**Bimetallism**

The international monetary system prior to the 1870s can be characterised as based on bimetallism, in the sense that both gold and silver were used as international means of payment. This does not, however, imply that each individual country was on a bimetallic standard; many countries accepted either a gold standard or a silver standard. For example, China, India, Germany and Holland were on the silver standard while in the UK, bimetallism was maintained until 1816 when Parliament abolished the free coinage of silver. In the United States, bimetallism was maintained until 1873, when Congress adopted the gold standard only. Similarly, France introduced bimetallism from the French Revolution to 1878, when the franc effectively became a gold currency. Note that the exchange rates among currencies were determined by their gold or silver contents, and sometimes by their exchange rates against another currency. For example, the exchange rate between the British pound (gold standard) and German mark (silver standard) was determined by their exchange rates against the French franc (bimetallic standard) using mint ratio or gold style ratio.

For example, you had the following:

British = gold

France = gold and silver

Germany = silver

Determining exchange rate between Britain and France was not a problem. To determine the exchange rate between Germany and UK, France had to be used.

Example

British currency was equal to 4 ounces of gold and French currency was equal to 2:20 gold silver ounces ratio. So, the exchange rate British pound vs French franc = 4/2

1 British pound = 2 French franc

Now German currency was equal to 10 ounces of silver.

So, the exchange rate - French Franc vs Germany = 20/10

1. French Franc = 2 German Euro

So 2 French Franc is 4 Euros (2 × 2)

So, 1 British pound would equal 4 German Euro

The collapse of bimetallism

The era experienced a phenomenon called Gresham’s Law – where countries did not trade on bimetallism anymore. Gresham’s law states that bad money drives away good money, leading to unilateralism.

Bad money refers to abundant money and good money refers to scarce money. Lets say France discovered gold mines and now it has more of gold as compared to silver. That is gold is abundantly available in France so gold has less value. They started using more gold than silver. Silver therefore went out of circulation. Hence, in such a way the countries became unmetallic. Hence the system collapsed.

**Classical Gold Standard**

By 1879, all major industrial countries and most smaller countries had adopted the gold standard. Country’s currency or paper money has a value directly linked to certain quantities of gold. Let’s say you want to buy something from country x, you need to take your paper money, get it converted to gold and use that to trade with other countries.

Three rules of the game:

* Only gold is used for international payment.
* Two-way convertibility between gold and currency at a fixed rate.
* Free export and import of gold.

For example,

£1 = 2 ounce of gold

$1 = 6 ounce of gold

Exchange rate of $/£ = 6/2 = 3

So, £1 = $3