

From Hegemony to Transformation: The Institutional Logic of the Pound Sterling's Millennial Evolution

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Abstract. The pound sterling is one of the world's oldest currencies. Its evolutionary process from a global hegemonic currency to an important international currency provides a unique historical perspective for understanding the dynamic changes of the international monetary system. This paper adopts the analytical framework of historical institutionalism, reviews the nearly millennial evolution of the pound sterling through a literature review, and focuses on analyzing the institutional logic of its achievement of hegemony in the 19th century relying on the gold standard system, its hegemonic decline under the impact of the two World Wars in the 20th century, and its final post-war transformation into a modern international currency. This study shows that the essence of monetary hegemony is an extension of a nation's comprehensive strength, but its maintenance depends on a stable credit anchor and the ability to adapt to changes in the global economic landscape. The history of the pound sterling indicates that even a declining hegemonic currency can find its position in the new international order by virtue of its institutional resilience and historical accumulation. This process has practical implications for understanding the current trend of diversification in the international monetary system.

Keywords: Pound Sterling; Monetary Hegemony; Gold Standard; International Currency; Hegemonic Decline.

1. Introduction

The pound sterling is one of the few currencies in the world that carries a millennial depth of history. It once dominated the international financial order for nearly two centuries based on the strength of the "Empire on which the sun never sets," becoming a "hard currency" for global trade. It has also experienced the vicissitudes of time, shed its hegemonic halo, and plays its own role today by virtue of stable credit and rich historical accumulation [1]. From the metal coinage of the Anglo-Saxon period to the current era of electronic payments, its evolutionary trajectory is not only a microcosm of British economic development but also reflects the changes in politics, order, trade, and culture in Europe and even the world [2].

The study of the rise and fall of international monetary hegemony has always been a core issue in the field of international political economy [3]. Scholars have extensively discussed the macroeconomic conditions for the replacement of hegemonic currencies, such as national economic strength, trade share, and financial market depth [4]. However, the case of the pound sterling is not just about the rise and fall of economic aggregates, but a complex story about monetary credit, institutional design, and interaction with the global landscape. Although existing research is abundant, it often focuses on a specific period (such as the gold standard or the Bretton Woods system), lacking a long-term perspective of institutional evolution to systematically sort out the complete logical chain of the pound sterling's "hegemony-decline-transformation" [5].

The core argument of this paper is that the hegemony of the pound sterling was built upon its strong real economy and the innovative anchor of the gold standard system; its decline stemmed not only from the depletion of national power by the two World Wars, but more so from its failure to adjust institutional arrangements in time to adapt to the changed global economic landscape. By analyzing this process, this paper attempts to provide a historical mirror for understanding the essence of monetary hegemony and the diversified transformation of the current international monetary system.

2. Research Method and Analytical Framework

The research method of this paper is mainly based on a systematic review of relevant academic literature and historical comparative analysis [3, 5].

This paper adopts the perspective of Historical Institutionalism, which emphasizes the role of "Path Dependence" and "Critical Junctures" in historical development [6]. This paper regards the establishment of the Bank of England, the establishment of the gold standard system, the two World Wars, and the collapse of the Bretton Woods system as "critical junctures" affecting the status of the pound sterling, and analyzes how, at these junctures, Britain's policy choices were influenced by previous institutional paths and, in turn, shaped the future trajectory of the pound sterling. In this way, the purpose of this study is to transcend mere comparison of economic strength and reveal the deep logic of the rise and fall of the pound sterling's hegemony from an institutional level.

