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CAN A MONETARY STANDARD BE DISPENSED WITH? ¹

THE generally admitted principle that modern trade is, in substance, the exchange of commodities for each other, and the fact that more than 95 per cent. of transactions through banks are carried on by some form of paper credit, has raised the question in some minds whether the mechanism of credit cannot be so much further perfected as to suffice for the settlement of all exchanges and permit metallic money to be dispensed with. To such minds the existence of a metallic standard has become a fetich, which might well be brushed away among advanced commercial nations. If trade is only the refined barter of goods for goods, it has been argued, why is it not possible to abolish gold reserves and to settle all transactions by mutually clearing them against each other? It was declared long ago by Ruskin :—

“It [money] is not wealth, but a documentary claim to wealth, being the sign of the relative quantities of it or of the labour producing it, to which at a given time persons or societies are entitled. If all the money in the world, notes and gold, were destroyed in an instant, it would leave the world neither richer nor poorer than it was. But it would leave the individual inhabitants of it in different relations.”

Underlying the view that money can be dispensed with lies, consciously or unconsciously, the theory that there can be some other standard of value than gold. The present investment of capital in gold money throughout the world is about eight thousand millions of dollars, upon which the annual interest rate at three per cent. would be \$240,000,000. In the sense of the critics of the gold money standard, this vast amount of gold, representing the labour of decades in taking it from the ground and transporting it to financial centres, has been labour which might have been applied more profitably to the production of food, shelter, or other articles directly useful to humanity. The system of gold money

¹ This article is not to be understood as expressing any opinion, favourable or adverse, upon the adoption of the tabular standard or the standardised dollar, which would be subject to discussion from entirely different points of view.

is also subject to the criticism that gold has not proved a steady and unfluctuating measure of value. It has even been sarcastically attacked as the attempt to measure length by a yard-stick which was constantly changing.

Closely related to the belief that money is a fluctuating, and therefore unreliable standard of value, is the attack made by Socialists upon the profits of bankers. It is contended that if the products of the community could be exchanged more directly with each other, without the intervention of money, the banker would cease to rob the community of unearned increments, and substantially the entire volume of national capital would be at the command of the workers.

The theory of a non-monetary economic system has been reduced to definite terms by a number of Socialist teachers. It was the doctrine of Robert Owen, the English Socialist, who sought to put it into practical operation through his Labour Exchange Bank; it was the policy of Proudhon, the French Socialist, who endeavoured to establish a new mechanism of exchange at the time of the crisis in French credit during the Revolution of 1848; and it has been worked out in more recent times by M. Ernest Solvay, a large Belgian manufacturer, who has imbibed Socialistic doctrines and advocated them in the Belgian Chambers.

These theories are based fundamentally upon the conception that goods can be exchanged for each other through a system of checks or commodity bonds. If the shoemaker has produced a pair of shoes worth \$3, he is given a bond by some central authority entitling him to the value of \$3 in other commodities. By the use of these bonds or certificates of exchange he obtains the advantages of the general command over commodities which belongs to money as a medium of exchange. The system of M. Solvay would reduce exchange substantially to a system of book credits, which in his view would approach much nearer to invariability of value than a single article of merchandise, such as gold, which "society is liable either to want or to have too much of." His theory of the new standard is thus set forth¹ :—

"At the very outset, from the moment barter is abandoned and it is no longer necessary to give a kilogram of wheat to obtain possession of a thing, at that very moment a book entry would confer on the holder of a thing a right representing a value equivalent to it and permitting him to effect under the same conditions new transactions.

¹ *Social Comptabilism*, Brussels, 1897, p. 8.

"If things can thus take place, it will be seen how absurd it becomes to persist in the custom of representing materially a unity which should be detached from the support which has served to define it at a given moment, and which no longer appears as anything but an abstraction permitting in a homogeneous manner the arithmetical representation by figures of the value of things relatively and individually. This abstract unity ought to be detached from every material tie."

