The Social Consequences of a Return to Gold :

An Analysis of Certain Current Proposals for an International Monetary Standard

by

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In the years following the Napoleonic wars an important section of those working for the cause of social justice—more particularly in England—paid great attention and attached great hopes to the possibility of monetary reform. Robert Owen, who at the Congress of Vienna put forward the first sketch of what is now the International Labour Organisation, was among the many who wrote and worked on behalf of a more efficient currency and banking system. During the long depression of the seventies and throughout the bimetallist controversy, interest in this subject was again acute : but from the turn of the century, with the stimulus to trade afforded by an upward trend in world prices, there was a not unnatural reaction, and interest in monetary problems suffered a temporary lapse.

During the troubled decade succeeding the World War there was a notable revival in the movement for monetary reform. With the onset of industrial depression in the autumn of 1929 and the subsequent monetary collapse in 1931, the relevance of monetary questions to social conditions became generally recognised. The preoccupation of the 1932 Session of the International Labour Conference with the inter-relationship between financial, economic and social questions afforded striking evidence of the movement of opinion in this direction.[1]

It is now common ground that, with the gold standard operative in some half-dozen countries only, a reshaping of the world's monetary system has become imperative. One of the chief tasks of the forthcoming International Conference on Monetary and Economic Questions will undoubtedly lie in this field. In the

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[1] Cf. *International Labour Review*, Vol. XXVI. No. 2, Aug. 1932, pp. 199-223 : „Wold Economic Reconstruction: An Analysis of the Economic Resolution adopted by the International Labour Conference", by P. W. MARTIN.

ensuing analysis an attempt is made to clarify certain of the major issues on which decisions must be taken and to indicate their relevance to the work of the International Labour Organisation.

FOR well over a century the gold standard has been the monetary system *par excellence*. At a time when the developing world community required above all else a single monetary standard, and a reasonably stable one, it supplied that need. With its aid an expansion of world commerce unparalleled in history was rendered possible. Its temporary abandonment during the war period, far from lowering its prestige, served but to stimulate a universal determination to restore it with the shortest possible delay. By 1925 the return movement had begun in earnest ; by 1928 it was virtually achieved. The world was a gold standard world more completely than ever before. Three years later the system so laboriously restored was in ruins. At the present time six countries only can be considered as applying the gold standard—the United States of America, France, Belgium, the Netherlands, Switzerland, and the Union of South Africa.[1] The remaining countries have either definitely abandoned it or have imposed such regulations upon the free movement of money across their respective frontiers that the system is in more or less complete abeyance.

The disastrous influence this has exercised and is still exercising upon international trade and business confidence—and through them upon living and working conditions—can hardly be exaggerated. The index of production in the chief industrial countries, already abnormally low, has fallen on the average some 10-15 per cent. below the 1931 level ; gold prices at wholesale, likewise already much depressed, have declined about 12 per cent. in the same period ; everywhere the frontiers have been closed by tariff, quota and exchange restrictions, so that the index of the value of international trade, which was 19 per cent. lower in 1930 than in 1929, and 28 per cent. lower in 1931 than in 1930, declined 34 per cent. in the first six months of 1932 as compared with the corresponding period in the previous year. At the same time, unemployment has increased to an altogether abnormal extent—in Europe and North America alone the

[1] At the time of going to press the position of South Africa is uncertain, but it would appear that it can no longer be regarded as operating the gold standard in its entirety.

number unemployed is conservatively estimated at 20-25 millions; the earnings of labour have been reduced—the index of payrolls in the United States, for instance, has fallen in the course of the past twelve months by over 35 per cent. ; and net profits of manufacturing companies in that country have declined to approximately one tenth of what they were in 1931, and one twentieth of 1930 figures. [1]

That chaotic monetary conditions are largely responsible for this *débâcle* is generally admitted. Opinion is likewise unanimous that until some reshaping of the monetary system has been effected, there is little prospect of recovery. It is, however, very difficult to foresee what form this reshaping of the monetary system is likely to take. The one point on which there would appear to be a fair degree of certainty is that, in spite of present difficulties, a renewed attempt will eventually be made to work some system having gold as a basis. This, of course, does not necessarily imply that the adoption of a non-metallic system is impossible—still less that it is intrinsically undesirable. But it is becoming increasingly evident that those persons most influential in deciding the world's monetary policy are not at present prepared to experiment with a system wholly divorced from gold. [2] At some later stage the various countries may be driven to adopt other methods, but for the time being the choice lies, in practice, between the various forms of the gold standard.

On the other hand, this predilection for a gold basis to the monetary system does not by any means settle the question. It is not always recognised that the various possible forms of the gold standard differ greatly between themselves. There is, indeed, a far wider gap between the so-called "automatic" gold standard and a thoroughgoing "managed" gold standard, than there is between the managed standard and some monetary system divorced from gold. The really vital decision that has

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[1] For statistics cited in this paragraph cf. LEAGUE OF NATIONS : *Monthly Bulletin of Statistics* and *Review of World Trade, 1931 and 1932* (first half) ; INTERNATIONAL LABOUR OFFICE : *Industrial and Labour Information* ; *Federal Reserve Bulletin* ; and SECOND FEDERAL RESERVE DISTRICT : *Monthly Review*.

[2] Cf. the resolution of the Bank for International Settlements, 11 July 1932 : "The Board of the Bank for International Settlements, recognising the necessity of the re-establishment between nations of a monetary system with a common basis, in order to facilitate international settlements under more stable and secure conditions, is unanimously of opinion that the gold standard remains the best available monetary mechanism and the one best suited to make possible the free flow of world trade and of international financing ; it is desirable, therefore, to prepare all the necessary measures for the re-establishment of the functioning of the gold standard."

to be taken in determining the future monetary system is not so much whether gold shall be reinstated but what part it shall play.

The ensuing analysis represents an attempt to facilitate the task of arriving at some decision on this question. It deals, in turn, with the fundamental factors responsible for the breakdown of the so-called " automatic " gold standard; the various characteristic forms of " managed " gold standard that are now being put forward to replace it; and the social consequences that may be anticipated as a result of the application of these systems. The object in view is not so much to reach final conclusions on the questions at issue as to clarify these issues and to bring together at least some of the more important considerations which require to be taken into account.