3. Origin and Integration: The Unification and Credit Establishment of the Medieval Pound Sterling

The history of the pound sterling must begin with the monetary practices of the Anglo-Saxon period; its development in this phase mainly revolved around the two cores of "unification" and "establishing credit". At the end of the 7th century AD, the various Anglo-Saxon kingdoms began to mint silver pennies, which can be seen as the earliest prototype of the pound sterling [7]. At that time, the weight and purity of the silver pennies were uniformly stipulated by the king through decrees, and the coins would also be marked with the minting place and the ruler's name. This method, endorsed by state authority, laid the foundation for the later stable development of the pound sterling. The Norman Conquest in 1066 became an important turning point in the development of the pound sterling. After the establishment of the Norman dynasty, a policy of monetary unification was implemented, abolishing the independent minting rights of local mints, centralizing currency minting in a few cities such as London, and also establishing the "penny - shilling - pound" monetary hierarchical system. This system not only met the needs of medieval England's agricultural economy and daily commercial exchange, but also reduced transaction costs through a unified monetary standard, helping the domestic market to slowly integrate. This "silver standard" tradition continued for nearly 800 years [7].

After the 16th century, the global flow of precious metals combined with the advancement of the commercial revolution brought the first shock to the pound sterling's monetary system. As Britain's overseas trade gradually developed, a "bimetallic standard" situation was formed. However, problems of insufficient fineness and rampant counterfeiting often occurred in currency circulation [7]. To solve this problem, the British Parliament promulgated the "Coinage Act" in 1663, which standardized the minting standards for gold coins and, for the first time, clarified the exchange ratio between the "Guinea" gold coin and the penny. This also marked the pound sterling's slow transition from a single silver standard to a bimetallic standard.

The establishment of the Bank of England in 1694 provided an institutional guarantee for the modernization and transformation of the pound sterling [8]. As the world's earliest modern central bank, the Bank of England initially mainly raised war funds for the government, but it soon undertook the core responsibilities of issuing currency and regulating credit. By issuing banknotes that could be exchanged for gold and silver, it gradually replaced the traditional circulation of metal currency, which not only improved the efficiency of currency circulation but also established a "central bank - commercial bank" two-tier credit system. This innovation made the credit basis of the pound sterling no longer solely dependent on precious metal reserves, but also incorporated national credit and bank credit, laying the groundwork for the pound sterling's subsequent internationalization [8].

4. Reform and Expansion: Global Monetary Dominance under the Industrial Revolution and Colonial Expansion

In the 1760s, the Industrial Revolution rose in Britain, making Britain the world's first industrialized country. The status of "world's factory" also provided a solid material foundation for the pound sterling's internationalization [9]. During the Industrial Revolution, the output of Britain's cotton textile, iron and steel, coal, and other industries leaped to first place in the world. The goods it produced dominated the global market by virtue of price advantages. When other countries traded with Britain, they had to accept the pound sterling as the settlement currency. By the mid-19th century, Britain's foreign trade volume accounted for more than 25% of the total global trade volume, and the pound sterling also became the most primary settlement currency in global trade [1].

The formal establishment of the gold standard system was the key symbol of the formation of the pound sterling's hegemony. In 1816, the British Parliament promulgated the "Gold Standard Act," which clearly stipulated that gold was the sole benchmark of value for the pound sterling, with 1 pound convertible to 7.322 grams of pure gold, while silver currency was downgraded to auxiliary currency. In 1821, Britain further announced that the pound sterling could be freely exchanged for gold [6]. The gold standard system gave the pound sterling a stable and transparent value basis, solved the problem of currency value fluctuations under the previous bimetallic system, and greatly enhanced the creditworthiness of the pound sterling in the international market. Other countries, in order to facilitate trade with Britain, also followed Britain's example by implementing the gold standard, gradually forming a global monetary system with the pound sterling at its core and gold as its foundation. The prototype of the "Sterling Area" also emerged at this time.

The expansion of the global trade network and the establishment of the colonial system further consolidated the strong position of the pound sterling. Since the 19th century, Britain, through colonial expansion, brought vast regions such as India, Canada, and Australia into its own colonial system. These colonies were forced to use the pound sterling as their official currency and also held most of their foreign exchange reserves in London banks. By 1914, Britain's total overseas investment reached 4 billion pounds, accounting for more than 50% of the world's total overseas investment. Most of these investments were denominated and settled in pounds sterling. London, as the issuing center of the pound sterling and the global financial center, aggregated funds from all over the world and became an important hub for global capital flows [9].