One of these plans was put in operation by Robert Owen about 1832, through the creation of what were called "labour exchanges." Their fundamental principle was that labour is the source of all wealth, and that labour cost is the true measure of value. It was the theory of Owen that the free play of this principle was interfered with and distorted by the intervention, as the medium of exchange, of money, which was a monopolised and limited commodity. Accordingly, labourers were invited to bring their product to a central office, where certificates were issued to them, no longer in terms of pounds and shillings, but in terms of hours. The hour-values were determined by managers of the exchanges, in cases where they were not willing to accept the time valuation of the maker of the goods. The holder of the certificates, thus expressed in hour-values, was able to purchase for given numbers of hours other goods which met his needs for consumption. Thus, according to the theory, the exchange of goods for goods would be effected among the producers themselves, without the intervention of bankers or of money. Labour exchanges were established in London, Brighton, and other communities about 1832, to which goods were brought by the followers of Owen and his school, and exchanged for labour exchange notes.¹

Not unlike the project of Owen was that of Proudhon, who in 1848 established in Paris an exchange bank. The object was explained by Proudhon to be to secure to every member of society all produce, commodities, merchandise, services or labour, and subsequently to procure the reorganisation of agricultural and industrial labour by changing the condition of the producer. The plan of Proudhon differed from that of Owen in providing a form of bank-note, expressed in terms of money, upon the deposit of the produce of labour—these notes being intended to serve the purpose of money, without any metallic backing. "To pass from the monetary medium to direct exchange—this is the central idea

¹ Photographs of several forms of these notes, with details of their issue, are given in Palgrave's *Dictionary of Political Economy*, edition of 1912, Vol. II. pp. 520—23.

which determines the search for appropriate means!" declared Proudhon. "It is necessary to destroy this royalty of gold and to republicanise money."¹

Inevitably, these plans presented serious difficulties, even in their first application, apart from the fundamental errors which underlay them in regard to the function of money. In the first place, the attempt to fix a time standard of value instead of a monetary standard involved great inequalities in the valuation of different types of labour. Those whose labour was of small value must either be put arbitrarily upon a level with those whose labour was of a high value, or some means must be found of measuring the differences in time value of different classes of labour. This problem was faced in part by permitting the labourer to include in the cost of his produce the amount paid for raw materials, upon the arbitrary basis of sixpence per hour. If a bootmaker had paid five shillings for leather, he was allowed to add this payment, at the rate of sixpence per hour, or ten hours, to the time-value of the boots which he produced. Bad work was arbitrarily valued at fewer hours than had been spent upon it. This admission of other factors than labour into the equation, however, was an admission of the essential weakness of the labour standard.

Owen was sincerely impressed with the social inequalities of his time, and the apparent failure of the labourer to obtain his share of the increase in productive power due to machinery. He attributed the evil to the intervention of money in exchanges, declaring that "the labouring class was rendered the slave of an artificial system of remuneration, more cruel in its effects than any form of slavery practised in barbarous or civilised societies."² But it is evident, in the light of later knowledge, that it was not the system of the use of money which was at fault, but the organisation of industry and the division of the proceeds of machine production. It was almost inevitable that a diagnosis of the disease of the economic body which read so inaccurately the character of the symptoms should lead to a treatment which was disappointing and abortive. And so it proved. The projects of Owen and of Proudhon alike broke down. Owen himself was superseded in control of the labour exchange on July 27th, 1833, within little more than a year after its inauguration, and the central organisation broke up in 1834.

The underlying defect of these systems, apart from immediate practical difficulties, was the absence of any rule for determining

Aucuy, *Les Systèmes Socialistes d'Échange*, p. 137.

² Aucuy, p. 57.

the ratio of demand and supply of commodities. Owen and Proudhon were alike oblivious to the great truth, admitted by the much keener mind of Karl Marx, that the labour spent upon commodities "counts effectively only in so far as it is spent in a form useful to others," and that whether such labour is useful "can be proved only by the act of exchange."¹ The attempt to make labour a test of value broke down when the demand for certain commodities increased their exchange value above the labour cost, and the lack of demand for others depressed their exchange value below the labour cost. Almost from the beginning sharp tradesmen accepted labour notes issued under Owen's plan for their own goods, and employed them at the exchanges in picking out the articles which were saleable to the outside public at a profit above their labour value. This process soon left on the hands of the labour exchanges only stocks which no one cared to take at the price of sixpence per hour for the time of their makers. The labour note began depreciating with the impairment of the quality of the security on which it rested; its depreciation enabled the traders who continued to take it at its reduced value to obtain a further advantage in purchasing the goods in stock, until the notes had fallen in exchange value to an amount below that which the workman of average skill could earn in the labour market in the time represented by their price.

This sequence of events was not an accident, due to defective management, but laid bare a fundamental defect of any plan to conduct exchanges without money. Metallic money, while not unvarying in its value in relation to the aggregate of goods, has the merit of being always exchangeable at some rate for all classes of goods in the market. In times when other goods are least exchangeable, money is most exchangeable; in other words, the amount of goods to be obtained by a given sum of money increases with the over-production of goods or with distrust of credit or of the saleability of goods.

