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A 'FIXED VALUE OF BULLION' STANDARD—A PROPOSAL FOR PREVENTING GENERAL FLUCTUATIONS OF TRADE.

CLEARLY if we could by magic increase the weight of gold in a sovereign just in proportion as the purchasing power of a single grain of gold decreased, and decrease the weight just as the purchasing power of the grain increased, we should keep the total purchasing power of the sovereign constant. This in effect without any magic, but substituting 'pound sterling' for the word 'sovereign' I propose that we should do.

In a country having a circulation—apart from small change of token money—wholly made up of paper, and where the Government was always prepared to buy or sell bullion for notes at a price, the standard of value might be kept constant by varying from time to time this price, since this would be in effect to vary the number of grains of gold in the standard unit of money: it would vary the number of grains of gold which could be got for a note representing that standard unit, and which would instantly procure such a note on demand. If gold appreciated, the number of grains given or taken for a unit of paper money would be reduced: the mint-price of gold bullion raised. If gold depreciated, the number of grains given or taken for the note would be increased: the mint-price of gold bullion lowered. Why then should not this system, which for shortness I will call the 'value system' be adopted, and the standard of value effectually regulated?

Let me now attempt to trace in some detail the effects of the proposed change upon (I.) home trade, and (II.) foreign trade.

I.—HOME TRADE.

Let us suppose the system to be established in Great Britain. Probably a certain number of notes might then, as now, be

issued against Government security, but above that number the Government must, to secure the perfect convertibility of its paper money, retain its full value in bullion against every note in circulation. This value, however, would not then, as now, be always 113 grains of pure gold, per £ corresponding to the mint-price of 77s. 10½*d.* per oz. of gold of standard fineness. On the contrary, a tabular statement of the chief prices would be constantly prepared, and if it showed general prices to be falling, in other words gold to be appreciating, the mint-price of bullion would be put up in proportion, *i.e.* the number of grains given or taken by Government for the pound note would be reduced. This I shall call reducing the mint-weight. We might perhaps take for granted the tendency of this reduction of mint-weight to counteract a fall of prices, for if a certain list of commodities whose standard value was £113 had fallen to £112 when each pound was of 113 grains of pure gold, it is pretty clear they would be worth £113 each of 112 grains. Still, it will be best to trace the process in some detail. The Government upon lowering the mint-weight would find its stock of gold more than equivalent at the new rate to its outstanding notes, and would have a surplus of gold against which to issue new notes. These as soon as put into circulation would of course increase the volume of loanable capital, and so tend to reduce the rate of discount. They would moreover, either in the hands of the Government or of some one deriving from them, constitute a fresh demand for commodities and labour, and so again tend to stimulate trade and prevent the fall of prices. In an exactly corresponding way an increase in the mint-weight would tend to correct a rise of prices. It would leave the Government a deficient stock of gold, which must be met by suppressing notes. This would reduce the loanable capital and the demand for commodities and labour.

Now if the rise or fall of prices shown by the tabular statement were an isolated change, the change in mint-weight above described would correct it, and in the next making up the index number would be found to have returned to its normal figure. But instead of being isolated it might be the beginning of one of those mysterious credit fluctuations. Let us take the case of a tendency to inflation of credit arising. It would be self-destructive. As soon as general prices began to rise the mint-weight would be put up: if the change did not restore the index number to normal, then a second and a third increase of the mint-weight would take place, and so on till it did. There would never be any considerable rise of prices established, but the volume of currency

would be steadily contracted until the tendency to inflation ceased. If thus an inflation of credit were prevented from showing itself in a general rise of prices, it seems certain that it could hardly proceed to any appreciable extent, inasmuch as it is this very rise of prices which now feeds such an inflation. Even if an expansion of credit did take place it would merely mean the substitution of documents, or other means, of credit for Government money, and not meaning a rise of prices it would not mean an inflation of trade and the demand for labour. Similarly a tendency towards a contraction of credit would defeat itself.

But if the cause of the depreciation or appreciation of bullion were a change either in the supply of precious metals or in the demand which currency laws, &c., create, the case (which will have to be further considered under the head of foreign trade) would be somewhat different; but the pound sterling as a standard of value would still maintain its constancy.

First, if the mines produced bullion out of proportion to the growth of commerce, or if some foreign country ceased to coin gold, it would be brought more abundantly to the English mint to be sold for currency. The increased supply of gold as of any commodity must cause it to fall against other commodities; prices would *tend* to rise. This tendency, if unchecked, would lead to an expansion of credit and of trade, but it would be checked steadily by increasing the mint-weight exactly in proportion as the purchasing power of a grain of gold fell. As fast as new gold was brought in and exchanged for notes the Government would have to suppress old notes. Thus there would simply be more bullion held as reserve against the same circulation, and prices in spite of a constant tendency to rise would not be able to do so.