The " Automatic " Gold Standard

The reasons for the breakdown of the so-called " automatic " gold standard in the autumn of 1931 are many and confused; but the fundamental factors responsible are now fairly clear.

The pre-war gold standard, though international in scope, was based on no specific international agreement. It was able to survive, and to function successfully over an extended period, chiefly because the policy which suited Great Britain—the outstanding industrial, financial, trading and creditor nation of the time—was conducive to the maintenance of gold as a world currency. Throughout the ten or twenty years preceding the World War, Great Britain at any moment, by calling in her foreign investments, could, in theory, have drawn into her coffers the great mass of the world's stock of monetary gold. In point of fact, she followed precisely the opposite policy. While selling abroad in large volume she permitted the free entry of goods in exchange. Furthermore, British investors were always ready to seek increased profits abroad, so that the balances that would otherwise have tended to accumulate within the country were regularly lent overseas. Under these circumstances, the " automatic " gold standard was in fact not so much an international system as a British system applied internationally ; and, as such, it worked.

Since the World War the United States and France have shared with Great Britain the privilege and burden of the international application of the gold standard ; but both in their tariff and in their investment policies these two countries follow radically different lines from those followed in pre-war Britain. They do not permit the free entry of goods and they do not consistently invest abroad on long term to the full extent of their resources. Consequently, their position as creditor countries, notably on reparation and war debt accounts, has led to a flow of gold into their reserves at the expense of the reserves of other countries. The diagram on the following page shows the progressive increase in the sum total of gold held by the central banks of these two countries during recent years. In addition, large gold hoards are known to be in private hands, in both the United States and France. Roughly speaking, each of these countries now holds about a third of the world's monetary gold, leaving the other fifty or more countries just over a third on which to do their business.

A second and closely related factor tending to make the "automatic" gold standard unworkable in the post-war world is that it is no longer permitted to have its "automatic" effect. According to the classical theory of the gold standard, a country which is living beyond its means—typically, importing more than it is exporting—will sooner or later have to make good the difference by paying away gold. This will bring about a monetary stringency in the country in question which, by forcing down money incomes, prices and costs, will discourage its import trade and encourage its exports. Conversely, the countries receiving the gold will expand their monetary circulation and the consequent increase in money incomes, prices and costs will tend to encourage their imports and discourage their exports ; this process continuing until imports and exports find a new equilibrium.

There is some doubt whether this system ever worked strictly according to theory, but there is no doubt that of recent years positive steps have been taken in various countries to prevent it from working. An efflux or an influx of gold is not permitted to have its full effect upon the monetary system of the country concerned. Furthermore, the monetary system itself no longer dominates the price and cost position. In this way, contrary to the whole theory of the "automatic" gold standard, one country may lose gold without any marked effect upon its economy, while another may accumulate gold rapidly and at the same time have its price level rapidly decline (cf. the diagram on the following page). Under such conditions it is only a matter of time and circumstances for the system to collapse.

FIGURE I. WHOLESALE PRICES IN FRANCE AND THE UNITED STATES.

(Annual averages, 1924-1932. Base: 1913 = 100.)

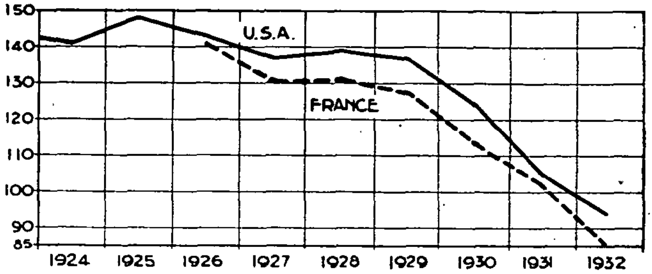
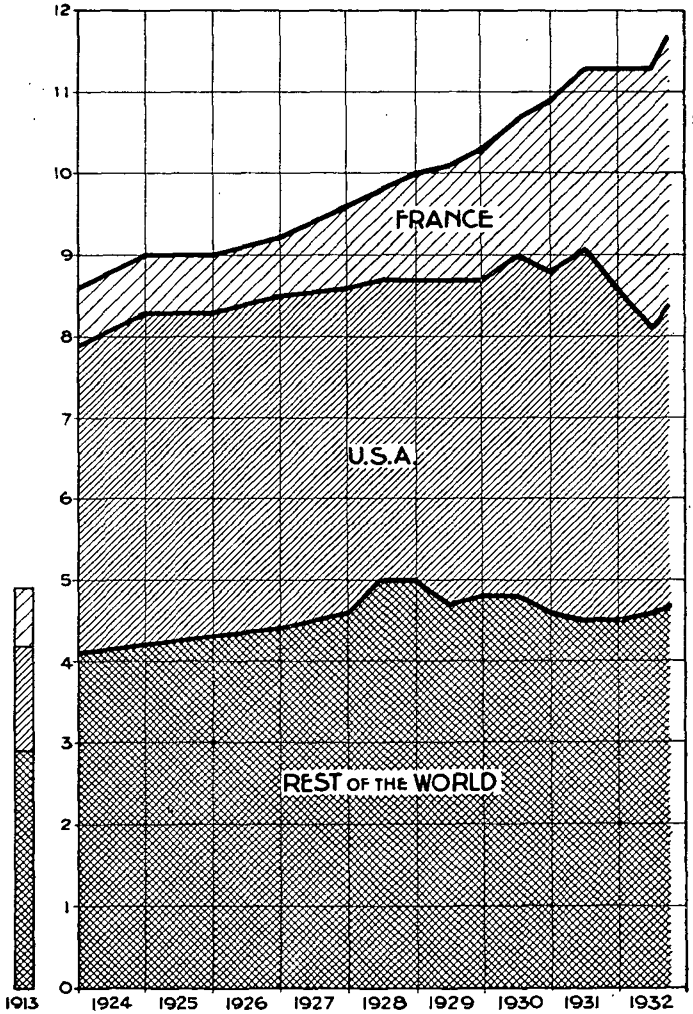


FIGURE II. GOLD RESERVES OF CENTRAL BANKS AND GOVERNMENTS, 1924-1932

(In thousand million dollars.)



