

A Price **BENCHMARK** for the Ages

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We reproduce here the speech which Rachel delivered on 12 September, 2019 at the reception to commemorate the centenary of the London gold price. Fittingly it was held at the fourth New Court, the offices of Rothschild & Co in the heart of the city, built on the site of the second New Court where the gold auction took place for much of the last 100 years.

It is a both a pleasure and honour to be here. I first encountered the London Gold Fix in Timothy Green's books 20 years ago, or the LBMA Gold Price as it is currently known. Since then, I have spent a great deal of time both researching and writing about the history of this auction. I never imagined that when I began my research that I would be here on its centenary. My excitement has been so great that

my friends have had to listen to me talk about this event – more than once. As might be expected of good friends, they were very happy for me. At the same time, I know they were slightly perplexed by the idea of a gold price having a birthday party.

As I prepared for this talk, I reflected on my friends' genuine curiosity about this event and the questions it raised about the significance of the LBMA Gold Price and its historical antecedent, 'the Gold Fix'. Taking their perspective – and they are people who have little

knowledge of the LBMA Gold Price – I heard them saying: "You can find gold prices everywhere – from the shops with 'We Buy Gold' signs to gold industry focused websites. What makes this one different?"

My answer to their question has two parts. First, over the last 100 years, this small but mighty auction has played important roles in the global financial system. Second, in these roles, it has produced a publicly visible, prominent and trusted price, whose significance has extended far beyond the transactions upon which it was based.

**THE FIRST WORLD WAR
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I will elaborate on these 2 points as I provide a broad overview of the history of this auction, with a particular focus on the development of the ritualistic form that it has been associated with for much of the 20th century.

Our first historical stop – and a very fitting one for a birthday celebration – is the start of the auction in 1919. At that time, the First World War was over and the Bank of England (the Bank) was focused on re-establishing the Gold Standard, as well as the international importance of the City of London and pound sterling. As part of these objectives, the Bank felt it was critical to ensure that the London gold market, which was closed during the war, be returned to its pre-war stature. Toward this objective, the Bank arranged for the world's largest gold producer – South Africa – to market its gold in London (Ally 1994). It then asked the firm acting as the agent for the South African gold producers, N M Rothschilds & Sons – or 'Rothschilds' – to chair the market in which this precious metal would be sold.

A key question that needed to be resolved was what form the market would take. It was within this context that an important conversation occurred on 6 August 1919. On this day, Anthony de Rothschild, a Rothschilds managing partner, was invited to the Bank to meet with Governor Sir Brien Cokayne. During their conversation on the marketing of South African gold, the Governor expressed what he wanted the market to look like:

AN OPEN MARKET FOR GOLD IN WHICH NOT ONLY EVERY SELLER WOULD KNOW THAT HE WOULD RECEIVE THE HIGHEST PRICE THE WORLD COULD PAY, BUT ALSO EVERY BUYER WOULD KNOW THAT HE WOULD GET HIS GOLD AS CHEAPLY AS THE WORLD COULD SUPPLY IT.¹

In this simple statement was a core principle about the auction that has been consistent across the past 100 years. All gold on offer was to be transacted at the same publicly visible price, and on the same terms. These elements contrasted with transactions in the over-the-counter gold market, or OTC market, whose price and contract terms were individually negotiated and private. By having an auction where the price and terms were public, buyers and sellers could trust that they would get the best deal from the existing order flow. It was these conditions established by the Governor that would distinguish the auction and its price for decades to come.

ANOTHER DEVELOPMENT DURING THE 1920S WAS THE ADDITION OF A SINGLE PHONE – PERHAPS AROUND 1923

The Governor's wishes came to fruition on 12 September 1919. At around 11:00 am on that morning, Rothschilds settled on the opening price of 98s/6d, based on the main factor impacting gold prices at the time – the dollar-sterling exchange rate. The brokers were then notified by phone and asked to place their orders. The participating brokers were bullion firms whose names would become synonymous with the auction in the coming decades: Mocatta & Goldsmid, Samuel Montagu & Sons, Sharps & Wilkins and Pixley & Abell (the latter two merged in 1957 to become Sharps Pixley & Co). Additional phone calls might have been made that day to adjust the price to accommodate the existing order flow, but at the end of the process, all gold was transacted at a single price of 98s/8d (Green 1978).

