Gold During Periods of Conflict

By James Steel, Chief Precious Metals Analyst, HSBC

The search for gold and silver played a key part in shaping the modern world. Wars waged over the possession of gold and silver, and territories rich in those metals influenced the conquest and colonisation of the Americas, Australasia and Southern Africa, to name just a few well-known examples.

Introduction

But the story did not end with the acquisition of gold and silver. Rather, the way bullion was used, moved, stored and shifted had profound effects on long-term economic or military success. Indeed, the role of gold and silver in wars not only influenced the shape of the world today, but laid the foundations for the modern financial system. The story of how gold was used impacted which countries emerged as winners and losers in conflicts dating back to the 15th century, the beginning of the modern era. At times, the efficient mobilisation and use of bullion through credit and the financial system shaped an economy and aided a country during times of conflict. Though not a guarantor of victory, gold played an important function in the great European rivalries and struggles up to and throughout the 20th century, as well as in civil wars and revolutions, notably the American Civil War, and the Spanish and Russian Revolutions.

The Spanish Experience: a lesson in the dangers of too much gold

The massive influx of precious metals into Spain acquired by conquering the New World turned the Iberian nation into a superpower after the 15th century. This wealth financed troops in the Netherlands, Italy and Germany, and paid for a large fleet. Yet, despite the vast importation of gold and silver, little of these riches were funnelled into domestic economic development. The influx of bullion effectively buoyed the money supply without stimulating additional production of goods and services. The result: domestic inflation. Most of it ended up simply 'passing through' Spain. That is to say the bullion headed into the more productive economies of England or the Netherlands, where goods were produced and sold to Spain. So much bullion was imported that it devalued those precious metals already in the European economy for decades afterward. Furthermore, so much more silver was brought in than gold that the gold-silver ratio, which had been fairly steady since ancient times, widened permanently, making gold more sought after and silver less so. It could be argued that this inflationary effect overpriced exports and thus that the industrial development of Spain was hindered by bullion inflows.

The long-term effect of this was to weaken the Spanish Empire in future conflicts with England and other powers. And it strengthened Spain's enemies. In *Economic Possibilities for our Grandchildren*, economist John Maynard Keynes dates the development of Britain's capital account directly to the capture of Spanish treasure by Sir Francis Drake in the 1570s. Queen Elizabeth I was able to pay off the existing national debt and invest an additional £40,000 with the crown's share of the proceeds from Drake's raids of Spanish commerce.

The French and Napoleonic Wars: first signs of cracks in the gold standard

Gold's role was not what would have been expected in the long clash between France and Britain in the French and Napoleonic Wars. Great Britain abandoned the gold standard early in the struggle in 1797 in response to a doubling of the national debt since the start of the French wars in 1793. France, meanwhile, maintained a bimetallic standard for the duration of the conflict. On the face of it, the nation that stuck with the gold standard – France – should have had an advantage over Britain. But as pointed out by economists Bordo and White in a 1991 paper, Britain's financially stronger position – and reputation for repaying debts – allowed it to abandon the gold standard and still borrow heavily to sustain the war effort, albeit at the cost of higher inflation. France's poorer reputation in this regard following a track record of defaults during its revolutionary period meant that it had to rely on taxation and remain on a bimetallic standard that limited what it could import and pay for, as well as borrow. This allowed Britain to prosecute a long war.

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Financiers including Nathan Rothschild helped fund the national debt, which according to historian Roger Knight ballooned to £578 million, more than double the level of GDP. A portion of this was used to pay subsidies to Britain's allies on the continent, showing how important the finances were in shoring up the war effort. And only a fraction of the expenses were paid for by gold.

The American Civil War: gold helped finance victory

Access to gold and the effective use of bullion played a crucial role in the outcome of the American Civil War. It may be one of the best examples of a conflict where one side, the Union, had access to considerable gold, while the other, the Confederacy, was effectively starved of bullion. Early on, the Union recognised the need to maintain control of California and its valuable gold fields, as well as silver- and gold-producing areas in the Western territories. It is estimated that gold from California financed 10% of the Union's war effort. Adequate access to gold allowed the Union to come off the gold standard without provoking hyperinflation. According to the California historical society, steamer ships sailing out of San Francisco to the US East Coast carried an average of US$1 million in gold coins and bullion produced by the San Francisco Mint two to three times a month from 1861 to 1865. This gold was key to sustaining the costs of military operations.

The Legal Tender Act of 1862 essentially outlawed privately minted gold and silver coins, and effectively took the Union off the gold standard. The public hoarded gold and silver, but the Public Credit Act passed after the war stated that 'Greenbacks' and bonds issued during the war would be redeemed with gold or silver coins over the next 10 years. The steady flow of gold from the West essentially propped up the Federal Greenbacks even though they were not backed with gold by law. General Grant said in regard to California's support to the war effort: *"I do not know what we would do in this great national emergency if it were not for the gold sent from California."* Although not paid directly to the troops, the gold was used to raise cash, and most of the Union government's gold was sold to the Bank of England at a price of US$16/oz.