Sources: See footnote on opposite page.

There is, moreover, a powerful factor, come into full operation only during the past few years, making such collapse far more likely and far more sudden than it would otherwise be. Under modern conditions the transfer of capital from one country to another can be easily and rapidly effected, so that a mere rumour may result in progressive sales of securities and withdrawals of short-term balances, leading in turn to a large-scale expatriation of capital, against which the most massive gold reserve in the world is powerless. Thus, although the United States held at the time well over one-third of the world's gold, it was, according to the statement of its competent authorities, very nearly driven off the gold standard in the first half of 1932. At the present time countries whose central banks can cover their sight liabilities up to 100 per cent. in gold are notoriously afraid of a similar contingency arising. Admittedly the conditions are exceptional; but it must nevertheless be recognised that the facility with which capital can move from one country to another—the fact that such a thing as a " flight " from a currency is possible—has gravely impaired the working of any monetary system of the pre-war type.

It should perhaps be emphasised that in thus drawing attention to the phenomena fundamentally responsible for the breakdown of the " automatic " gold standard, there is no intention either of condemning or of approving the policies followed by certain of the leading countries. In this whole question, indeed, attempts to apportion responsibility are for the most part beside the point. The essential fact that requires to be brought out is that, quite apart from whether these various policies were right or wrong in themselves, they were not compatible with the " automatic " gold standard. If this standard is to work, creditor countries must use gold, not hoard it; gold movements must be permitted to have their full effect upon the monetary mechanism; and prices and costs must be made to respond. Whether under these conditions the " automatic " gold standard is worth the working is of course another question. But to endeavour to work

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Sources of diagrams on opposite page:

Wholesale Prices: LEAGUE OF NATIONS: *Monthly Bulletin of Statistics*, Nov. 1932. (France: *Statistique générale de la France* index of gold prices; United States: Bureau of Labour Statistics.) The 1932 figure represents in the case of France the average for January-November inclusive, and in the case of the United States the average for January-October inclusive.

Gold Reserves: *Federal Reserve Bulletin* (Washington), May and Nov. 1932.

it with one hand and to prevent it working with the other is obviously a policy doomed to failure.

Particularly is it not practicable when, as in recent years, there are a number of special features—trade restrictions, reparation payments and war debts being among the most important—putting an additional strain upon the mechanism. Without these special features the restored gold standard might have lasted more than the three years it actually endured. But while this is true, it cannot be too strongly emphasised that the defects in this system, as it is now applied, are not accidental and temporary but—unless the countries most concerned are ready to make drastic changes in their financial, economic and social policies—fundamental and permanent.

In addition to these major factors basic to the breakdown of the "automatic" gold standard there are certain other features of the system which need to be taken into account in any reshaping of the monetary mechanism. The great positive achievement of the "automatic" gold standard was, of course, the approximate stabilisation of exchange rates between the various countries. That the pound sterling should always be worth approximately the same number of dollars, that the French franc bore an approximately stable relation to the German mark, and so on throughout the gold standard countries, was undoubtedly a great convenience to international trade and a factor of stability in industry generally. Success in this connection was, however, accompanied by two major disadvantages of another kind.

In the first place, the commodity price level was liable to fluctuate widely, in the course of a single decade or less. Owing to such chance circumstances as the discovery of new gold mines, or the spread of the gold standard to other countries, the same gold coin might buy only half as much—or double as much—as a few years before. Under these conditions, a country's currency was an "honest" currency for dentists, jewellers and others who wished to buy gold, but for all those whose chief use for money was eventually to buy goods, it was not so much a currency as a lottery.

In the second place, the banking technique associated with the "automatic" gold standard was liable to have the most untoward consequences. Whenever the volume of effective demand for goods in general tended to exceed the volume of goods being offered for sale, thereby forcing up prices and sowing the seeds of an inflationary boom, the banks, provided they had sufficient gold reserves, instead of restraining this tendency, proceeded to enlarge credit and so accentuate the upward movement. Conversely, whenever gold reserves were coming near to whatever conventional or legal minimum the banks maintained, or when for any reason effective demand was failing to keep pace with production, the banks were liable to restrict credit, thereby precipitating the decline in trade. In this way the " automatic " gold standard and the banking technique associated with it played an important if incalculable part in exaggerating and sometimes actually promoting the alternate booms and depressions to which capitalistic methods of production have shown themselves to be subject.

In sum, therefore, the monetary system destined to succeed the "automatic" gold standard has three main problems to solve : the problem of repairing the break-down of the international standard and securing approximate exchange stability ; the problem of achieving a larger measure of price stability ; and the problem of so influencing the volume of buying of goods in general as to ensure that industry shall at all times be reasonably fully employed. Each of these problems calls for the adoption of new methods. International co-operation of a more definite and organised kind than anything yet known is essential if exchange stability is to be secured and, indeed, if any *international* monetary system is to function at all. A greater measure of price stability can be achieved only if monetary policy is freed from the domination of fortuitous changes in the gold supply and is consciously directed to the maintenance of greater stability in the unit of value. The problem of keeping the volume of buying adequate but not excessive calls not only for a new aim but for a new technique widely different from anything so far attempted.

It is with these three problems that the principal forms of the gold standard now under consideration are designed to deal.

The Report of the Gold Delegation

The first of these systems to which attention may conveniently be directed is that embodied in the Report of the Gold Delegation of the Financial Committee of the League of Nations.[1]

The type of gold standard recommended by the Gold Delegation derives directly from the " automatic " gold standard. At

[1] League of Nations : *Report of the Gold Delegation of the Financial Committee.* Geneva, June 1932.

the same time it differs from it in one fundamental respect—it is essentially a " managed " standard. This is not to say that a large amount of management did not enter into the so-called " automatic " system. It undoubtedly did. But the Gold Delegation lays down far more specific aims and specific methods than the " automatic " gold standard ever admitted ; and, moreover, implies, if it does not actually prescribe, that these aims and methods should be consciously pursued on a world scale.