In the opposite case of a scant output from the mines, or of a new demand for gold, the enhancing purchasing power of the pound sterling would constantly be kept down by reducing its weight in the way we have before traced out. Thus would general prices be maintained and depression of trade avoided. The reserve of gold might dwindle—or as the case was, not increase in proportion to the growth of trade—but that circumstance would not affect the volume of circulation or the level of prices. I say ‘would not affect,’ but of course there must be some fall or rise of prices shown by the index number before a change in the mint-weight would be made. By constantly collecting prices, by the use of the telegraph, and by taking a simple form of tabular statement rather than attempting

theoretical perfection, the index number might surely be made up every night, and thus the *tell-tale* change in prices would never be allowed to reach any magnitude, and even the greatest forces of disturbance would never have any appreciable effect on the general state of trade.

If I have shown that such a currency would give a steady standard of value, and so far as home trade is concerned prevent fluctuations, it does not need much to prove also that it would answer all purposes at home as a medium of exchange, a common measure of value, a standard of deferred payments, and a store of value. Why should it not? Neither buyer nor seller, debtor nor creditor, need care or know what the weight of gold in a pound sterling was, so long as the purchasing power of the pound note was assured and remained constant, and any change of mint-weight applied to all citizens and all obligations equally.

A word as to the cost, &c., of working the system. Evidently as long as gold appreciated there would be a profit to Government upon the stock, and there seems little doubt that gold will appreciate decade by decade. The first profit accruing might be employed to purchase consols and thus a fund be accumulated, of which part could be sold when a depreciation of bullion took place and notes were wanted to be suppressed. This would probably be better than applying the gains directly to reducing taxation and making good by extra taxation the losses. Even if there should be no appreciation of gold from decade to decade, there is certainly no reason to expect the reverse, and therefore the gains at one time on the stock of gold would at least equal the losses at another, and the cost to the nation would be simply that of making up and publishing the tabular statement.

II.—FOREIGN TRADE.

So far as to trade within the country using the proposed system; the more difficult question is how it would affect foreign trade. Two cases require separate consideration:

(a) Trade between two countries, each employing the 'fixed value of bullion' standard.

(b) Trade between a country employing the value standard and others retaining the present 'fixed weight of bullion' standard.

If in case (a) the fluctuations in the value of bullion were identical in the two countries, and if the necessary changes of

mint-weight were made simultaneously, the working of the system between them would closely resemble its working in a single country using it : this we have just considered. The fluctuations are largely but not altogether the same in all the chief commercial countries. So far as they did not coincide, and so far as the necessary changes of mint-price were not made simultaneously, the trade would resemble that between a country using the proposed and one using the present system. This is case (b), which I now proceed to consider.

First of all there is nothing, of course, in the system to interfere with the real mainspring of foreign trade—the special facility of producing certain commodities in certain countries. Equally, of course, so long as the English mint-price of bullion remained unchanged the exchanges would operate, and gold would flow in and out of England just as at present. But suppose an increase in the mint-weight involving a check to the rising tendency of prices. The alteration would not prevent commodities in England being worth more bullion than formerly, just as they would under the present system. Instead of cloth selling for more pounds, each having the same weight of gold as formerly, it would sell for the same number of pounds as formerly, each having a greater weight. Similarly if the mint-weight had to be reduced. Thus the purchasing power of bullion in this country would fluctuate under the proposed system as under the present. Gold money exported to a foreign country is but bullion : so far therefore the proposed system would not affect foreign trade. If prices tended to fall here, there would still be the same inducement to foreigners to send their money and bullion here to pay for goods, and if prices tended to rise here. England would still be a bad country to buy in and a good one to sell in.

But undoubtedly the foreign exchanges would be affected ; every exchange would be altered each time the mint-weight was altered. Nor would these alterations then as now be corrected by the flow of bullion. A raising of the mint-weight would raise all the *pars* of exchange and a lowering would lower them. If, for instance, the mint-weight were put up one per mille, clearly all the *pars* of exchange and every gold point would be put up in that proportion : if the French par of exchange had stood at 25·22½ it would be raised to 25·25. How great might these changes be ? How far would uncertainties, and therefore impediments to trade, be caused thereby ? And here I hesitate, having to deal with a subject so abstruse. I try to forecast the operation of the

system, but I by no means claim to speak as an expert on foreign exchanges. I only desire to put forward the scheme for consideration.

