

MONETARY STABILITY



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MONETARY STABILITY

BY

J. R. BELLERBY

AUTHOR OF

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PREFACE

THE subject treated in the present pages is closely connected with that of unemployment. It was, in fact, the study of unemployment which first led the present writer into the field of monetary policy; for it is now widely recognised that the relationship between these two questions is so intimate that neither can be examined without some reference to the other. However, although the connection is close, there are many considerations other than unemployment which affect monetary policy. Financial, economic and social interests of a varied nature are involved, all of which demand due consideration before the final policy can be decided. Thus, although the search for a solution of unemployment leads to the study of monetary principle, it thereby opens up a wide field of research involving other complex problems.

The examination of such problems has entailed frequent application to economists and organisations of various kinds in order to secure a clearer understanding of the technical points involved. The advice received, although originally intended for more

official use, has to a large extent assisted the preparation of the present essay, and I had hoped to take this opportunity of expressing my appreciation for the exceptional courtesy and kindness shown by those approached. If, however, my debt appears to go unrecognised, the failure lies rather in the difficulty of interpreting so wide and personal an obligation. Happily, those to whom I owe the greatest debt are independent of any notes which might appear in these few intended lines of thanks.

J. R. B.

INTRODUCTION

THE events of recent years have added considerable support to the thesis that disaster is perhaps the most effective spur to progress. In general, serious loss provides incentive to search, not merely for a temporary remedy or device, but rather for a permanent cure. The war itself has been perhaps, of all catastrophes, the most fruitful of such results. For although in many spheres confusion has resulted from relaxed control, constructive thought has also broken from the bondage of convention, and has been able to produce, out of the confusion, new structures built on more logical and lasting bases.

Monetary systems have been no exception to the rule. Several years of swiftly changing standards have caused such widespread dislocation as to compel the adoption of active measures of reform. Already developments have taken place in different quarters, which mark a definite gain on pre-war principle; and there is reason to believe that the process of reconstruction will continue until the ultimate position reveals a universal balance of advantage.

At the present time, however, the situation is so

fluent and uncertain as to give reasonable occasion for doubt as to the immediate future of monetary reform. It is true that real gains can be recorded. Money has now, in point of fact, acquired more stable value than at any time since the outbreak of the war. In the United States, Great Britain, Sweden, Switzerland, the Netherlands and many other countries, the past three years have been marked by a relatively high degree of price stability. Numerous other countries, such as Germany, Hungary and Austria, have succeeded in stabilising their exchange and so tying their fortunes to the dollar or to sterling. But in spite of this appearance of gradually increasing solidity and strength, a certain lack of confidence still prevails. Nowhere is there adequate assurance that the relative price stability attained will be preserved. And whereas the stability itself is important, confidence in its continuance into the future may be almost equally so.

Two conditions would seem essential before full confidence in the price policy of the future can be restored. The first is that of securing universal agreement on the monetary standard which would yield the best results. This problem is, however, approaching daily nearer its solution and will therefore receive comparatively little attention in these pages. It seems probable that the various forces working for the return of gold will bring that metal into use in the large majority of countries just as

soon as industry is able to support the strain and undertake the risks. And whereas one may hold the view that the non-metallic standard constitutes the Utopian way, there can be no question that the gold regime is capable of being moulded in such a manner as to satisfy completely the requirements of a price stabilisation policy. In these circumstances, the nature of the system itself may be of less importance than the achievement of general unanimity thereon. However this may be, the argument throughout these notes assumes—a little regretfully, perhaps—that there will be a widespread abandonment of the greater freedom of the paper standard and a general concentration on a theoretically perfect, but perhaps less plastic regime, the Genoa system for a gold exchange standard.¹

The second principal condition for the return of general confidence, and the one with which this essay is more particularly concerned, is that clear definition should be given to the policy of stabilisation to be adopted. In illustration of this requirement, it may be shown that when, for instance, the value of a currency is stabilised in terms of gold, that currency is made equivalent to a *defined* weight of gold. Similarly, when one currency is stabilised in relation to another, precise limits are *defined*

¹ These pages were written before the resumption of the gold standard by Great Britain, a circumstance which makes the above forecast still more certain.

within which fluctuations of the exchange rate are to be restrained. Without such clarity of definition the policy of stabilisation would in either case be meaningless. The same is true of any policy of price stabilisation; if stability of currency in terms of what it buys, commodities, is to be secured, one essential element for the new development is to define in unambiguous terms the precise nature and degree of the stability to be attained.

The importance of giving clear definition to the objective in view will be more readily perceived when, in the chapters which follow, an account is given of the somewhat complex machinery necessary for securing price stability. Under the gold regime, no country will be entirely independent in its monetary policy; and in order to safeguard the principle of price stability, international agreement and co-operation will be necessary. It is evident, however, that international agreement is impossible unless the policy to be mutually approved is capable of definition. Neither is it sufficient merely to express the policy in terms of general principles; for, when the aim in view can only be attained through a number of countries working separately in their different spheres, they must one and all interpret that aim alike. And for uniformity of interpretation, clarity of definition is the first essential.