Thus, the Gold Delegation, while in favour of a return to the " automatic " working of the gold standard, recommends that henceforward the influence of gold movements upon prices and costs should be not only permitted but deliberately engineered.

> As a general rule, gold movements should not be prevented from making their influence felt both in the country losing gold and in the country receiving gold. Not only should these movements not be prevented from exercising their influence, but their working should be reinforced by other means — especially by changes in the discount rates and by open-market operations — when the disequilibria of which the gold movements give evidence cannot be removed merely by the effects of these movements. [1]

Whether or not this proposal should be considered as entailing specific international agreement is left uncertain. But in either case, whether specific international agreement is envisaged or not, certain difficulties are likely to arise. If no international agreement were made, then it is hard to believe that this injunction would be put into effect. At the present time, for instance, it would presumably mean that the countries with swollen gold stocks would have to take deliberate action to force up their price levels—to the detriment of their export trade—while countries losing gold or having inadequate gold stocks would be expected to deepen depression still further by aggressive deflation. If, on the other hand, international agreement to carry out this policy *is* intended, it is not easy to imagine how it would be possible to decide whether or not the agreement was being kept. The countries losing gold would be likely to complain that the countries gaining gold were not inflating sufficiently rapidly, and the countries gaining gold would reproach the countries losing gold for their ineffective efforts to deflate. The prospect of international chicanery and recrimination thus opened up bodes ill for the success of any such measure.

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[1] *Op. cit.*, p. 24.

The second major proposal concerns the methods for dealing with changes in the purchasing power of gold, i.e. the fluctuations in the commodity price level. Here also the action to be taken is not very explicitly laid down.

> The stability of the price level which we envisage as being practically possible is a relative, but not an absolute, stability of wholesale commodity prices as measured by their movement over a long series of years. . . . We consider that monetary policy designed to avoid violent fluctuations of purchasing power should be based upon a variety of considerations which we mention later (paragraph 196) [1], interpreted by the judgment of central bankers and expressed in national policies arrived at after due consideration and co-operative consultation concerning their international repercussions. Movements of the index numbers of wholesale prices should be used, not as a single determinant criterion of immediate policy, but as one among many factors to be taken into consideration.
> The relative stability of these index numbers of wholesale commodity prices over a term of years will, however, provide a test of the success of the policies that have been pursued. [2]

The signatories to the Note of Dissent appended to the Report of the Gold Delegation remark that they " are not clear what is intended by the reference to relativity " ; and unquestionably, to anyone who reads the section of the Gold Delegation Report dealing with this question of price stability (Section XIV), the difficulty of obtaining any definite idea of what it is proposed to do, or how it is proposed to do it, will be apparent. In this case also it is not laid down whether any specific international agreement is intended, or whether the obligation to preserve such " relative " price stability is to be left to each individual country to interpret and act upon according to its lights.

The third main recommendation of the Gold Delegation is in many ways the most interesting and important, as it is also the most specific. Its aim is a freer monetary position than at present obtains.

> We have already drawn attention . . . to the effect of recent banking legislation in raising and making more rigid the reserve requirements of many Central Banks. Under the system most generally

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[1] The paragraph in question reads as follows : " With reference to the other indices which should be taken as a guide to monetary policy, varying opinions, in our present state of knowledge, are likely to be held. They are all those indices which reflect business activity — the market rates of discount, the yield of bonds, the prices of different classes of shares, the value of building permits, the debits to individual deposit accounts, the production of various primary products, the international movements of capital, etc. The significance of these will vary from country to country and from epoch to epoch. No set rules for their interpretation can be laid down. "

[2] *Op. cit.*, pp. 48-49.

in force to-day, many of them are compelled, either absolutely or subject to certain penalties, to keep a minimum ratio between their reserves in gold (or gold and foreign assets) and their obligations at sight. . . . In our opinion, this whole system of defined ratios has proved itself in the light of the special circumstances of post-war years to be too rigid and inadaptable. . . . We are of opinion that it would be advantageous, as we argued in our first Interim Report, to reduce the reserve ratios from their present high levels. If this were done, the immediate effect would be to free the hands of the Central Banks by enlarging the free margin of their gold reserves which they can use for international payments without endangering the legal minimum ratio. [1]

As will be seen, there is no indication how this freer monetary position is to be used, but manifestly it would tend to give more play to judgment and discretion in monetary and banking policy, since there would be less risk of a country being forced to the position where judgment and discretion must give way to the necessity of preserving a certain minimum legal gold reserve.

In effect, therefore, the type of gold standard advocated in the Gold Delegation Report makes positive efforts to deal with the three main points that must be covered by a monetary system making any pretence to completeness. Exchange stability, it considers, can best be secured by adjustment of prices and costs as dictated by gold movements. In this respect it is simply the " automatic " gold standard brought up to date. But, in addition to this, it aims at some measure of price stability and it endeavours to secure a freer monetary position which would at least reduce the danger of monetary factors exercising an actively harmful influence upon business activity.

Stability of the Price Level

The second outstanding type of monetary system based upon gold is that which aims primarily at price stability. It has not been described from the international point of view in such detail as the system advocated by the Gold Delegation, but its essential features are sufficiently clear. [2] Starting from the present stage of extreme depression, it would have the various countries take

[1] *Ibid.*, pp. 52-53.

[2] The Report of the British Committee on Finance and Industry (the Macmillan Committee), the Note of Dissent appended to the Report of the Gold Delegation and, possibly, the Report of the Financial and Monetary Committee of the Ottawa Conference may all be regarded as advocating a line of action more or less in conformity with this general type of monetary system.

immediate steps to raise their respective price levels until business was again on a remunerative basis. Once this was done, some sort of international monetary agreement would be concluded by which each signatory State agreed to keep its commodity price level approximately stable. The methods to be used in bringing about this initial rise and subsequent stabilisation of the price level vary greatly as to detail ; but they all involve some actual or potential increase in the total quantity of currency and credit in circulation, and in making the necessary adjustments from time to time the discount rate and open-market operations would presumably be the principal instruments employed.