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In contrast, lack of gold severely inhibited the Confederate war effort. According to civil war historian Charles Flato, at the beginning of the war, the seven Confederate states only had US$27 million in gold and silver specie. The South could not compete with the North for financing from the major financial institutions in Europe, so the Confederate Treasury turned to smaller houses willing to take on risk. Economic historian Marc D. Weidenmier estimates that they raised US$15 million in gold by selling Confederate bonds. The gold in turn purchased war materiel. The Federal Mints located in the Confederate States of America ceased operation entirely in 1861. As the Confederate currency became almost worthless, fewer bonds could be sold abroad for gold and the few imports the rebel states could afford had to be paid for with the limited available gold, severely curtailing purchases.

The Russian revolution: gold paid the bill

Imperial Russia held one of the world's largest gold reserves on the eve of the First World War. These stocks were severely depleted during the war, but they were not exhausted by

Admiral Alexander Kolchak (sitting) with British officers on the Eastern Front, Russia, 1918

1917. In 1918, the Allied powers intervened in the Russian Revolution on the side of the Whites or counter-revolutionaries and organised a blockade on Soviet Russia. This included 'Soviet gold', the bullion the Bolsheviks had seized from the Imperial Central Bank. The embargo was circumvented and a lot of the gold was used to acquire much-needed imports by the revolutionaries.

The Whites were also able to obtain some official sector and Imperial gold. What became known as the famous 'Kolchak's gold' was the name given to a large portion of the Russian Empire's gold reserve, which came into the possession of Admiral Kolchak's government during the Russian Civil War. The Imperial Bank's gold was sent to Kazan, in southwest Russia, in 1915, as the Germans advanced into Russia. The Russian Academy of Sciences estimates that by the summer of 1918, the State Bank's vaults in Kazan held more than half of all Russian gold reserves. This eventually ended up in Bolshevik hands. By 1921, Bolshevik reserves were depleted, leading War Commissar Leon Trotsky to seize private stocks. The imports paid for with gold were an important element in the Bolshevik's victory and in sustaining the revolution in its early years.

The World Wars: control of gold mattered in both conflicts

Gold gave the Allies a notable advantage over Germany and the Central Powers in World War I. Great Britain had access to bullion produced by various parts of the British Empire, notably South Africa, Australia and Canada. Of these, South Africa provided two-thirds of all the gold production in the British Empire. In addition to supplying the UK, the South African government, in collaboration with the Bank of England, effectively blocked gold shipments to Germany. Mine owners were also compelled to sell bullion exclusively to the UK Treasury. This provided a ready source of capital to pay for wartime imports, mostly from the US. Being cut off from fresh gold supplies crimped Germany's ability to import goods needed for the war effort.

The UK did not hold particularly large gold reserves at the start of the conflict. Even before the war, City of London banks had argued that the Bank of England's gold stocks should be higher. The war would put further strain on bullion reserves. As during the war years in the late 1700s, the UK abandoned the gold standard with the Currency and Bank Notes Act of 1914. This was issued just one day after Britain declared war on Germany and allowed the government to print notes as legal tender in place of gold sovereigns and half-sovereigns. By withdrawing gold from circulation, the Act effectively suspended the gold standard. The Bank of England could thereafter increase the money supply free of restraints. Largely because of Britain's place in global finance, its principal allies – France and Russia – looked to the UK to help finance their war effort through loans and credits. Despite the Bank of England's central role in global finance, both the Banque de France and the Russian Imperial Bank held substantially greater gold reserves. According to historian T.M. Meacher, as much as one-third of the world's gold reserves were held by the Banque de France.

Table 1: Volume of Sovereign Production by Mints During WWI

	Bombay Mint	London Mint	Melbourne Mint	Ottawa Mint	Perth Mint	Sydney Mint
1913	0	24,539,672	2,323,180	3,717	0	2,249,000
1914	0	11,501,117	2,012,029	14,900	4,815,996	1,774,000
1915	0	20,295,280	1,637,839	0	4,373,596	1,346,000
1916	0	1,554,120	1,272,634	6,119	4,096,721	1,242,000
1917	0	1,014,714	934,469	58,875	4,110,286	1,666,000
1918	1,294,372	0	4,809,493	106,570	3,812,884	3,716,000
1919	0	0	514,257	135,957	2,995,216	1,835,000

Source: Royal Mint

The UK government encouraged the public to surrender their gold sovereigns in exchange for new Treasury notes or war loans. The public responded positively to the campaign to the extent that by mid-1915 gold sovereigns had effectively disappeared from circulation in the UK. Although gold sovereigns continued to be produced throughout the war by the Mint, they were mostly subsumed within the reserves held by the Bank of England. By 1918 production of the gold sovereign had ceased, and branch mints in the commonwealth reduced their output, with only Ottawa increasing its production (see table 1).