During this period, the influence of the pound sterling was not only reflected in currency circulation, but it also constructed a global economic order with the pound sterling at its core. Under the gold standard system, other countries' monetary policies had to depend on Britain. In order to maintain a fixed exchange rate between their own currencies and the pound sterling, countries had to reserve sufficient pounds, and their monetary policies also had to remain consistent with the interest rate adjustments of the Bank of England. This "center-periphery" monetary pattern allowed Britain to influence the global economy by adjusting interest rates, controlling gold flows, etc., and the pound sterling also became an important tool for Britain to maintain its global hegemony. By the eve of the outbreak of World War I in 1914, the global hegemony of the pound sterling reached its peak [1].

5. Shock and Decline: The Two World Wars and the Collapse of the Pound Sterling's Dominant Position

The outbreak of World War I became the key turning point for the pound sterling's hegemony, from prosperity to decline. The enormous consumption brought by the war gradually disintegrated the foundations for maintaining the pound sterling's hegemony from three aspects: the economic basis, monetary credit, and the global landscape. During the war, in order to support huge military expenditures, Britain broke the restrictions on currency issuance under the gold standard system, suspended the free exchange of pounds for gold, and covered its fiscal deficit by massively increasing the issuance of paper money [10]. From 1914-1918, Britain's money supply surged from 700 million

pounds to 2.3 billion pounds, an increase of more than 3-fold in just four years, which directly triggered severe inflation. By the end of the war in 1918, the domestic purchasing power of the pound sterling had fallen by nearly 50% compared to before the war; in the international market, because Britain's export trade stagnated and import demand surged, the exchange price of the pound sterling against gold also quietly fell by about 1/3, and monetary credit began an irreversible decline.

The war's blow to Britain's economic strength was also severe. Britain's industrial production was greatly damaged during the war. Many factories were requisitioned to produce military supplies, and the production capacity of civilian industries dropped significantly, leading to a huge balance of payments deficit of 1.3 billion pounds. In order to balance its international payments and repay war debts, Britain had to sell off overseas assets in large quantities. The total amount of overseas investment fell from 4 billion pounds in 1914 to 3 billion pounds in 1919, and its status as the world's largest creditor nation also became precarious. More critically, during the war, countries began to reduce their pound sterling reserves, turning instead to gold or US dollars for settlement. The proportion of the pound sterling in global trade settlement dropped significantly [10], and the previous "center-periphery" monetary pattern also began to loosen.

After World War I, the British government made the decision to restore the pre-war gold standard exchange rate, which further exacerbated the crisis of the pound sterling. In 1925, the then Chancellor of the Exchequer, Churchill, announced the re-pegging of the pound sterling exchange rate to the pre-war level of 1 pound to 4.86 US dollars, intending to re-establish the hegemonic status of the pound sterling by restoring monetary credit [11]. But at that time, the British economy had already been severely damaged, and the relative strength compared to the United States had fundamentally changed. For example, in 1925, the US industrial output accounted for 45% of the global total, while Britain's accounted for only 14%. Under the circumstance of unrecovered economic strength, forcibly maintaining an overvalued exchange rate caused British goods to lose their price advantage in the international market. Export trade remained sluggish; from 1925-1931, Britain's export value decreased by an average of 3.2% annually, the unemployment rate remained above 10% for a long period, and the domestic economy fell into a six-year stagnation [6].