While price stability is thus the ultimate aim of the system, exchange stability and the maintenance of effective demand are not neglected. In the words of the Macmillan Report on Finance and Industry, the aim should be " to regulate the volume and price of bank credit . . . so as to maintain output power and employment at the maximum compatible with adherence to the international gold standard and with maintenance of the stability of the international price level ".

The aims in view are comprehensive, but it may be doubted whether the means suggested to achieve these ends are wholly adequate. To take first the question of exchange stability, it would seem likely that so long as the various countries held their respective price levels approximately stable, fluctuations in the exchange rates between the countries in question would tend to be less frequent and less violent than if price levels varied considerably. At the same time circumstances might well arise tending to bring about occasional fluctuations or long-period movements in equilibrium parities. Tariff changes ; changes in the direction and volume of foreign investment ; unequal rates of increase in productivity in undertakings catering for the home market and for the foreign market respectively ; variations as between different countries in the rates of increase of productivity ; these and other factors would undoubtedly tend to upset such degree of exchange stability as might be achieved. Nevertheless, all things considered, there is much to be said for the view that approximately stable price levels in the various countries would provide at least as sound a basis for exchange stability as would the recommendation put forward by the Gold Delegation, based upon the working of the old " automatic " gold standard. A stable price level, carefully defined, is at least a fairly objective criterion, while an undertaking, implicit or explicit, to make gold movements have their full effect upon the price and cost situation is susceptible of many interpretations.

On the whole, therefore, far from being incompatible with approximate exchange stability, the maintenance of reasonably stable price levels, supplemented from time to time by any revision of parities rendered necessary by the factors just enumerated, may thus prove as effective a means as any yet devised to keep the various currencies in steady relation one to the other. Criticism of this type of gold standard on the score of failure to ensure exchange stability is consequently not conclusive. There is, however, stronger reason to doubt whether, with manipulation of the discount rate and open market operations as its principal instruments, it would be successful in sustaining industrial activity on all occasions. In particular, experience would not appear to warrant the belief that these instruments alone are capable of restoring the volume of buying when once a depression has set in. It is one thing to make credit cheap by lowering the discount rate, but it is quite another at such a time to find sound and willing borrowers ready to take it up. Again, by open market operations it is possible to put additional credit and currency into circulation. But, as events in the United States have shown, this additional credit and currency may pass out of circulation almost as rapidly as it goes in [1]; and, if it remains in circulation, is inherently more likely to bring about a security market boom than to affect the volume of demand for commodities. This is not to say that such action is useless. On the contrary, it can be and sometimes is extremely valuable. Cheap and plentiful credit unquestionably helps to make a revival possible; but there is no assurance that it will revive and sustain the volume of buying when this latter is insufficient to keep industry reasonably fully employed. [2]

The Maintenance of Active Purchasing Power

The third main type of managed gold standard has this maintenance of the volume of buying and industrial activity as its

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[1] Cf. *Journal of the American Statistical Association*, Sept. 1932: "Gold, International Credits and Depression", by James Harvey Rogers.

[2] For a more detailed discussion of this question cf. *International Labour Review*, Vol. XXIV, No. 6, Dec. 1931: "Finance and Industry: The Macmillan Report as a Basis for International Action", by P. W. Martin, pp. 691-695.

principal object. The essential features of the system would appear to be that the various countries should enter into an agreement to take positive and direct measures to reinforce the present volume of buying of goods in general (producers' goods as well as consumers' goods) until prices are once again remunerative ; and after that, as a permanent policy, to adjust the stream of purchasing power coming upon the buying side of the market so as to sustain effective demand to the utmost extent possible short of giving rise to an upward movement of commodity prices.

As will be seen, this system differs from the one previously examined to some extent in the matter of aim—the insistence is upon sustaining the volume of buying as well as upon keeping the price level stable—but principally in the matter of technique. Instead of relying solely upon manipulation of the discount rate and upon open market operations, the maintenance of active purchasing power involves direct adjustment of the volume of buying of goods in general. If the volume of buying is insufficient to keep industry reasonably fully employed, steps must be taken to increase it—by reinforcing the stream of purchasing power coming into the hands of potential buyers of goods. If, on the contrary, the volume of buying is such as to threaten price inflation (i.e. an upward movement of the commodity price level), action must be taken to reduce the stream of purchasing power coming upon the buying side of the market. In short, the essential object is to keep up the volume of buying and hence the volume of employment, but always within the limit laid down by the condition that the price level must not rise. It is not intended, of course, that the price level should be the determinant of what action is appropriate at any particular moment. Far more sensitive indexes are available for this purpose and it is these indexes that the advocates of this third type of gold standard would use. The rôle played by the price level would be that of a boundary beyond which further reinforcement of active purchasing power would be undesirable, since, if the reinforcement were carried beyond this point, price stability, and with it the essential basis of exchange stability, would, it is held, be upset.

It is not easy to criticise this system adequately, for, although emergency proposals for maintaining active purchasing power have been put forward, no authoritative statements of the *permanent* measures to be taken have been elaborated. The emergency proposals having this end in view envisage the setting on foot of public works [1]—particularly in the creditor countries—the works in question to be financed in such a way as to bring about an increase either in the velocity or in the quantity of currency and credit in circulation, or preferably both. In this way, it is argued, the volume of demand for goods in general could be increased directly, since the purchasing power put into the hands of the public works contractors, and the men employed by them, would represent a net addition to the volume of buying of producers' and consumers' goods ; while the roads, parks, public buildings, etc., so produced would not, of course, be offered for sale. Such absolute reinforcement of purchasing power would be continued until industry was once again fairly fully employed and thereafter used to the extent necessary to keep the price level stable. [2]

Leaving on one side, for the moment, the question of how far such a measure can be looked upon as feasible, it is evident that the successful maintenance of active purchasing power would be far more powerful as an instrument of adjustment than the regulation of credit pure and simple ; and as such would permit of a greater measure of conscious direction of economic movements than would otherwise be possible. For instance, under present conditions a grossly inflationary boom on the security market, such as arose in the United States in 1927-1929, places a central bank in a grave dilemma. If it takes steps to reverse the movement before it has gone too far, it runs the risk of throwing industry as a whole into depression and being unable thereafter to take effective measures to bring about a revival. If, on the other hand, it permits the boom to run its course, it is likewise helpless in face of the ensuing depression. With means available for acting *directly* upon the volume of commodity buying, a country would not be in this embarrassment. For whichever course was pursued, the oncoming depression would be met by a reinforcement of the volume of buying of goods in general and the whole movement thereby checked and reversed—a course of action impossible under present conditions.

