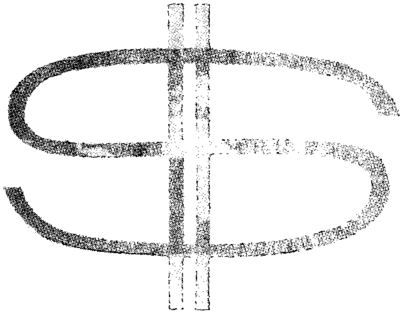

A World Monetary System

GEORGE WINDER

FROM THE DAYS of the goldsmith bankers until the outbreak of war in 1914, the cash which British bankers promised to pay their depositors, and to holders of their notes if called upon to do so, consisted of gold or silver coins. The only exception was during the Napoleonic Wars, but, in 1821, after more than twenty years of inconvertible paper money, the British banks reverted to gold payments, and Great Britain entered upon her great age of expansion.

During the nineteenth century, all the other leading commercial nations of the world adopted gold as the basis of their currency. Although it is not always realized now, the effect of this was to give the world an international money. The metal coins of the world might bear different names and have different weights, but, as long as they were gold and could be exchanged freely, what did that matter? An ounce of gold is an ounce of gold whether it is made up of sovereigns, louis d'ors, ducats, or the chief coins of any nation, and it can measure values anywhere on earth.

The result was that international payments during the nineteenth century ceased to be a problem. The only obstacle confronting those who wished to send money from one country to another was the cost of shipping and insuring gold, which was seldom more than one per cent of the value involved. This meant that rates of exchange never varied more than one per

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cent from the gold parities of the currencies.

In actual practice, the international money which facilitated the world's trade consisted not of gold itself, but of promises to pay gold written on Bills of Exchange. A Bill of Exchange signed by one of the famous London acceptance houses became the currency by which most of the commercial world carried on its international trade. Even the Chinese, who still clung to silver coins, received without question a Bill on London in exchange for their cargoes, for they knew it gave them a currency which was accepted anywhere in the world. India gained all the benefits of the international gold standard by keeping the rupee at a fixed ratio of fifteen to the pound.

The existence of this international money was also of great benefit to the London financial houses in enabling them to invest money abroad. They lent British pounds sterling, convertible into gold, in return for promises of repayment in money convertible into the same weight of gold, and with interest in the meanwhile. Between lending and repayment this weight could not vary, so that the possibility of repayment in seriously depreciated currencies did not arise.

In practice, the money never left England. It was used to purchase capital equipment, such as railways and harbor installations, farming implements, and tools, and was repaid not in gold but in wool, cotton, rubber, meat, cheese, butter, and a thousand other kinds of foods and raw materials.

Nineteenth Century Development

In 1821, when Great Britain returned to the gold standard, New Zealand, Australia, Canada, and South Africa were only the outpost homes of poverty-stricken pioneers. In 1914, when she left that standard, they were great and prosperous nations. We are sometimes adjured today to invest money in the Empire. Never has more money been invested in an Empire, and never have so many countries developed more quickly than during the nineteenth century, and no government ever thought of asking its people to invest money. People invested because there was security in the world, and the existing monetary system facilitated the free transfer of money from one country to another.

The Industrial Revolution, and more particularly the development of steam transport, both on land and sea, had made small economic units in the nineteenth century quite incompatible with modern ideas of prosperity. The expanding world economy, with its growing economic unity, was the world's response to its new environment. Of course, this very desirable measure of unity was not brought about solely because the world possessed in the gold standard an international currency, but this was undoubtedly a very important factor in its development.

A Free Market for World Trade

Another factor, which must not be overlooked, was that during the whole of this period Great Britain was a free trade country. This gave the world a central market in which there was hardly a commodity which was not bought and sold. Such a market, in which the price of world commodities fluctuated in accordance with the laws of supply and demand, unhampered by state intervention, acted as a co-ordinator of production all over the world.

In the price of goods on the London market, producers had a sure guide as to what the world needed, and what commodity it would pay them best to produce. In the nineteenth century the wealth-creating division of labor, with its specialization of production, was practiced more than ever before or since.

In particular, it should be noted that the willingness of Great Britain to take all the products of her Colonies and Dominions – without obstructions from tariffs or quotas of any kind – was a vital factor contributing to their economic growth. Although, before the end of the nineteenth century, the Dominions had placed protective tariffs against certain products of the Mother Country, they were of minor importance, so that it can safely be said that, at this period in its history, the British Empire constituted a free trade unit as important to the world as the internal free trade area of the USA is today.

While the gold standard, and the British policy of free trade, induced the countries of the British Empire and the New World to specialize their production to meet the demands of an international market, it also had the effect of forcing Great Britain similarly to serve that market, and to do so with great efficiency.

The British banker had every inducement to lend as much money to the British manufacturer as he could. His profits depended on his doing so. At the same time, he knew that every loan by creating new deposits increased his liabilities. As a result, he placed his loans where they would produce the most returns. Invariably, of course, this was where they would enable the borrower to produce the greatest value in salable goods.