Much like a newborn, at its birth, the auction did not look like its more mature form. The ritualistic quality associated with the auction for most of the 20th century was absent at the first meeting. These features would emerge slowly over the next 20 years. The first step in this development began a few weeks later. Rothschilds still arrived at the opening price based on the dollar-sterling exchange rate, but now the participating bullion brokers came to Rothschilds' offices. At 11:00 am, everyone would enter a room at New Court with their orders in hand, and they needed to remain in the room for the duration of the auction if they wanted to purchase gold. At first, only Mocatta & Goldsmid was a regular participant.

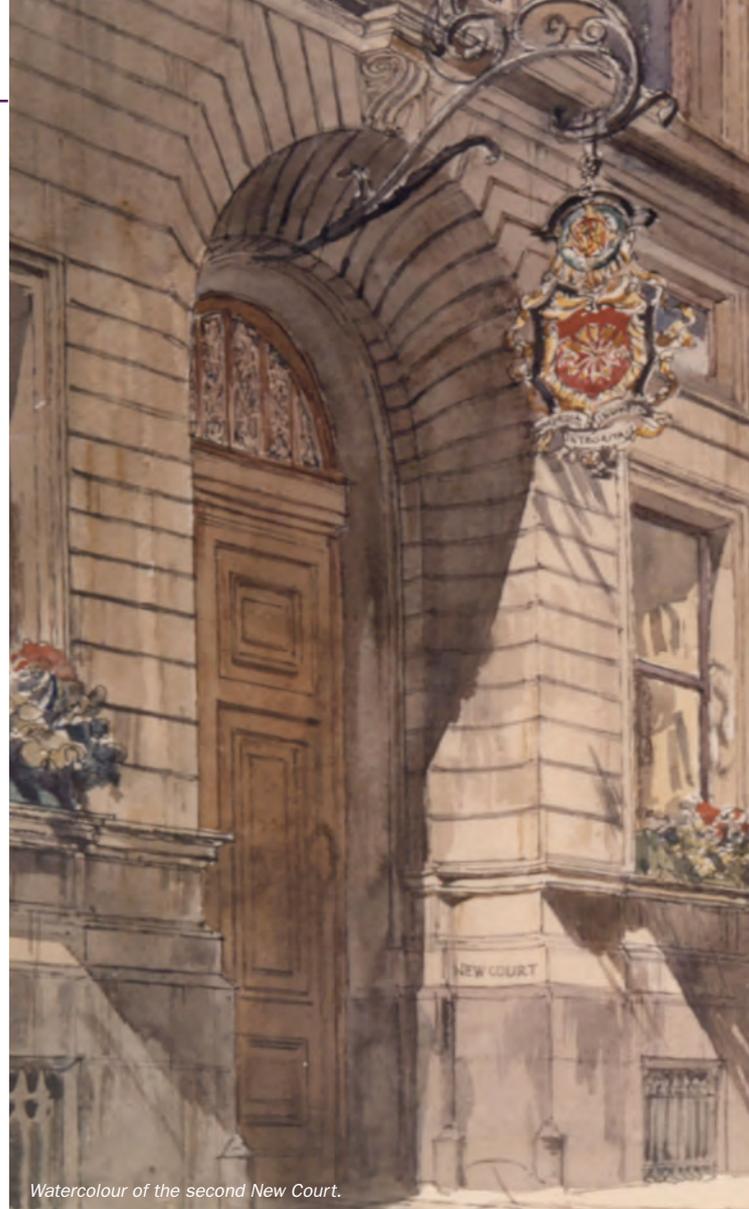
In time, the other firms began to participate in the auction each day and, by 1925, all four bullion brokers were regular attendees.

By 1926, the refiner Johnson & Matthey was also invited to join the auction.

Another development during the 1920s was the addition of a single phone – perhaps around 1923. This allowed the participants to have contact with their firms during the auction.

THE FIXING ROOM AT ROTHSCHILD'S, NEW COURT

This gradual development of the auction continued in the 1930s. The decoupling of the pound from gold on 21 September 1931, the collapse of the post-First World War gold standard, worldwide economic depression and monetary uncertainty lead to a period of unprecedented turnover, volatility and price levels in what was now a free gold market in London. The resultant price fluctuations meant that brokers needed to be in communication with their firms to see how these movements impacted their order flow. With only one phone in use, the brokers had to "queue up in order to use it".² It is not surprising that additional phones were added – perhaps in 1933.



Watercolour of the second New Court.