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[1] Cf. Addendum 1 to the Macmillan Report on Finance and Industry, signed by six of the members of the Committee ; the Economic Resolution adopted by the International Labour Conference, 30 April 1932 ; and various schemes put forward in the United States ; all of which have advocated measures along these general lines.

[2] For a brief description of this method, cf. *International Labour Review*, Vol. XXVI, No. 2, Aug. 1932 : " World Economic Reconstruction : An Analysis of the Economic Resolution adopted by the International Labour Conference ", by P. W. MARTIN, paras. 4-24.

From a wider point of view, also, the maintenance of active purchasing power would have the advantage of supplementing the price and cost mechanism which, under modern conditions, is too rigid to make the many adjustments that the classical economists expected of it. It is impossible in the present context to go into this question deeply, but it may be very briefly outlined.

Under the "automatic" gold standard every shock and strain to which the economic system was subject had to be borne by prices and costs alone. If the demand for coal was shrinking and the demand for oil increasing, prices and costs in the two industries must move to make the necessary adjustments. If a particular country got out of step with the rest of the world and was importing more than it could pay for by exports, prices and costs must again adjust themselves so as to correct this discrepancy. If gold production were declining and/or the productive capacity of industry were increasing more rapidly than new money could be put into circulation, again prices and costs must respond. If banks extended credit excessively and a sudden monetary stringency ensued, or if, for any reason, loss of confidence led to a falling-off in buying, once more it was prices and costs that had to move. This perpetual and many-sided strain upon the price and cost mechanism has had the consequence that might have been expected. These springs of the economic system have become stiff and set, and when they—or some more vital parts—eventually give way, the result is liable to be catastrophic. The successful maintenance of active purchasing power would introduce a new resiliency into the system. Although adjustments as between one industry and another and, to some extent, between one country and another, would still require to be made by the movement of prices and costs, the new instrument of monetary policy would act as a shock absorber for larger displacements arising from any general superabundance or deficiency of effective demand.

Great, however, as the advantages of such a system might be, it must be recognised that its actual application is likely to encounter a number of obstacles. How many and how considerable these would be, it is by no means easy to say, if only for the reason that the proposals so far advanced are obviously incomplete. It is clear, for example, that if approximate stability of the general price level is to be maintained at a time when productivity is increasing, some means must be devised to prevent the development of profit inflation and consequent investment booms and exchange fluctuations. Whether this could be achieved by some system which, while allowing a "normal"[1] return to enterprise, would ensure the rapid reflection of increased productivity in higher wages, is a possibility which would have to be examined. It would also seem necessary, in the elaboration of any permanent measures, to guard against certain other difficulties of the kind already noted in connection with the type of monetary system designed primarily to secure price stability.

The technical and administrative difficulties of making positive adjustments in the volume of buying of goods in general are likewise serious, though not, perhaps, insuperable. Were the treasury and banking authorities of the leading industrial and commercial countries—and, particularly, of the creditor countries—given a clear mandate to take such action, they might well be able to find a way. It is true that a number of the smaller countries whose monetary and financial organisation is as yet rudimentary would not be able to take any active part ; but with price levels in the economically important countries approximately stable and with the buying of goods in general in those countries regularly sustained, they would be likely to find their task of maintaining exchange stability much simpler than at present. This, of course, is not to say that the scientific adjustment of the volume of buying would be a simple matter. On the contrary, to be well done, it would call for the utmost skill a country could command. It would require, moreover, like any new policy, the development of a new technique, based on experience gradually accumulated and on information collected for its special purpose. Complete success could not be expected immediately ; but even a rough adjustment might represent a great improvement upon the fatalistic acceptance of the situation that has characterised world monetary policy during the past three years.

More serious, perhaps, than such technical difficulties are the psychological barriers and the opposition of vested interests which any new and striking proposal must overcome. For over ten years the evils of "inflation" have been preached with eloquence and zeal. Germany and other countries where currency

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[1] In the sense used by J. M. KEYNES (*Treatise on Money*, p. 125).

depreciation was carried to extreme lengths in the years following the World War have been held up as dreadful examples of what any departure from the strait and narrow path of financial rectitude must necessarily entail. Inflation has been represented as an insidious spirit, which creeps in unawares and can be exorcised only by the process of forcing prices to lower and still lower levels. In this way the very real peril of extreme currency depreciation has been, not exaggerated—to do that would be next to impossible—but misrepresented. It has been used to force the pendulum of public opinion to the opposite extreme, so that now in many countries any proposals, however conservative, for a positive monetary policy fall at once under the suspicion of being " inflationary ", even though their express purpose, once industrial activity has been resumed, may be to prevent the price level from rising.

On the conscious opposition of vested interests, and the automatic, if unconscious, barrier of habitual ways of thinking, it is, perhaps, unnecessary to dwell, since they are common obstacles to all new development. It would, however, be idle to expect that those who believe their interests better served by continuous deflation and those whose whole training and skill are in the administration of an earlier system would welcome without hesitation a radically different orientation of monetary policy.

The Probable Social Consequences

So much, then, for the main features of these three forms of the gold standard. It remains to emphasise the point to which this whole analysis must lead—the necessity to consider the social consequences of monetary measures. There is, indeed, no other criterion than this by which the various proposals can finally be judged. To speak of " sound " money is to beg the question. In monetary matters, as in every other sphere of public policy, the probable effect on social conditions, on the life and work of the great mass of the people, must be the final standard of " soundness ".