Money thus becomes in effect the touch-stone of the demand for different classes of goods. If the quantity of goods which can be obtained for a given sum of money increases, it is an indication that the supply of such goods is excessive in relation to demand; if the quantity of a given class of goods which can be obtained for money decreases, it is evidence that the demand for those

¹ *Capital*, p. 57. Marx indulged in a caustic criticism of one of these labour-value systems, in which he observed that the dogma that merchandise is money became a truth only when a bank believed it and acted accordingly. Cf. Aucuy, pp. 80—81.

goods exceeds the supply. From this simple statement of the ratio of goods to money flows the entire theory of credit, the determination of the direction in which capital shall be employed, the regulation of supply and demand at home, and the operation of the foreign exchanges in determining the movement of capital and the relations of supply and demand between nations.

The essential flaw in the reasoning of Owen and Proudhon was to treat demand and supply for goods as constant, instead of variable. If it were certain that a community of 1,000 persons would consume annually exactly 2,000 pairs of shoes, 2,000 woollen suits, and 1,000 barrels of flour, then the entire resources of the community could be devoted to the manufacture of these three classes of articles in these quantities, without fear that they would depreciate in value or change in their relations to each other. A calculation could be made to determine what proportion of labour was required to produce each class of article; an apportionment of labour-time could be made to each producer; and to each member of the community could be distributed his two pairs of shoes, his two suits of woollen clothing, and his barrel of flour annually. Within the limits of such a community labour exchange notes would form as safe and useful a medium of exchange as gold or any other form of money.

The problem in reality, however, is not only highly complicated by the necessity of determining the labour exchange value of many hundreds of commodities and of many classes of personal service, such as those of physicians, railway employees, and personal servants, but it is altered fundamentally by the fact that there does not exist, in the State or in any body of private citizens where free initiative survives, sufficient foresight to determine accurately in advance the amount of each particular article which will be called for by the community. Hence any system which proposes to substitute certificates of labour at a constant value for the system of fluctuating values expressed in money is based upon a fallacy.

The fallacy lies in the assumption that the value given to articles by labour remains unaltered by changes in the demand for such articles. It assumes that if there is a production of 2,000 pair of shoes where the community needs but 1,000, the excess of 1,000 shoes above the demand shall remain at the same price, representing the same value, as if all had been demanded. Obviously, such a view of exchange would remove the great corrective to the misdirection of productive power which exists in the competition

of the market. The only possible conditions in which such a system of values could persist would be a system of State Socialism, under which the Government should prescribe the exact consumption of each individual—not only in number of shoes, woollen suits, loaves of bread and pounds of meat, but even the exact number of corsets of a certain size and colour, the number of bottles of rouge and perfumery, of boxes of face-powder, and of millinery of given patterns, so far as the consumption of these articles was permitted in a Socialistic State. Only by forcing the wants of every member of the community into a uniform groove could miscalculations in production be avoided. Hence the theory of a substitute for money which is not based upon an article containing exchangeable value, and more readily exchangeable than other articles, could have no standing except in a Socialistic State in which the liberty of the individual was completely extinguished and a despotic central bureau prescribed minutely for every citizen the amount of his consumption, not merely of necessities, but of articles of luxury and fashion.¹

The demand for currency in an advanced commercial community is for a sufficient sum to carry on retail transactions, pay wages, and support the fabric of credit. Bank credits are the right to demand gold or other lawful money. They conform to the theory of Owen and Proudhon in the respect that they are certificates of the exchange of commodities; but they depart radically from these theories in the fact that a sound bank will accept certificates of the production and transfer of commodities only to the extent that they are exchangeable for money. If a banker discounts a bill of exchange based upon manufacturing production, he does it because the goods upon which the credit is based have been already valued in money in the market, or because the person to whom the credit is granted has other assets capable of covering any downward variations in their value due to changes in the ratio of demand and supply. A legitimate bill of exchange of the European type is based upon a shipment of goods to a purchaser who has already agreed to accept them at a certain money value, and who in addition has usually obtained from a banker a credit by which the banker stands ready to make an agreement (called an acceptance) to pay the face of the bill, irrespective of the price at which the goods may ultimately be sold to retailers. Hence a bill of exchange of this type is accepted

¹ It is correctly declared by Langworthy Taylor that "There would be no credit in a socialistic State," and "nothing which properly could be called 'business.'"—*The Credit System*, pp. 48, 89.

at par, if payable at sight, and is subject only to discount on account of time if payable at a later date.