1. Bank of England Archives (BEA), C40/360/90, Sir Brien Cokayne's notes on a meeting with Anthony G. de Rothschild, 6 August 1919. 2. BEA, C43/661/172, Letter to J.B. de K Wilmot, South African Reserve Bank, from L.T.G. Preston, Bank of England, 10 August 1955.



In the 1930s, the stature of the auction and its price expanded. Comments written in 1938 by a Bank staff member express this point:

GRADUALLY THE LONDON GOLD FIXING ASSUMED INTERNATIONAL IMPORTANCE AND FROM 1934 ONWARDS WE WERE FORCED TO INTERVENE TO AN INCREASING DEGREE IN THE BULLION MARKET... THE CURRENT LONDON GOLD PRICE HAS BECOME OF PARAMOUNT INTEREST AND THE FIXING PRICE IS REGARDED BY OTHER CONTROLS AND THE GENERAL PUBLIC AS THE KEystone OF THE SYSTEM.⁵

What is captured in this quote is how the economic and monetary uncertainty of the 1930s increased the auction's importance. In their efforts to stabilise currencies and exchange rates, the Bank and other financial authorities intervened in the auction. As a result, the significance of the auction further increased as did its public visibility.

The stature achieved by the auction during the 1930s extended beyond this decade. When plans were being made to reopen the auction nine years after the end of the Second World War, the Bank still wanted it to be the only publicly visible market clearing price denominated in pounds. Yet it also considered making dramatic changes in the auction's organisation. For a variety of reasons, such as expediency, these plans never came to fruition. One factor behind this outcome that is particularly relevant to why we are here today is expressed in comments by a Bank staff member in January 1954:

PARTICIPANTS WOULD, HOWEVER, YELL "FLAG" TO SIGNAL THAT THEY WANTED TO PAUSE TRADING

WE MAY HAVE TO FACE SOME CRITICISM FROM OUTSIDE ON THE GROUNDS THAT WHATEVER THE SHAPE OF THE MARKET WAS PRE-WAR IT WORKED. MOREOVER, IT WAS PERFECTLY RESPECTABLE AND GENERALLY ACCEPTED IN THE CITY. WE MAY, THEREFORE, BE CALLED UPON TO EXPLAIN WHY SUCH RADICAL ALTERATIONS ARE NECESSARY.⁶

Another change was that the auction found a permanent home in New Court when it moved into a conference room that in the future would be known as the 'Gold Fixing Room'.³

For those of you familiar with the older form of the auction, you have likely noticed that an important feature is still missing – the flags. Initially, these were not used in the auction. Participants would, however, yell "flag" to signal that they wanted to pause trading.⁴ In the late 1930s, George Matthey, a director and descendant of one of the founders of Johnson Matthey, suggested that each participant should have an actual small Union Jack flag before them to use when they wanted to halt proceedings to confer with their trading room (Green 1978).

By the time the auction was closed due to the outbreak of the Second World War, the ritualistic elements that characterised it for most of the 20th century were well established.