Recognition of this fact, while it should ensure that essential issues are not obscured by a maze of technicalities, will not in itself make the choice of monetary policy an easy matter. To say positively what would be the social consequences of adopting one or other of these systems is of course impossible. Quite apart from anything else, there is no means of telling how far such a system would work successfully in practice. Each of the possible successors to the "automatic" gold standard has formidable obstacles to overcome ; but to what extent these obstacles can be turned or surmounted and to what extent they are impassable, only experience can decide. It is not at present possible to predict the course of world economic policy, with which the fate of monetary measures is necessarily linked ; and in the present stage of economic science, although pronounced—and divergent—opinions may be held, there can be no claim to certainty in any estimate of a particular system's chances of survival. It is, however, not without profit to consider what the effect upon living and working conditions is likely to be if the three main aims discussed above—exchange stability, price stability, and the maintenance of active purchasing power—are *not* achieved.

The probable consequences of unstable exchanges have been well illustrated during recent years, and in the last few months in particular. Unstable exchanges are a standing temptation to countries to lower their exchange unduly so as to secure a competitive advantage on world markets ; and even if they resist this temptation it is more than likely that events themselves may bring about some such movement. When this occurs, trade is filched from other States and sooner or later these States endeavour to protect themselves by trade barriers, with the result that, between the exchange fluctuations themselves and the restrictions on trade thus occasioned, industry and commerce are everywhere disorganised. Markets are lost, thriving and efficient industries are destroyed, while elsewhere uneconomic industries are artificially encouraged.

The social consequences of such a situation are necessarily serious. The uneconomic re-orientation of industry involves an inevitable loss in productive efficiency, and reduced standards of living throughout the world. The restriction of trade to national markets leads to widespread unemployment and business losses in industries organised to meet a world demand. The continual changes in the currents of international trade brought about by shifting exchange rates and multiplying tariff barriers imply chronic insecurity for every worker and every employer who in any way depends on products bought from or sold to other countries. Whatever the absolute merits of exchange stability may be—as compared with price stability, for instance—there can be no question that it is of the very greatest practical significance to the generation now living. For the present edifice of production and trade has been built upon the foundation of exchange stability, and to rupture that foundation permanently would be likely to entail years of economic chaos and social regression.

The social consequences of an unstable price level have likewise been well illustrated within the present generation. A rapidly rising price level destroys the value of savings and discourages thrift ; automatically reduces real wages ; and leads to great social and industrial unrest. A rapidly falling price level increases the burden of debt, handicaps all enterprise and forces countries and business undertakings into suspension of payments, bankruptcy and default. Workers lose by unemployment much more than they can gain by falling costs of living, and constant pressure for wage reductions leads to the loss and waste of industrial strife and social unrest. Even if the purely economic considerations were against a larger measure of price stability—if it could be shown that the production of material wealth would be greater under a fluctuating price level than under an approximately stable price level—the social considerations would be likely to outweigh them. But, in point of fact, economic considerations and social considerations now point in the same direction. A price level liable to move inconsequently upwards or downwards destroys confidence, fosters errors of optimism and pessimism, and makes intelligent planning in large part impossible. Given approximate price stability there are grounds for anticipating not only a larger measure of security and social justice but, with the removal of one of the major causes of uncertainty and economic disorganisation, an improvement in industrial efficiency also.

The consequences of unstable exchange rates and of wide fluctuations in the commodity price level are sufficiently serious ; and their elimination is an urgent task of monetary policy. Whether this task can be achieved with lasting success in the absence of more positive measures to promote and sustain business activity is open to some question. Still more is it to be doubted whether exchange and price stability alone can suffice to keep industry employed. Apart altogether from the specific maladjustments of the past decade there are, under modern conditions of inflexible economic and social organisation, two characteristics inherent in competitive industry which make such achievement difficult. One is the recurrence of booms and depressions with their trail of waste and curtailed production. The other is the disruption of industry and the unemployment of capital and labour consequent on technical change and the continual adoption of " labour-saving " devices. In both cases the automatic adjustments on which the competitive system relies function inefficiently or partially break down. In both cases there is an appropriate field for monetary action. Other methods of combating trade depression and the consequences of technical change must not be neglected, but if definite progress is to be made it is on the task of monetary policy that attention must now be concentrated.

The third aim of a new gold standard system—namely, the maintenance of business activity by measures designed to sustain the volume of active purchasing power—is thus of peculiar importance. If it is not achieved the social consequences may well be disastrous. There is very little likelihood that the economic system can in any predictable future be made flexible enough to respond automatically and efficiently, through the mere force of deflationary pressure, to the fickle shifts of consumer demand and national economic policy. There is indeed a very real risk that, as the rate of technical change and the variability of demand increase, the severity of booms and depressions, in a world where economic nationalism and the striving of the individual for security combine to make adjustments ever more difficult, may grow steadily greater. It is perhaps unnecessary to elaborate the dangers involved, but it may be doubted whether our modern industrial civilisation could long survive such accumulating strain.

The gains to be expected from a positive monetary policy—supplemented by those other measures of economic sanity on which experts are already largely agreed—may be correspondingly great. By taking effective steps to reinforce the volume of active purchasing power whenever a deficiency is evident, by sustaining effective demand so as to stimulate the absorption of men thrown out of work by " labour-saving " devices, there can be little question that unemployment could be reduced. How great this reduction would be there is no means of telling in advance. There would be definite limits—imposed by the necessity of avoiding price inflation and/or profit inflation—to any scheme for reinforcing purchasing power. But in spite of these limits—rendered necessary by considerations of price stability and exchange stability alike—there can be little doubt that the elimination of those monetary factors which now promote or accentuate depression would bring a substantial reduction in the volume of cyclical unemployment. Similarly, it may be said with a fair degree of safety that in a period of rapid technological advance, with men being continually displaced by new machines, a system that took conscious and direct measures to sustain the volume of buying and thus encourage the full utilisation of productive resources would be likely to constitute an appreciable check on the volume of technological unemployment.