These safeguards thrown around a bill of exchange extinguish the ingenious analogy which Proudhon sought to establish between such bills and the documents which he proposed. It was his declared purpose to generalise the bill of exchange by permitting any producer to draw a bill against his own finished products, which would entitle any holder to an equivalent amount of some other product. But such a document would lack the essential features of a bill as recognised by the practice of merchants. It would not designate the party who was to pay or to accept; it would have no designated maturity; and therefore could not conform to the requirement that it should be an unconditional order to pay a sum certain. Lacking all these elements of the true bill of exchange, or even any effective guarantee of the character or genuineness of the goods against which it was drawn, it was hardly capable of realising the project of its author that it should become "the general instrument of payments and of credit which will be carried on reciprocally by all men,—the universal method of the extinction of credits and of debts."¹

Certainty of convertibility into money, without delay and without question, is the characteristic which it has been the aim of the merchant and law-maker for many centuries to impose upon the bill of exchange. Through every stage of the processes of credit the principle is recognised that the value of goods in money is variable, and that the test of their value is the amount of money for which at any given moment they are exchangeable. It is the function of the banker to determine these ratios of value. If he miscalculates, and makes a loan (without other security) upon goods in warehouse which fall in value below the amount of the loan, he is guilty of bad banking and suffers the loss arising from the variability in the money value of the goods.

Bank deposits are assimilated to money, but it requires the skill and experience of the banker to determine just what measures are necessary to keep them equal to money by maintaining his solvency. A deposit represents a deferred demand for money or money value. It is not money of which the entire amount is likely to be immediately called for, but it is a certificate of the transfer of money which is likely to be called for from time to time. It has required several centuries of banking experience to make clear just how far the banker can avail himself of the principle of compensation, or clearing, to meet the demands of

¹ Cf. Aucy, pp. 140—142.

his clients for the transfer of titles to money. Experience has shown that, in order to maintain his ability to meet demands for metallic money as they arise, it is necessary to maintain certain reserves in gold and further to maintain assets which can be converted into money within short periods. To rely for such purposes upon mortgages on real estate, or on the real estate itself, is to lean upon a broken reed, because mortgages and real estate are not readily convertible into cash.

The banker, therefore, impelled by the imperative motive of protecting his own solvency, must pass upon the question whether commercial paper and other documents upon which he makes loans represent prompt convertibility into money in amount sufficient to cover his risk. Hence the banker becomes "of high potency in determination of outlay, investment, and capitalisation." As his function is set forth by Professor Langworthy Taylor¹ :—

"In the management of his discounts, of the flow of paper through his portfolio, and of his reserve, he possesses a peculiar mechanism, by means of which he coerces the merchant to do what the latter ought to do anyhow, but might not, if there were not at hand a specialist, master of a potent agent that can be brought into contact with the merchant's affairs."

The function of metallic money, therefore, is not to provide a large proportion of the medium of exchange in large transactions. These transactions compensate each other, by the exchange of written documents, so long as no miscalculations are made,—so long as the parties to them are able to fulfil their obligations. But at various stages in these transactions the banker intervenes to give his guarantee of the fulfilment of obligations, and that if they are not fulfilled in kind, they shall be fulfilled in the medium in which they are expressed and which it is his special function to provide. It is when the cycle of credit activities is interrupted that money intervenes largely in such transactions. In the language of Professor Langworthy Taylor² :—

"The momentary return to metallic money is fraught with a biological significance, for it points plainly to the inference that a crisis is the breaking down of a credit structure, of a business organisation which had been painfully built up and had hitherto escaped the need of cash payments. An elaborate process of setting-off can no longer be kept in operation ; an intricate system of balances and equalisations which had been created by the evolution of business had suddenly ceased to work ; the community grasps for some means to carry on its affairs, and returns to the

¹ *The Credit System*, New York, 1913, p. 32.

² *Ibid.*, p. 38.

practice of an early epoch, when actual, physical, materialistic money was current."

It is precisely at this point that the system of exchanges based upon the immutability of values fails and gold stands forth the unimpeachable store of value—the only commodity which is universally exchangeable. Unsound enterprises break down, and their remains soon cease to cumber the earth, and capital, after a moment of hesitation, finds its way into new and safer channels.

