

MONEY AND BANKING

A REGULATED GOLD STANDARD

Discussion of the nature of the international monetary system of the future is increasing in volume in all countries. The following is a contribution to this discussion by Professor F. A. von Hayek, of the London School of Economics. As Professor Hayek points out, the gold standard is subject to two defects—the first applying to all international standards, namely, the unwillingness of individual countries to adjust their national economies to an international standard; the second inherent in gold, namely, the periodic maladjustments between the demand for and the supply of gold. Professor Hayek's suggestion would be an ingenious device for assisting to overcome the second difficulty. But we cannot agree with Professor Hayek that the problem of national adjustment is the same whether there is a gold standard with rigid parities or not. Adjustment there must be; but the rigidity of modern national economies are such that they neither can nor will be brought into line with each other solely by internal adjustments. In our opinion, any proposal for an international monetary system which ignores this fact is of doubtful practical worth.

It is still impossible to predict when conditions will make a solution of international currency problems appear practicable. This does not mean that it is too early to ask what sort of system we really want, and we can begin to survey the practical possibilities of a permanent reorganisation, even if the actual decision should only have to be made at a fairly distant date.

The case against the gold standard, in the form in which that case is now most popular, is based on two separate counts. One is directed not against gold in particular, but against any kind of international standard. It is hoped to protect the economic system of any country against all disturbances originating abroad, by cutting loose the rigid connection between the national currency and those of other countries which a fixed parity provides. It would make little difference whether this was done by remaining on an independent paper standard, or by ostensibly adopting a gold standard but with a proviso for variable parities or wide gold points within which considerable fluctuations will be possible, or by any similar device. In all these cases no common international standard would really exist.

This part of the anti-gold argument must, I think, be unreservedly rejected as equally wrong on theoretical as on practical grounds. It is a delusion to believe that a country can really avoid the necessity of adapting itself to changing international conditions by simply changing the external value of its currency. The adjustments may take place by a somewhat different route, and in some cases the burden of the readjustment may be shifted to another country. There is, however, strong reason to expect that such a system will set up very considerable new disturbances by intensifying the erratic movements of short-term funds. And, even more serious, the latitude which such a system allows to the decision of the national currency authorities would undoubtedly be abused in some instances to snatch a temporary advantage from the other countries by depreciating the national currency to an unjustified extent. And who could say in the concrete case whether such an act of policy was "justified" or not?

Since we cannot really evade in this way the effects of the real changes in the underlying conditions, or the effects of the errors and mistakes in the monetary policy of other countries, the only hope lies in the creation of an international system which will minimise the causes of such external disturbances. The main requirement of a new system is that it should ensure that the policies of the individual countries will move in step. The problem is to find some kind of international standard which will effectively do this and at the same time give scope for such a degree of international control as will allay legitimate apprehensions. Is the gold standard in any of its forms a possible solution?

The second count is against the choice of gold as the international standard, and it is quite strong. The possibility of an absolute scarcity of gold, which only a few years ago was so widely canvassed, does not seem as great now as was then commonly assumed. But there is undoubtedly danger of grave disturbances arising out of changes in the demand for gold.

There is, however, no practical alternative to the gold standard. No other standard has the slightest chance of general agreement or even of support from all the great countries. Even if an international agreement on some more scientific standard could be arrived at, there would be little hope that it would last. It is most unlikely that in difficult times individual countries would make serious efforts to preserve an international standard unless these efforts also permitted the maintenance of a national monetary reserve, which would be of use even if the international agreements broke down. If an international standard is wanted, the gold standard, in spite of its undeniable defects, is the only practical choice. The real problem is, therefore, how the gold standard can be made subject to some kind of international control which would remedy its more serious defects. The immediate practical problems will arise out of changes in the demand for gold, which will be the consequence of the restoration of a gold standard.

It is impossible to prophesy at what value gold would settle down after the restoration of an international gold standard if the building up of new gold reserves were simply left to competition. The problem of correcting the initial maldistribution of gold and of adapting later the supply of the international medium to changes in demand will have to be solved if the gold standard is to become an anchor to which individual nations can safely entrust the fate of their monetary systems. There are, however, serious obstacles which make it difficult to obtain that kind of international control of gold supplies which is needed. No nation is likely to give up its control of whatever gold it possesses. That every nation will always regard its gold stock as an ultimate reserve against an emergency, be it a war or the breakdown of the international agreement, is a fact which must be accepted. The idea of a deliberate redistribution of gold reserves, or of the centralisation of a part or all of the gold with an international authority which would issue "gold notes" against it, and all similar proposals must in general be regarded as utterly impracticable.

Fortunately there seems to be a method available which is practicable and would make possible effective international control of total reserves without any radical departure from familiar practices. It is the regulation of the extent to which gold exchange (immediately realisable claims on other gold standard currencies) shall be used as a substitute for gold in the reserves of central banks.

Some kind of international agreement on this point would be needed in any case. In the decade after the war the use of gold exchange in place of gold was carried to a considerable extent by many of the smaller countries, as a device to avoid the necessity of acquiring great quantities of gold, and to make the reserves a profitable investment. The losses made on these holdings of gold exchange when many of the larger countries went off gold have now greatly discredited this "gold exchange standard." A restoration of the gold standard at present would have the consequence that an effort would be made to substitute gold for these exchange holdings. Indeed, that process has already begun. For some time at any rate the holding of gold exchange instead of gold would be regarded as a sign of weakness and undue dependency on other countries. But after some years the cheapness of the gold exchange standard would again begin to attract more and more countries, and lead to a process of international credit expansion which would tend to cause another collapse.

The unregulated use of gold exchange as a substitute for gold in the reserves of central banks is therefore in itself a cause of disturbance. But since the need for some regulation of its use is unquestionable, it might as well be used to counteract discrepancies between the demand for and the supply of gold itself. An international agreement which fixed the percentage to which gold exchange should be substituted for gold in the reserves of *all* countries would provide a mechanism which could adapt total reserves to changing situations, by varying this percentage. The practical procedure would probably be to establish, by periodical international agreements, definite limits within which the exact percentages would be fixed at shorter intervals by a permanent international body, such as the Board of the Bank for International Settlements.

In effect, such variation of the proportion of gold exchange held in lieu of gold by all central banks would be equivalent to changing the size of the metallic gold reserves. But it would have the important advantage that each country would still be free to determine the *total* size of its reserves, according to the exigencies of the moment. It would require little change in established central bank technique, and a minimum of interference with national policies. No change in the demand for or the supply of gold is likely to occur, the effects of which could not be counteracted by appropriate changes in this ratio. Any additional demand for gold could be met by increasing simultaneously the percentage of gold exchange in all central bank reserves to an extent which would just release the amount of gold required, while undesirable additions to the supply of gold could be similarly absorbed without disturbance by a corresponding reduction of the percentage. Any change of this sort could easily be made gradually, without interfering with the normal operation of the gold standard. While this device would provide an instrument of control to be used whenever needed, it would not present an inducement to all too frequent or unjustified changes. Comparatively few and small changes would probably be sufficient to preserve reasonable stability after an initial period of readjustment. Indeed, it is one of the main advantages of this scheme, that it would fully preserve the mechanism by which national policies are adjusted to each other.