A decrease in unemployment is therefore the major social consequence to be expected from the successful maintenance of active purchasing power. With it there would presumably be some advance in the general standard of living, since production would no longer be restricted to the same extent by a rigid monetary system. Here again it is impossible to say how large the advance would be, since there is no means of telling to what degree full employment could be maintained by a policy which took stability of the commodity price level and the avoidance of profit inflation as its chief criteria of adequacy in the volume of buying. But here also it is reasonable to suppose that it would be greater than in present circumstances, whereby production as a whole intermittently becomes unremunerative for lack of effective demand.

Finally, it is reasonable to anticipate that with a system specifically designed to sustain the volume of buying, the bargaining power of those who work for their living would be such as to enable them to obtain their full share in the increased output. As matters stand, even in times of relative prosperity, lack of demand for labour and lack of demand for goods sap the strength of trade unions and make the employer unwilling, at times definitely unable, to grant an increase in wage rates even when the advance in productivity would appear to justify it. If the demand for goods in general, and hence for men to make these goods, were consistently sustained, it is to be expected that there would be a marked change in the situation, making on the whole for a far greater measure of economic equality than is possible under present conditions.

Conclusion

Such, in brief, are the three most typical forms of the gold standard at present before the world, and such the social consequences attaching to the three main aims with which they deal —exchange stability, price stability and the maintenance of active purchasing power. To attempt to formulate any positive course of action as an outcome of this analysis would hardly be justified ; but certain very general conclusions may perhaps be drawn.

The first and most obvious is that the form of gold standard adopted is of great significance to all those engaged in industry, workers and employers alike. Ten years ago it was still possible for a well-known economist to open a popular treatise on money with the epigram that money is fundamentally unimportant. In a subsequent edition this epigram no longer appears. Money is indeed of the very first importance, constituting as it does what might be termed the higher management of industry. No matter how hard and how ably those actually engaged in industry may be working, inefficient monetary control—whether it is in the direction of a reckless over-issue of money or a scarcely less dangerous under-issue—can go far towards nullifying all their efforts. Rule-of-thumb control, such as was the " automatic " gold standard, while less dangerous so long as it worked, is as out of date under modern social and industrial conditions as the rule-of-thumb methods of manufacture in use a hundred years ago. A more scientific monetary control has yet to be tested ; but there seem grounds for believing that it may go some way towards eliminating the notorious inefficiency and waste of an economic system which, in the most advanced industrial countries of the world, permits one wage earner in every four to remain idle.

The second main conclusion is that all of the possible successors to the " automatic " gold standard considered here pronounce, implicitly or explicitly, in favour of some measure of " reflation ". The Gold Delegation Report calls for a reduction in the legal reserve ratios of central banks ; and there can be little question that in practice the freer monetary position thus obtained would make for some recovery in prices. The other two systems definitely postulate a resumption of buying and a return to a remunerative level of prices as the essential first step.

Of the need for some such "reflationary" measures there can indeed be little reasonable doubt. An increase in the volume of buying of goods is the first prerequisite to business recovery. Until such an increase occurs and industry is once again on a paying basis there can be no real economic reconstruction.

A third general conclusion, of which acceptance is now certain, is that very little can be done in the way of permanent improvement without international collaboration. It is of the utmost importance that an agreement should be reached between the chief industrial and commercial countries to bring order out of the chaos of shifting exchanges. Until this is done no thoroughgoing measures against the artificial restrictions upon international trade would appear to have much chance of success. Such international co-operation, moreover, must be a great deal more explicit than has been the case in the past. To return to a loose system such as the "automatic" gold standard which, whatever its past merits, under present-day conditions does not work and cannot reasonably be expected to work, would be manifestly absurd. Quite apart from the actual methods employed to secure exchange stability—whether by making gold movements exercise their full effect upon the economic situation, or by the various countries holding their price levels approximately stable, or by some other means—the methods in question must be consciously and specifically international if they are to stand up against the strain to which they are likely to be subjected.

Closely allied to this problem of international co-operation is the fact that none of the systems considered here has yet been adequately thought out in all its details from the international point of view. Economists and financial experts, with a few distinguished exceptions, have only recently begun to look beyond their national frontiers and place their problems in the world setting in which they must ultimately be considered if they are to be solved. As a consequence, quite apart from the normal differences in approach and emphasis to be found in different schools of economists, there are widely different national outlooks on economic and monetary questions arising essentially from the fact that the economic experience of the persons concerned has been nationally limited. Such a situation makes world agreement exceedingly difficult. It would seem essential that the three major questions considered here —exchange stability, price stability and the maintenance of active purchasing power—should be exhaustively examined by international commissions of independent experts having a real authority in their field.

Lastly, it may not be inapposite to bring out the close relationship between this whole range of questions and the work of the International Labour Organisation. By Part XIII of the Treaty of Versailles, the International Labour Organisation is dedicated to the ideal of universal peace based upon social justice; and the "prevention of unemployment" and the "provision of an adequate living wage" are specifically laid down as among the measures appropriate to such purpose. Much can be and has already been done in this direction by way of international Draft Conventions and Recommendations tending to eliminate bad conditions of labour. But as the events of recent years have conclusively shown, to carry out this task successfully the International Labour Organisation must necessarily extend its activity into wider spheres. So long as the monetary mechanism is such that the process of production and exchange intermittently breaks down, and even at the best of times does not enable productive capacity to be used to full advantage, efforts towards the provision of an adequate living wage are likely to prove futile. So long as the monetary system fails to take the measures necessary to sustain effective demand at reasonably remunerative prices, the prevention of unemployment is likewise impossible. And so long as monetary mismanagement can at any moment make a living wage and an adequate return to enterprise unattainable, social justice, even in its most attenuated form, is out of the question. If there is to be any relationship between means and ends it would seem inevitable that the International Labour Organisation should play an increasing part in the monetary and economic reconstruction with which the world is now faced.