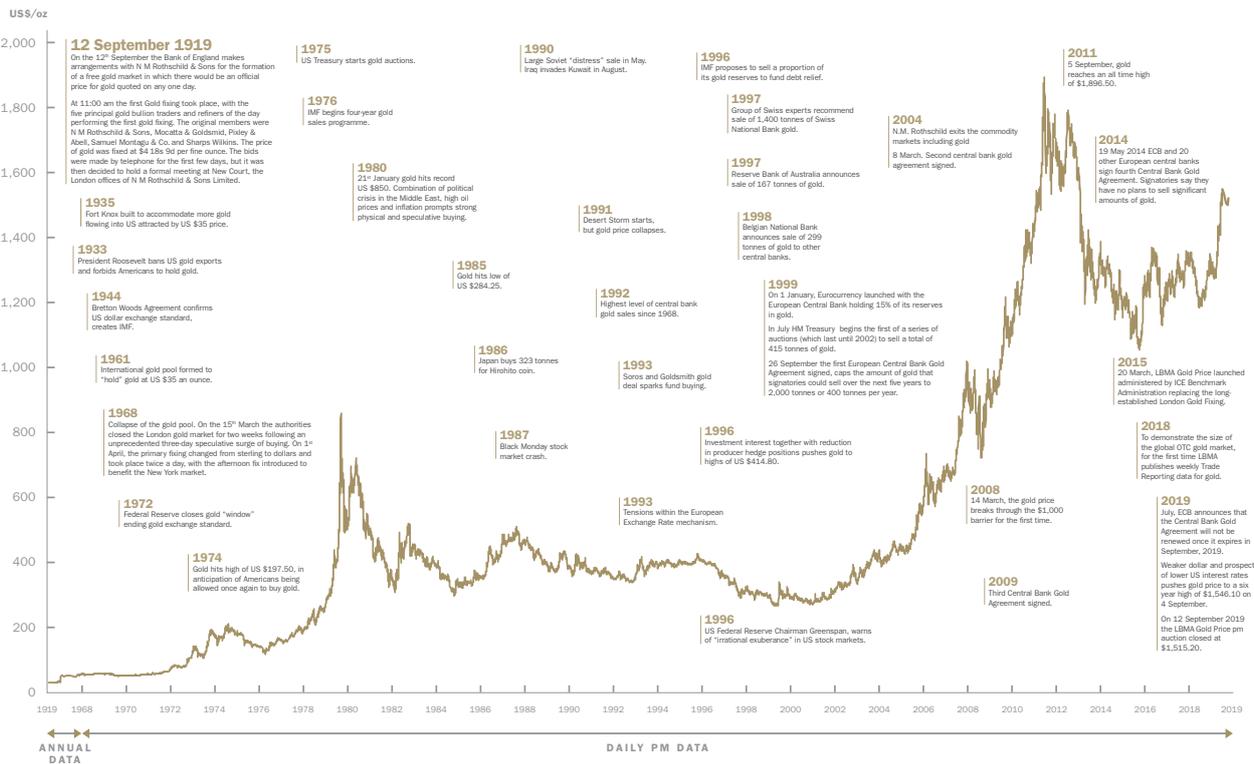
The availability of archival documents and periodicals that provide detailed information about what some might consider to be the minutia of this auction hints at its historical importance. From its inception, the auction was clearly important to the Bank.

ANOTHER CHANGE WAS THAT THE AUCTION FOUND A PERMANENT HOME IN NEW COURT WHEN IT MOVED INTO A CONFERENCE ROOM THAT IN THE FUTURE WOULD BE KNOWN AS THE 'GOLD FIXING ROOM'



3. Ibid. 4. The Times (London), "Those Gold Market Flags" 17 March 1960. 5. BEA, C43/142/50, "Gold Market: Exclusive Relations with Rothschilds", 24 August 1938. 6. BEA, C43/159/5, "London Gold Market", 8 January 1954.

GOLD PRICE CENTENARY 1919 - 2019



LBMA have updated the chart produced by Rothschild & Co. to celebrate the 80th anniversary of the gold price. This updated chart features the price and key events over the last 100 years.

Almost 15 years after its closure, the stature of the auction and trust in its price were so great that any alternations in its form would have raised questions. In the end, the Bank's decision paid off as the reopened auction worked "quietly," "efficiently" and had "quite a reasonable volume of business".⁷

Unlike the 1930s, the auction was not a free market and UK residents were banned from owning monetary gold. This did not mean that the auction was unimportant in the post-Second World War era. Gold and the US dollar were at the heart of the post-World War II international monetary arrangements known as "Bretton Woods". By the 1960s, the overseas commitments of the United States and its growing deficit led to increasing doubt worldwide that the country could maintain the US\$35 dollars per ounce of gold parity level at the centre of the Bretton Woods arrangements. This first manifested in the auction on 25 October 1960, when its price increased to \$38.00 (270s). These events and the worldwide concern and attention they garnered, signalled how the price was acting as a barometer for international confidence in the US dollar. In an effort to create international monetary stability, eight central banks⁸ – possessing nearly 80% of the world's gold reserves – created a 'gold pool' that the Bank could use to buy or sell gold

in London in order to counteract speculative attacks on the US dollar. The Gold Pool operated successfully until March 1968. At this point, the speculative attacks became so great that the Pool was losing too much gold. On 15 March 1968, the US government requested that the UK Treasury close the London gold market. Comments by a Bank staff member on why the auction was to be closed capture its importance and the trust placed in its price:

THE OBJECTION TO THE LONDON MARKET REMAINING OPEN SEEMED TO STEM FROM THE FACT THAT LONDON HAD ALWAYS BEEN REGARDED AS A WELL-ORGANIZED AND RESPECTABLE MARKET AND THAT THE LONDON FIXING PRICE WAS A "THERMOMETER" IN RELATION TO GOLD. THERE WAS A FEELING THAT IF THE THERMOMETER WAS BROKEN THE TEMPERATURE WOULD NOT BE KNOWN.⁹

These events marked the beginning of the end of the Bretton Woods arrangements and were the start of a new era for the auction and its price.