Of course the fluctuations in the pars of exchange would be identical with the fluctuations in the mint-weight and therefore in prices measured in bullion. The most violent of these latter recorded in England, seems to have been from 1816-1818, when after the overthrow of Napoleon, prices rose 42% from their lowest in two years. This under the value system would have meant a rise in the pars of our exchange of about fifty to forty per mille every three months—which I take as an average length for a commercial bill of exchange to run, or for goods to be bought and sold before delivery. The next most violent fluctuation was from 1809-16, when prices fell about 42% from their highest in seven years. This is about fifteen to twenty-five per mille in every three months. I shall, however, try to show that such violent fluctuations in the value of bullion could not occur if the proposed system were adopted even by one great commercial country. First of all these very violent fluctuations are all of old date. At any rate, the maximum within the last thirty years or more has been about 7% in a year. It is therefore pretty clear that modern conditions have gone far to limit the rapidity of fluctuations of prices. Secondly, even when we see a fluctuation of 5% or so in a year in English prices, this is not as a rule due to any change in the value of the precious metals at all approaching to permanency, but simply to a transient fluctuation in English credit. These credit fluctuations, we have seen, the system would strongly tend to check. Lastly, taking our present stock of gold at £100,000,000, an appreciation of fifteen per mille in three months, which is 6% per annum, would liberate half a million pounds' worth of bullion, or circulate the equivalent thereof in notes, every month. This would clearly have a great tendency to check the appreciation.¹ A depreciation at the same rate would cause half a million to be absorbed every month, which would exercise a great effect in checking the depreciation.² We may then safely say that the value of bullion would be far more constant than now. Moreover, the effect of the system would certainly be to render gradual such changes as did occur, and therefore, as in the past thirty years a change of sixty

¹ The process would probably be: surplus of gold in hands of Government; issue of notes against this; presentation of notes to obtain gold for export.

² The process would probably be: deficiency of gold in hands of Government suppression of notes; influx of gold to Bank to make new notes.

per mille in a year has been almost unknown, we may take something under fifteen per mille in three months, perhaps ten per mille, as the limit of change in the value of bullion, and hence in the *pars* of exchange. Even this is assuming that only one great nation adopted the system. It is apparent how much greater the effect would be if two or more did so; and how much easier it would be for other nations to adopt it when one had done so.

Fluctuations about the *pars* of exchange would go on as now according as the balance of indebtedness took the exchanges above or below par; only they would be movements about a moving point like the moon's about the earth. The actual fluctuations in current rates would therefore be sometimes the sum and sometimes the difference of the new fluctuations in the *pars* and of the present fluctuations, and hence would sometimes be greater, *sometimes less* than at present. These present fluctuations, which may occur not over three months but at any time, vary in the case of gold-using countries from I think eleven per mille in the Paris exchange for bills at sight, to forty per mille in the Australian, and even, according to Mr. Goschen,¹ to as much as one hundred per mille, in rare cases, for bills with some months to run. With countries having inconvertible paper currencies, fluctuations are unlimited, and even with silver-using India a change of sixty per mille in a single day would be no great marvel, and changes of seven and a half or fifteen per mille in a day (*i.e.* $\frac{1}{8}d.$ or $\frac{1}{4}d.$ in the rupee) occur with great frequency. Should America resume free coinage of silver, our exchange with India would jump 300 and more per mille.² While, therefore, I do not wish to make nothing of an addition of ten or fifteen per mille to the possible variations in foreign exchanges within three months, I do claim that it would not be so great a matter as might at first sight appear. Its effect indeed in such cases as the French exchange would be considerable, but bills at sight or for very short periods would scarcely be affected, at least with countries near to us, and the cases in which the present fluctuations for bills at three months are not large, comparatively, must be almost limited to a few European countries and the United States of America. This last again will probably be on a silver basis soon.

But what of the action of foreign Governments? If, for instance, one of them should establish a gold coinage, might not the effect

¹ *Foreign Exchanges* (14th edition), p. 64.

² *i.e.* from about $17\frac{1}{2}d.$ per rupee (August, 1891) to nearly $24d.$

be to appreciate gold beyond the suggested limit of 6% per annum? Perhaps, but even in this case hardly much beyond. It must be remembered that all the gold for such a purpose would not be drawn from England; we should surely not, in any conceivable circumstances, give up more than ten millions in a year, and this would correspond to a change in par of exchange equalling twenty-five per mille in three months. Perhaps, however, no country is likely to take such a step unless some other should liberate gold: the ruinous cost and disastrous effects have been too well proved. In any case this is no new danger: it is only the form that is new. I have not, therefore, included it in my estimate above of the possible additions to the fluctuations of exchange. Under the present system it would inflict untold disaster upon both our home and foreign trades: under the proposed our home trade would be thoroughly protected and our foreign at least no more vulnerable than now. In the reverse case of any great foreign country demonetising gold the change in our exchanges could hardly be greater, even if the great countries now so eager for gold (Germany, *e.g.*, with her half-demonetised silver) did not snap up the whole amount liberated.

