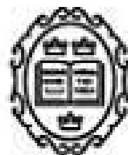

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GOLD AFTER THE WAR IN RELATION TO INFLATION AND THE FOREIGN EXCHANGES.

IN an article on "Currency and Gold now and After the War," in the March number of the ECONOMIC JOURNAL (1918), Mr. O. T. Falk remarks that "Dr. Cassel's theory that the movements of the exchanges are simply determined in the main by the quotient between the inflation of the different countries" appears to be quite untenable under recent war conditions.

If by inflation nothing else is meant than the rise in general prices compared with their level before the war, this proposition is no doubt untenable, and this has in fact been recognised in later articles by Professor Cassel himself.[1] Supposing, for instance, that a country were to place prohibitive duties on all imported goods, whereas some of its exported commodities could not be dispensed with in other countries, there is apparently no limit to the rise in prices of that country, although the rate of its exchanges with other countries might have remained at par during the whole time. While this could, perhaps, not be called inflation, properly speaking, at any rate the above result would be inevitable in such circumstances. Gold would merely pour in, and this influx could only be checked by an extension of the note issue within the country. The same result would follow if its import of goods were prohibited by measures taken on the part of other countries. This at present is precisely the case with Sweden. Our exports have been free, or nearly so; our imports, on the other hand, extremely reduced, and in many cases quite annihilated, as a result of the well-known political difficulties which happily are now coming to an end. The result, even supposing that the gold standard had been maintained by all countries, Sweden included, would have been a rise of prices in Sweden far above the level of prices in all other countries; as a matter of fact, Swedish prices have risen during the last year and a half much more than English prices, and they certainly would stand still higher had not the value of the Swedish krona been raised by the restrictive credit policy of our central

[1] See Professor Cassel's article below, p. 413.

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bank and its refusal to accept gold in unlimited quantities, somewhat over that of the monetary units of most other countries.

This is the real meaning of the Swedish barring of gold, the only fault of which in my view is that it has not been carried through with the necessary strength and consistency. The present state of our price level may be regarded as the combined effect of three forces, of which two are working strongly in the direction of raising, and the third very slightly in that of depressing, prices.

(1) The general inflation of world prices;

(2) The cutting off of our imports during the latter part of the war, while our chief export articles have had a free sale;

(3) As the only counterpoise against those mighty influences, the gold and credit policy of the Bank of Sweden referred to above.

Mr. Falk believes that it would be an easy thing for England to bring back the exchanges to parity with neutral countries, and I suppose he does not except our country. Perhaps he is right in that, for the present. But if the gold policy of Sweden were carried to its last consequences, as in my opinion it ought to be, so that our central bank were to buy *and sell* gold at a price in notes decidedly lower than the legal mint price, I cannot see how it would be possible for any country to keep its exchanges at par with ours—except only by using precisely the same policy.

And here I come to Mr. Falk's remarks on the *rôle* of gold after the war, partly in controversy with an article of mine in this JOURNAL. "Is it not in the power of the Allies," he asks, "to maintain the rise of gold by a convention, if they wish to do so, and by maintaining the use of it to secure a powerful protection against its further depreciation?" If by the word "use" he means a proper or adequate use, I fully agree. If the Allied Powers were to co-operate for that purpose they might easily bring up the value of gold to any height. The simplest and, from a broader point of view, by far the cheapest way, would be to buy up all or most of the gold mines and *stop their production;* then gold would be sure to rise by and by. Or, they might by other contrivances, equally sure but not so cheap, increase the demand for gold among themselves so as fully or more than fully to keep pace with the supply. But if by *artificial* means you steady the value of gold in order to regulate your own currency in correspondence with it, you might as well regulate the value of your currency *directly* and not by the roundabout way of gold.

The principle, however—or, rather, the *fiction*—which lies at the base of the metallic theory is that gold will maintain

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its value *by itself*, if only it is in general use as a *standard of value*. And this proposition I deny. That it is a pure fiction is shown to superfluity by the monetary history of the last forty-five years: the increase in the value of gold during the period 1873–96, its progressive fall in value during the next eighteen years, and its unparalleled collapse during the war.

Of course, it may recover once more, but that is not the point: falling prices are just as bad as rising prices; it is *steadiness* of prices and consequently of the standard of value that we want; a standard which is apt to vary in a short time by some 100 per cent. is worse than no standard at all; we could as well get on with a foot-rule of india-rubber. At any rate, the belief in the *natural* or *intrinsic* steadiness of the value of gold should by this time have disappeared for ever. The more so, if Mr. Falk is right, as I think he is, in his prophecy that the countries which before the war had a circulation of gold coins among the public will content themselves after the war with maintaining a paper currency, leaving their stocks of gold with the banks. If so, there is hardly any *real* factor left for determining the value of gold. Dr. Karl Helfferich (the present politician), no doubt one of the ablest German writers on questions of money, made some years ago (long before the war) the remark that the difficulties sometimes felt by the central banks in keeping a proper amount of gold were caused almost entirely by the *internal* market and the fluctuations of its cravings for gold in the circulation, and far less by the need of international gold payments. Indeed, those payments are every day, at any rate in peace time, getting less important, and the actual movement of gold from country to country is in the main reduced to the necessary distribution of the metal from the gold-producing countries over the world. If, then, the possibility of the internal drain, for which the banks hitherto had always to be prepared, is to cease altogether, the size of the gold stocks kept by the different banks relatively to the volume of trade and payments might fall to almost any extent without causing any *real* difficulty to the banks. Only when, in consequence of the rising prices of commodities, the diminished production of gold had become insufficient to answer even the industrial demand for gold, and the stores of the banks therefore became constantly diminishing, a reaction against the too liberal credit policy of the banks would *perhaps* set in, but this would be a very long vista indeed.

"International trade without a material standard of value is surely an impossibility," says Mr. Falk at a time when for about

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four years almost the whole world has been living—and before that date about half the world was living—without any material standard of value at all. "We know," he goes on, "what chaos results even within a single State under a *régime* of inconvertible paper, and the world is not yet a single State with one supreme authority in currency matters." Can, then, the monetary system of Austria before the war, or that of India, be properly described as a chaos? But neither the former, nor, for several years, the latter of these countries had a material standard of value. Moreover, there is no need for a "supreme authority in currency matters," or for a central bank of the world, or anything like it. Each country might keep its own money just as now, regulating it in the usual way so as to keep its rates of exchanges at par with the leading commercial countries of the world. But as a change in a certain direction in the rate of exchange between countries A and B can be effected as well by A's raising its rate of discount as by B's lowering its rate, there exists obviously, as it were, a *second degree of freedom*: over and above the international regulating of the exchanges by discount rates moving in *opposite* directions there might come about by common agreement a general rise or lowering of rates in the *same* direction when needed in order to lower or raise the world's general level of prices, properly measured by some improved index method.

I hope for a monetary congress, which will be able to solve this question, which from a theoretical point of view meets with no difficulty whatever. If not, then every land had better regulate its own level of prices, even though it thereby sacrifices the parity of its exchanges with the rest of the world, which, commodious and desirable as it no doubt is, after all must be regarded as a matter of only secondary interest compared with the former.

KNUT WICKSELL

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