The auction reopened two weeks later on 1 April 1968. It was now part of the free section of what was an international two-tier gold market. Unlike the tier used by financial authorities to trade gold at the \$35.00/ounce parity level, the auction's price would be allowed to fluctuate according to supply and demand only. During the enforced closure, the auction's participants made some changes. There would now be two auctions – one at 10:30 am and the other at 3:00 pm. The afternoon auction was established for the Canadians, Americans and South Americans, who preferred to see the state of the market "when they were awake".¹⁰ In addition, the

6 → 55

With the end of currency controls in 1979 the number of firms active in the London market increased from six to more than 55 by 1985

7. BEA, OV48/13/137, "Copy of the Governor's Letter to Mr. Towers", 29 March 1954. 8. West Germany, France, Italy, Belgium, the Netherlands, Switzerland, the United Kingdom and the United States. 9. BEA, OV53/38/78, "Closing the London Market", 18 March 1968, L.T.G. Preston. 10. BEA, 3A139/1/80, Miscellaneous note, approximate date is 29 March 1968.

benchmark price would be a dollar price for gold. This change simply reflected the fact that the auction had been a de facto dollar market for quite some time even if the initial price it produced was quoted in pounds.

In addition to the structure of the auction, trading conditions within it also changed. During the 1960s, the auction's participants were primarily buyers, with most of the gold coming from the South Africans or the Gold Pool via the Bank. In the new era, the bullion firms now arrived with both buy and sell orders.

These changes occurred within a dramatically shifting gold market landscape. During the auction's two-week closure, several countries removed restrictions on their residents owning and trading gold, and some even created their own fixings. This trend was to continue over the next decade as a round-the-world, round-the-clock gold market emerged as gold was demonetised, restrictions on gold ownership lessened and foreign exchange controls decreased. These factors also spurred growth in the London gold market. With the end of currency controls in 1979, the number of firms active in the London market increased from six to more than 55 by 1985. The number of firms participating in the auction was still limited to five, but the nationalities of the participating companies started to change. By 1993, only two firms of British origin had seats in the auction, with the other three hailing from the United States, Germany and Hong Kong.

With these changes, the auction was now part of a tightly interconnected network of gold dealing centres spanning the globe. Participants in the auction during the closing decades of the 20th century were well aware of this.

TO ROUND OUT THIS BREAKNECK-SPEED JOURNEY THROUGH THE AUCTION'S HISTORY THE FACE-TO-FACE AUCTION DISAPPEARED IN 2004 WHEN IT WAS MOVED TO A CONFERENCE CALL

Acting for a firm in the auction did not require great trading skills, but the individuals present recognised that it was a public venue and they were representing their firms.

It was a more formal affair with jackets being worn and an expectation of decorous behaviour. Participants also had an awareness that their London colleagues were not the only ones watching them. The auction was the centre of organisational and trading networks spanning the world. It was not simply that fabricators, central bankers, mining companies or even the general public used the auction's price as a reference point for their valuations or in pricing their own transactions. The transactional price benchmark was used in derivative contracts and could even be part of arbitrage strategies involving the auction and markets in New York and Hong Kong. Gold might have been demonetised and there was a 24-hour a day spot market, but the auction and its price continued to play a significant role in the global financial system.

To round out this breakneck-speed journey through the auction's history, the face-to-face auction disappeared in 2004 when it was moved to a conference call.

The only reminder of its ritualistic past was participants using the word "flag", followed by their firm's name, to pause trading. Perhaps somewhat ironically, its telephone-based form represented a return to the auction's origins. There was an additional element that stretched across the previous 85 years as well. As had occurred on 12 September 1919 and as would continue to occur over the next 15 years – a single price based on transactions conducted on the same terms was the essential principle structuring the auction. Through economic depression, a world war and dramatic changes in the global financial system, this one feature was a critical underlying principle behind the creation of a trusted and reliable price benchmark for the ages.

The gold fixing in action. Left to right: Keith Smith (Mocatta), Patrick Smith (Samuel Montagu), Alan Baker (Sharps Pixley), Alistair Christmas (Rothschild) and Dick Gazmararian (Republic Bank of New York). Circa 1992



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