The exchange rates were stabilised (Gardner, R.N. 1980) without requiring all currencies to be directly convertible into gold. The US dollar was set as the primary reserve currency of the post-war world reality.

The system was very stabile at the start. It encouraged the development of the economies devasted by the WWII. It further facilitated international trade. However, by the late 1960s, the United States (Bordo, M.D. and Eichengreen, B. 1993), faced persistent disbalance of payments and rising inflation. These events put into question the ability of USA to stick to the Bretton Woods Agreement. Not surprisingly, President Richard Nixon suspended the dollar's convertibility into gold in 1971. This decision effectively brought the Bretton Woods system to an end. The event is known as the "Nixon Shock". It marked the end of the last official connection between gold and international currencies. A new era began when the global monetary system (Boughton, J.M. 2002) transitioned to a regime of fiat money and largely floating exchange rates, not backed by gold.

Post-Gold Standard Era

The Bretton Woods system collapsed in 1971. This led the world economy to a state of floating exchange rates. Currency values started being determined by supply and demand in global foreign exchange markets (Eichengreen, B. 2008) without being pegged to gold. This change marked the definitive end of the gold standard. The modern fiat money system was created. The exchange rate of currencies depended to a large extend on national monetary policy.

Nowadays, national currencies are no longer backed by gold. However, gold continues to play an important role in the global financial system. Central banks keep substantial gold reserves as part of their international reserves. Investors frequently use gold as a hedge against inflation, exchange rate volatility (World Gold Council, 2021), but also as a mean of holding value in periods of economic or geopolitical uncertainty.

Numerous academic papers continue to discuss both the advantages and disadvantages of the former gold standard system. Its main benefits included long-term price stability, high confidence in currency value and restrictions on inflationary policies. However, the system also imposed significant constraints (Kindleberger, C.P. 1986): governments had limited capacity for active monetary policy, it produced processes of deflation during and it restricted monetary policies, because the national currencies could not be devalued in order to support recovery.

The end of the gold standard marked a turning point. It allowed more flexible monetary policies on one side (Penchev, 2021) (Penchev, 2020). On the other, new challenges were introduced (Obstfeld, M. and Taylor, A.M. 2004): currency stability and financial governance. Processes of initial dollarization were later followed by ones of de-dollarization (Todorova, 2024) and euroization.

CONCLUSION

The history of the gold standard shows the complex balance between monetary stability and economic flexibility. The gold standard was a reliable anchor for currency values. It provided long-term price stability. Moreover, it gave confidence in international trade. The pegging to gold resulted in fixed exchange rates and gold convertibility. The challenge for the governments was the lack instruments to coordinate independent monetary policies. This often resulted into processes of deflation especially during recessions.

The ultimate collapse of gold-based systems in 1971 was predetermined by the inability of the USA to cope with persistent disbalance of payments and rising inflation.

Today, gold remains an important financial asset used to hedge against inflation, exchange rate volatility and a shelter in periods of economic and financial turmoil.

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