Furthermore, various important forces are working against the principle of price stability. There is

first the natural swing of industry itself. Unless the fluctuation of trade can be restrained, it will destroy the effort to maintain a steady level of prices. Again, with the restoration of gold as an essential element in the monetary system, there will be a tendency for that metal to claim complete command once more. The gold situation may gradually force its way into recognition as the dominant criterion for credit regulation, to the detriment of price stability. So long as such conflicting influences remain, there can be no security for the principle of price stability unless it is intelligibly defined. The executive responsible for monetary policy are lost unless they have in mind some precise conception of what they are trying to preserve.

Such broad ideas will take more concrete form when the mechanism for securing monetary stability is more closely examined. At the outset, it seems clear, however, that, both for the purpose of devising the national and international measures necessary for bringing price stability into force, and for the safeguarding of that principle once in operation, the clearest possible definition must be given to the aim in view.

The aim to be attained does not, however, lend itself easily to definition. Two alternative methods of describing price stability will be suggested here. The first, the more precise, requires the recognition of a given level of prices as "normal," and the main-

tenance of the price level always within reasonable range of that position. The second, permitting less precision, but more discretionary power, assumes that price fluctuations should be judged according to their effects; only when the movement becomes so rapid as to introduce unhealthy tendencies, should the movement be restrained. Under this second system, the price index is supplemented by subsidiary indices of speculation, employment and production, indicating the actual effects of the change of prices.

In order that these methods of defining the objective of monetary stabilisation may be clearly pictured, they are shown more fully as the working basis of two complete alternative systems of price stabilisation. The two systems, which are thus built up, are quite distinct; and they demand that a definite choice should be made between them. Accordingly, they are set up side by side and examined in relation to six important tests, to determine which will give the greatest satisfaction from all social points of view.

The defining and the testing of these two alternative systems of price stabilisation forms the principal theme of the present essay. Perhaps the task involved is of a somewhat exacting nature; for it entails the development of an imaginative picture, showing each stabilisation system in actual operation; and then a comparison has to be made of the probable results which each would give. All that is claimed, however, is that the task is an essential one, and must

inevitably be taken up by those who wish to see the principle of monetary stability applied. Without definition, this principle can inspire no confidence; neither can it be consciously attained by those who guide our monetary policy.

It is not suggested here that the urgency of giving definition to the desired objective has been entirely disregarded. Numerous economists have defined precisely the degree of price stability they think is needed, but unanimity is far from being reached. The arguments adduced are scattered wide in different works. Each author tends to emphasise one particular aspect, and a certain width of perspective is inevitably lost. Thus, the strong conviction still remains that, despite the mass of well-directed thought and unanimity on broad conclusions, society is not yet ripe for price stability, merely because it has not yet determined what precise nature or degree of price stability is universally desired.

CONTENTS

	PAGE
PREFACE	v
INTRODUCTION	vii

PART I

DESCRIPTIVE

CHAPTER I

THE NEW PROBLEM	1
(1) The aim of a continuous credit policy.	
(2) The selection of the indexes for the guidance of a continuous credit policy.	
(3) The alternative systems of price stabilisation.	

PART II

THE ALTERNATIVE SYSTEMS OF STABILISATION COMPARED

CHAPTER II

EASE OF APPLICATION	34
(1) Under the "constant price-normal" system stability is cumulative.	
(2) The influence on demand of the market rate of discount.	
(3) The regulation of the market rate of discount through the central bank rate.	

CONTENTS

xv

PAGE

- (4) The function of the State in monetary stabilisation.
- (5) The forecasting of price movements.
- (6) The choice of the price index to be stabilised.
- (7) The method of applying the "constant price-normal" system.

CHAPTER III

PRICE STABILITY IN RELATION TO CONSUMPTION 60

- (1) Price fluctuations and the growth of stocks of commodities.
- (2) The speculative stimulus.

CHAPTER IV

SOCIAL JUSTICE 69

- (1) The meaning of justice.
- (2) Price fluctuations in relation to the current idea of social justice.
- (3) The right of property.
- (4) Considerations of expediency.

CHAPTER V

INDUSTRIAL AND SOCIAL RELATIONS 82

- (1) The general connection between price changes and industrial relations.
- (2) The relative influence of rising prices and falling prices.
- (3) Indirect effects of price changes on industrial relations.
- (4) Development of measures of conciliation.
- (5) The evidence of statistics.

CHAPTER VI

INTERNATIONAL CONSIDERATIONS 104

- (1) The monetary link between countries.
- (2) Price changes and the real value of international debts.

CHAPTER VII

	PAGE
THE GENOA PROPOSALS FOR A GOLD EXCHANGE STANDARD	116
(1) The pre-war gold standard.	
(2) The present gold situation.	
(3) The possible effects of the post-war gold situation.	
(4) Measures recommended by the Genoa Conference for obviating the fluctuation of prices.	

CHAPTER VIII

THE BALANCE SHEET	133
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APPENDICES

I. INTERNATIONAL MEASURES NECESSARY UNDER THE GOLD EXCHANGE STANDARD TO SECURE PRICE STABILITY	147
II. BRIEF COMPARISON OF THE GOLD EXCHANGE STANDARD AND THE NON-METALLIC EXCHANGE STANDARD	159