However, the optimism of the businessman is contagious, and sometimes this infection is caught by the banker. Too much money is lent, prices rise, and a boom eventuates. This susceptibility of the banks has its advantages. It enables the businessman to seize a new market at the right time. Sometimes, however, the market dies, and British manufacturers find themselves producing goods that cannot be sold so easily, and costs which have risen during the boom prevent them from lowering prices. Exports begin to fall, and less foreign money is earned by Englishmen.

Those who want foreign money to buy imports have to pay more sterling for it, so the rate of exchange goes against the pound. It becomes profitable for a foreign holder of deposits in a British bank to demand gold for them and to ship it out of the country. In other words, because of high prices or the unsuitability of our goods, the foreign or Empire buyer with credits in Great Britain preferred our gold to our goods.

The remedy for such an unpleasant contingency was, of course, to cheapen our goods, and, at the same time, to redirect our resources to the production of commodities the customers did want.

Many modern economists would no doubt see in such a situation a strong argument for state economic planning. However, it is difficult to see how a democratic government can order factories to lower their prices and to lower their costs, including wages, and to produce exactly what the customers want. The remedy in Victorian days was at hand in the salutary working of the gold standard, which acted quickly and effectively without any centralized direction.

The Gold Standard

The first reaction to the substitution of gold for goods in our export schedule was that the banks, knowing that they could be compelled by law to meet all demands upon them in gold, took steps to reduce their liabilities. This meant that they reduced their loans.

They met the unusual demand for gold, first from their own gold stocks, and, for the rest, they called upon the Bank of England. When their demands began to be felt by this great bank, it became mindful in turn of its obligations, and the famous Bank Rate would be raised. This would increase the rate for discounting Bills, and eventually all other rates for new loans.

The whole economy would be tightened up. With dearer and reduced supplies of money, there would be an all-round fall in prices.

Industries which were in a bad way, through the loss of foreign markets, either reorganized themselves or went bankrupt. If the latter, their workers, and possibly their capital equipment, were thrown on the market, to be absorbed in a very short time by industries which could meet the existing demand. Lower costs, including lower wages, would enable industries to recapture the markets they had lost, and gain new ones.

The increased interest rates acted as an automatic test of the fitness of an industry to survive. Whereas a slack factory might just get by and wastefully utilize the factors of production when interest rates were 4 per cent, it would go out of production when that rate rose to 6 per cent.

At the same time, the higher Bank Rate would induce the oversea investor to leave his money in Great Britain to earn the higher rate of interest. Holders of foreign money became anxious to exchange it for British sterling, and gold would soon be streaming back to the bank's coffers, and interest rates would once again be reduced to their normal level.

Thus the gold standard, acting upon a free price mechanism, gave the British manufacturer a sure guide to world demand and so helped the British people to make their living serving the world's markets. After every depression they served those markets a little better, so that very soon wages rose again and, over the whole period, the real standard of living rose continuously in a manner unprecedented in history.

The age of the world's international gold standard came to an end with the outbreak of war in 1914, and, with it, ended that growing economic unity which was an outstanding feature of the world of the nineteenth century. • • •

EDITOR'S NOTE: The foregoing is a portion of Chapter XIV of Mr. Winder's new book, *A Short History of Money*, published by Newman Neame, Limited, in association with the Institute of Economic Affairs in London.

This highly readable story of the evolution of money also carries the author's explanation of the mechanism by which inflation has been brought about in Great Britain – and in other countries with a central banking system under government control.

Clothbound copies of the book (188 pages, indexed, $2.50) are available through the Foundation for Economic Education, Inc., Irvington-on-Hudson, N. Y.

THE ONLY WAY TO *Sound Growth*

LAWRENCE FERTIG

WARNING! Inflationists (and those who fall under their influence) are now operating under an effective disguise. Since they know that the word inflation is unpopular, they do not dare to openly endorse it. Instead, they try to achieve their objective by hiding behind a more popular word.

The inflationists' new device is to wave the banner of "growth." Of course, they say, we are against inflation. Of course, they assert, we are not in favor of zooming prices. But after all, they quickly ask, isn't growth the *really* important thing – shouldn't we achieve growth (with government in the driver's seat as planner and spender) *even at the expense of some inflation*?

By phrasing the issue this way they imply that inflation promotes growth. They imply that anti-inflationary measures and a stable or declining price level actually *prevent* growth. These assertions are made despite a long history which proves that the opposite is true. Inflation actually endangers sound growth. Much factual evidence on this growth-inflation subject is available, but within this brief column we have room for only a few instances.

German and British Experience

Take the course of the Federal Republic of Germany and of Great Britain from 1948 to 1955. Germany turned her face against inflation while Britain inflated at the rate of about 4 per cent per annum. German industrial production increased 134 per cent as opposed to the British 24 per cent. German *real* wages increased 90 per cent, whereas in the United Kingdom they went up only 7 per cent. All of this is related to the fact that German prices actually *fell* 5 per cent while British prices *increased* about 45 per cent. Cur-

Mr. Fertig is a columnist on economic affairs, *New York World Telegram and Sun* and other Scripps-Howard newspapers, in which this column first appeared August 24, 1959.