Of course the ordinary trader would have to insure himself against these fluctuations. If he were both an exporter and importer he would be insured by buying his imports and selling his exports in foreign moneys. Apart from this and other methods of 'cover,' and from the expedient of dividing the risk between buyer and seller, the bill-broker would be the buffer between merchants and the fluctuations. Merchant A having just contracted to receive 10,000 francs three months hence in Paris, instead of taking the risk on the exchange goes to a bill-broker and sells a bill at the current rate of exchange. Merchant B having just contracted to pay 10,000 francs in Paris three months hence, goes ten minutes later and buys that bill at a trifle higher rate. Thus A and B are both insured, while the bill-broker is equally secure. He no doubt takes the risk between buying and selling the bill, and also that of having a balance of gold to send to or receive from abroad, and of losing or gaining on that balance through the change in its English mint-price. If, for example, there is a balance of indebtedness from abroad to England, the bill-brokers will buy more bills on foreign cities than they can sell, and must bring home gold. If meantime the mint-weight has been raised, this will mean that having bought bullion, at, say, 77s. 10½*d.* per oz., they have now to sell it at less. For this purpose, be it noted, all foreign countries would be as one. The bill-brokers need not

mind what the English mint-weight was, if having a balance due in Paris they had an equal one to pay in Berlin. Again, it does not follow that the bill-broker would always lose on bullion shipped; of course he would have to bear the cost of transport, &c., but otherwise he might sometimes gain; he might sometimes sell his gold dearer or buy it cheaper than he calculated. It may be shown, however, that this would happen less often than the reverse. At any rate, it would only be a small proportion of all the bills he bought and sold which he would have to provide for by gold shipments, so that his net loss under this head could not be large when stated as a percentage upon his gross transactions. If in practice it proved that his risks were greater under the new than under the old system, his margin between the prices at which at any moment he will buy or sell bills on a foreign city must become greater. We have seen that this increment could not be great. Yet it measures the increased price which the foreign merchant would have to pay for insurance and the hindrance to foreign trade.

If we take the extreme case of a foreign Government producing an influx of gold into this country to the extent of ten million pounds sterling—an amount as we saw almost beyond possibility—we shall form some idea of the really moderate extent of this hindrance. It would involve a rise of mint-weight and therefore of par of exchange by 10 per cent. in a year, or 25 per mille in three months. Again taking three months as an average length of a bill, we find $2\frac{1}{2}$ per cent. of ten millions, *i.e.* a quarter of a million sterling, as the limit of loss to the brokers by having to remit this enormous if not impossible amount of gold. Even this is assuming they had not seen what was going on even when it had begun, or had taken no means to protect themselves by higher rates, &c. No doubt a quarter of a million is a very great sum, but divided among the bill-brokers, English and foreign, it would by no means endanger their position. In fact, it can only be a smallish fraction of 1 per cent. upon the total of English foreign trade for which bills are drawn, bought, and sold in a year. Compared to the effect upon us now of such supposed action of a foreign Government it is a mere nothing.

The really injurious fluctuations in exchange which most impede trade are those which occur from day to day, as when the rupee jumps a farthing. These coming between offer and acceptance in many a negotiation cannot be guarded against and are a grievous hindrance no doubt to trade; but the proposed system would not cause them to any appreciable extent. By making up

the index number nightly the fluctuations due to it could rarely exceed one or two per mille on any day or even in a week. Before leaving foreign trade we may note that in one very important respect it would be very greatly steadied and facilitated by the proposed system. The importer into England would be in much less doubt than now as to the price at which his goods would sell on arrival, and similarly the exporter from England as to the price at which he could purchase by and by. No doubt there would still be fluctuations in the price of individual commodities, but as these generally nearly all rise together and fall together the fluctuations even of an individual price must be less under the proposed system. The rise or fall, then, would only be equal to the amount by which now it differs from the average. Indeed we may go further, for now a great rise or fall in some particular commodity is often merely due to a general expansion or contraction of trade, and these latter being prevented by the proposed system, there would be, perhaps, no rise or fall of that individual price at all.

Professor Marshall, writing of another proposed method to make the pound sterling a unit of fixed purchasing power, has said :¹ 'The researches of Mr. Palgrave and Dr. Soetbeer show that a unit of fixed purchasing power in England would give a more nearly uniform purchasing power in any other civilized country than would an ounce of gold or an ounce of silver. On the whole this currency' [a regulated inconvertible paper one] 'would, I believe, give more stability to our foreign trade than our present one.' If this be so, it is surely much more true of a regulated *convertible* currency.

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¹ *Contemporary Review*, March, 1887, p. 371 n.