At the same time, the continuous outflow of international capital became the last straw that broke the pound sterling. Because the sterling exchange rate was overvalued, the market generally believed that the pound would devalue, and a large amount of international capital began to withdraw from London, turning to US dollar assets. After the outbreak of the Great Depression in 1929, this trend became even more pronounced. Britain's gold reserves fell from 120 million ounces in 1929 to 60 million ounces in 1931. In September 1931, facing increasingly severe capital flight and depleted gold reserves, the British government had to announce its abandonment of the gold standard again, allowing the pound sterling to float freely [11]. This event marked the official disintegration of the pound sterling's global hegemony, and the global monetary system began to enter an era of mutual competition between the "pound sterling - US dollar".

World War II completely ended the hegemonic status of the pound sterling, causing it to be gradually marginalized. During the war, Britain once again fell into a cycle of massive fiscal deficits and excessive currency issuance. From 1939-1945, Britain's money supply increased from 2.7 billion pounds to 7.2 billion pounds. More seriously, Britain completely transformed into a debtor nation during the war: in order to raise war materials, Britain borrowed 31 billion US dollars from the United States and 3 billion pounds from Commonwealth countries. By the end of the war in 1945, its total overseas debt was as high as 34 billion US dollars, while its gold reserves were only 1 billion US dollars, leaving it completely unable to support currency convertibility [12].

In stark contrast to Britain's decline was the rise of the United States. During World War II, the United States provided a large amount of materials to the Allies through the "Lend-Lease Act," becoming the world's largest commodity exporter and creditor nation. Its gold reserves increased from 14.5 billion US dollars in 1939 to 20 billion US dollars in 1945, accounting for 75% of the world's total gold reserves. Under such a comparison of strength, the US dollar had already become the de facto global dominant currency, and the establishment of the Bretton Woods system in 1944

institutionally established the hegemonic status of the US dollar [13]. This system stipulated that the US dollar was pegged to gold (1 ounce of gold = 35 US dollars), and other countries' currencies were pegged to the US dollar, implementing a fixed exchange rate system. The pound sterling was explicitly listed as a secondary reserve currency, and its exchange rate had to maintain a fixed ratio with the US dollar.

The establishment of the Bretton Woods system meant that the pound sterling completely lost its position as the core of the global monetary system, and the disintegration of the Sterling Area further accelerated this process. After World War II, Britain, in order to maintain the existence of the Sterling Area, mandatorily required colonies and Commonwealth countries to continue settling in pounds sterling and also restricted their free exchange of foreign currency, but this policy was met with resistance from various countries [14]. By the 1950s, countries like Australia and Canada also successively abandoned settlement in pounds sterling, and the scope of the Sterling Area continuously shrank. By 1958, the proportion of the pound sterling in global foreign exchange reserves had dropped significantly, while the proportion of the US dollar had risen to 56%. The transfer of global monetary hegemony was finally completed.

6. Adjustment and Transformation: The Post-War Dilemma and Modern Positioning of the Pound Sterling

After World War II, the British economy fell into weakness, the wartime foreign exchange control policies became unsustainable, and the international credit of the pound sterling continued to decline. In 1949 and 1967, the pound sterling underwent two major devaluations, further weakening its attractiveness to global investors and trade partners. The Sterling Area, previously established to save the pound sterling's influence, also gradually disintegrated due to member countries' dissatisfaction with the "freezing of sterling reserves." Countries left the system or turned to US dollar settlement one after another. By the 1970s, the Sterling Area existed in name only, and the pound sterling completely lost its dominant position as a regional currency [14].

Entering the 1970s, Britain officially abandoned the fixed exchange rate system in 1972. The pound sterling thereafter entered an era of free floating, and its exchange rate began to fluctuate frequently with factors such as international market supply and demand, and economic data. In 1973, Britain joined the European Economic Community (later developed into the EU). Although it never joined the Eurozone, its economy became deeply tied to the Eurozone, and the pound sterling's exchange rate became increasingly significantly affected by the Euro's movements. In the 1980s, the Thatcher government implemented financial liberalization policies, and the City of London was revitalized, which also allowed the pound sterling to maintain a certain influence in the international financial market. During this period, although the pound sterling still retained its status as a major global reserve currency, its share in the foreign exchange reserves of various central banks was far lower than that of the US dollar and the Euro [1].