The UK authorities required at least some payment in gold for credits and imports. France shipped nearly £117 million worth of gold to the UK, while Russia sent nearly £68 million during the war. While gold shipments to the US from the UK were also substantial, they were not nearly enough to pay for wartime purchases, but they did help ease the burden of the widening trade deficit. That said, France held the largest gold reserves in Europe and Britain had the best public credit in the world. Both worked to finance the war.

Going into the war in 1914, Germany's gold reserves were small compared to those of Britain and France. But one advantage Germany had was a higher war loan subscription rate. This meant that gold reserves were better preserved. Laws were passed early in the war to make gold inaccessible to the public and Germany also effectively left the gold standard. Germany provided financial support to weaker allies. But in return, Germany demanded at least partial payment in gold from its main ally, Austria-Hungary. By contrast, Germany lent gold to the Ottoman Empire. Almost 800 million gold marks were lent to the Turkish Empire. This was essential to keep the Turks in the war as troops and providers of military goods generally distrusted the inflation-prone Ottoman currency. Towards the end of WW1, the few imports that Germany was able to afford were increasingly paid for with gold. Between 1919 and 1932, Germany paid out 19 billion gold marks in reparations and received 27 billion gold marks in loans from New York banks and others. These loans were eventually paid back by West Germany after World War II.

Many of the same gold scenarios were repeated in the Second World War and control of gold was important. The draining of Germany's gold and foreign exchange reserves crimped the acquisition of war materiel and other essential imports on the eve of war. Towards the end of the 1930s, Germany's foreign exchange reserves were dwindling. By 1939, Germany had defaulted upon its foreign loans and most of its trade relied upon barter and gold. Once war commenced, very few neutral countries were willing to accept Reich marks for essential imports. German gold reserves were limited. The Nazi regime appropriated gold stocks from occupied countries. Some European central banks were successful in spiriting gold out of the country before it fell into Nazi hands, others less so. Even before the invasion of Poland, the Nazi regime was acquiring gold. The Nazis had already acquired Austrian gold and also demanded that the Czech National Bank give up its gold, amounting to 95t according to official records. Gold was also taken from victims of the Nazi regime. The strain on Nazi gold reserves was always severe and by the end of the war, as had happened during WWI, virtually all of the few imports that could get into Germany were paid for by gold. The Allies went off what can best be described as a modified gold standard but had access to immense gold reserves in the many parts of the British Empire and the US. Japan also looted gold, but to a lesser extent than Germany, and an increasingly effective Allied naval blockade inhibited the use of gold, with much of it kept out of the Japanese home islands until late in the conflict.

The Spanish Civil War

By the 20th century, at the outbreak of the civil war in the 1930s, Spain had the world's fourth-largest reserves of gold, held mostly by the legitimate Popular Front government in Madrid. Despite having such large reserves, the Republican government used the bullion inefficiently, highlighting that how gold is utilised can be just as important as having it in the first place. The Republicans received considerable materiel aid from Stalin's Soviet Union, but the assistance came at a price. Around 510t of gold from the Bank of Spain – almost three-quarters of the nation's bullion reserves – was shipped to the Soviet Union in the early months of the war. The remaining 193t was sent to Paris. This 'Paris' gold was exchanged for hard currency to finance the Republican war effort.

The deposited gold paid for some of the Soviet aid. But there were other costs from the gold leaving Spain. The absence of physical bullion in the country had a profoundly negative impact on the value of the domestic currency. Essentially, the lack of gold withdrew a base of support for Spanish banknotes. According to historians Santacreu Soler and Jose Miguel, the withdrawal of gold from the Bank of Spain's reserves was one of the main causes of the Spanish monetary crisis of 1937. This contributed to the Republican's defeat.

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Conclusion

Gold and silver are not just spoils of war, they have been the means by which wars and conflicts can be financed and prosecuted. Gold has played a central role in conflicts ancient and modern. However, it is not simply a question of which side has the most gold, but which sides utilises it most judiciously. In the case of Britain in the French and Napoleonic wars, the efficient mobilisation of bullion played a role in the financing a score of European coalitions against France, despite repeated victories by Napoleon and France's retention of a bimetallic standard. Gold helped overcome a broad-based financial embargo on Russia in the early days of the revolution. Gold was an important economic agent in both world wars, with the Allies at great advantage. Financing in periods of conflict is linked to investor confidence and the side with gold often commanded more confidence. Domestic currencies, which often come under strain during conflict, can be supported by gold and credit extended to belligerents based on their gold reserves. Similarly, unchecked outflows of gold can also be an effective bellwether for the losing side. While not a guarantor of victory, it can be a powerful indicator.

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