Metallic money is only one form of the expression of value, but a very important form, especially when distrust arises regarding the exchangeability of other goods. The value of gold, and even of forms of paper money, is determined by demand and supply. The normal demand for gold, so long as the credit system remains intact, is only for a sufficient amount to enable business to be carried on. It is a tool of exchange, but not the final object of exchange. In a sense, there is no more occasion for an increase in the stock of gold than there is for an increase in the number of freight cars when the stock is already fairly adequate for the goods to be carried. The supply of money in any community at a given moment is adjusted to the demand arising under existing conditions of production, monetary customs, and the state of credit. A supply of money, either of gold or paper, which is in excess of normal demand, under the existing state of the market, may result in the expulsion of the surplus money, if it is gold; in stimulating credit unduly; or in depressing the exchange value of the money, especially if it consists of paper, which is non-exportable.

Running through most of the theories which would discard gold as money and which attack the gold money system as creating a monopoly in favour of the owners of gold is, curiously enough, an exaggeration of the importance of money. Thus Kitson, an American author who has taken up the cudgels of Owen and Proudhon, declares¹: "Commerce is, in fact, constantly ground between two millstones, the upper being the law compelling settlements of debts in legal tender, and the lower the law which restricts this tender to a particular commodity or certain quantity wholly insignificant in amount to meet the necessities of business."

The fallacy which inheres in this form of criticism is the exaltation of money to the place which belongs to free capital. No one who has a commodity for which there is a demand is unable to turn it into money at some price. If more of other articles than formerly is demanded in exchange for a given amount

¹ *The Money Problem*, London, 1903, p. 217.

of gold, it is because the supply of those articles has become excessive in relation to effective demand. It would hardly be contended, even by Owen, Proudhon, or Kitson, that the shoemaker should give up shoes for wheat at a fixed rate, when he did not want the wheat. The substance of their contention is that he should give up the shoes for a certificate of general purchasing power. This is exactly what he gives them up for under the existing gold credit system, except that the certificate which he gets under this system is protected by a guarantee fund in gold against distrust of its permanent exchangeability for value. In a country with a gold currency, exchanges go on in normal times by the swapping of certificates of purchasing power in the form of checks, drafts, and promissory notes, just as freely and effectively as under the system of Owen or Kitson. If the time arrives when gold is husbanded by the banks, it is not primarily because of anything which has happened to gold or because there is any disposition to monopolise gold; it is because the supply of free capital has become reduced in relation to the demand for it. And this would as infallibly happen under a system of paper money as under the gold credit system. The real difficulty against which these critics are tilting their lances is the insufficiency of the capital produced by human labour to meet all demands upon it, or the misapplication of the capital actually produced. The gold stock is watched by international bankers, not because they prize gold, but because a certain ratio of gold to credit is the evidence that credit has not been expanded beyond its proper proportion to free capital. To annul these tests and substitute paper money would at most only postpone the day of reckoning and make it more disastrous; for the issue of paper will not create capital, and will draw it out of individual hands only to a degree which has very narrow limitations.

Incidental defects in currency systems, which prevent the free transmutation of forms of liquid credit into bank-notes, within the limits of safety and public convenience, have in certain cases imposed unwarranted fetters upon borrowers and upon the distribution of products. This was the case when Kitson wrote, under the operation of the national banking law of the United States, which compelled a bank to purchase United States bonds in order to be able to convert even the best types of credit into the currency form. Defects like this in currency systems, however, are cured by experience, or even by the substitution of other credit forms for those the use of which is unduly hampered. When Kitson asks, "Why should freedom to monetise gold be given

and the same right denied to other commodities?"¹ the answer is simple. It is, that through the mechanism of banking credit, all other commodities are monetised, up to the limit of money value which can safely be ascribed to them. Under the existing gold credit system, there is realised what this author contends would come about only under his system: "With freedom to monetise all commodities alike, the monopolisation of money would be as impossible as the monopolisation of *all* commodities."²

The elaborate organisation of modern credit has been the growth of experience. It now affords the means of mobilising nearly every form of property so far as it can be done without financial disaster. Improvements in the system have been made from time to time, and will continue to be made. They rest to a large degree upon the principle which Owen and Proudhon advocated,—that the exchange of products and services is essentially barter. But it is important that when the ratio of value of some commodities towards others is disturbed, and when certain commodities cease by an excessive ratio of production to be acceptable at their old values, there should be an article like gold, which no one will refuse in settlement of an obligation because it is of practically universal exchangeability and acceptability.

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¹ *The Money Problem*, p. 222.

² *Ibid*, p. 226.