Entering the 21st century, the pound sterling has faced multiple shocks such as the rise of the Euro, the 2008 financial crisis, and Brexit [15], but it has still shown a certain resilience: by adhering to monetary sovereignty, it has avoided the risks of the Eurozone; by relying on financial innovation, it has slowly restored exchange rate stability. To this day, the pound sterling is still an important global settlement currency and reserve currency [1].

7. Discussion

The history of the pound sterling provides rich material for discussion on this.

First, monetary hegemony is essentially an extension of a nation's comprehensive strength. The ebb and flow of national strength directly determine a currency's international status. The establishment of the pound sterling's hegemony in the 19th century relied on Britain's industrial advantage, maritime hegemony, and financial center status; its decline in the 20th century was due to

the exhaustion of national power by two World Wars, the independence of overseas colonies, and the rise of the US economy [2, 9]. This historical law has practical significance for understanding the challenges facing the US dollar's hegemony today. Although the US dollar's position is currently stable, the economic fundamentals behind it are being continuously challenged by emerging economies [4]. The history of the pound sterling warns us that no hegemony is eternal.

Second, a stable credit anchor is the foundation of monetary hegemony. The gold standard system provided the 19th-century value anchor for the pound sterling, enabling it to leap forward to become the global settlement currency [6]; whereas in the 20th century, abandoning the gold standard and multiple devaluations directly weakened international trust. This shows that "credit is the lifeline of currency"; whether in the era of metallic currency or paper money, a stable value commitment is the premise for a currency to be widely accepted. In the post-Bretton Woods system era, although the US dollar is decoupled from gold, its hegemonic status relies to a large extent on global trust in US national debt (i.e., national credit) [13]. The process of the disintegration of the pound sterling's credit shows that once national credit is shaken by war or debt, monetary hegemony will also be difficult to sustain.

Furthermore, monetary hegemony must adapt to the evolution of the global landscape; clinging to old models will eventually be eliminated by the times. The pound sterling's ability to dominate the global monetary system in the 19th century was not only due to Britain's own strong power, but also because it fitted the global landscape of that time, which was dominated by colonial expansion and commodity trade. But after entering the 20th century, the global landscape gradually shifted towards "equal trade among sovereign nations," the colonial system disintegrated, and emerging economies rose, yet Britain still attempted to preserve its hegemony through old methods such as maintaining the Sterling Area and forcing colonies to use the pound sterling, ignoring the changes in the global economic structure [14]. This reflects the "path dependence of hegemony" [6]. In contrast, the US dollar, precisely by conforming to the post-World War II global demand for a stable monetary anchor, successfully took over monetary hegemony by binding the US dollar to gold and global trade through the Bretton Woods system [13]. This illustrates that monetary hegemony is not an unchanging "iron throne"; it must be able to provide stable public goods to the world (such as a stable currency value and sufficient liquidity).

8. Conclusion

In summary, this paper, through a review of the millennial history of the pound sterling, especially the institutional analysis of its hegemony's rise and fall over the past two centuries, reiterates the multidimensional characteristics of monetary hegemony. The story of the pound sterling is not a simple "tragedy of decline," but an "epic of adaptation" concerning institutional innovation, the ebb and flow of national power, and interaction with the global landscape. Its transition from the silver standard to the gold standard, and then to the post-war managed float and eventual free float, every step of transformation was a passive or active response to changes in the internal and external environment. Although the pound sterling is no longer the global hegemonic currency, by virtue of the deep heritage of the City of London and Britain's relatively independent monetary policy, it still maintains an important international monetary status in the 21st century today. The evolutionary course of the pound sterling proves that a currency's international role is ultimately determined jointly by its economic strength, institutional resilience, and its adaptability in global governance.

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