

FIRST EDITION.

GOLD BOOM OR SLUMP

by
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**A Critical Examination of the Outlook for
Sterling and Gold Shares**

PART I. Forecasts.

PART II. The Dominant Risk.

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DEFINITIONS.

GOLD PRICES : Commodity prices, as measured by index numbers, within the on-gold countries.

THE PRICE OF GOLD : The statutory or market price for the metal.

STABILISED PRICES : A stabilised index level of prices, the individual prices composing the index being allowed to fluctuate according to demand and supply.

RISE OR FALL IN DOLLARS, ETC. : Throughout this book I use the expressions "rise" or "fall," not in terms of the numerical market quotation, but in terms of exchange value. For instance, I take a movement in the dollar from 5 to 6 to the £ to be a "fall" in the dollar, although it is a rise in the quotation.

PRICE INFLATION : A rise in commodity prices due to monetary causes.

PRICE DEFLATION : A fall in commodity prices due to monetary causes.

COUNTER INFLATION : A deliberate reduction in the volume of money aimed at checking a further rise in prices.

COUNTER DEFLATION : A deliberate increase in the volume of money aimed at checking a further fall in prices.

MONEY OR CURRENCY : Anything which is generally accepted by the public in settlement of debt, i.e., bank deposits, as well as notes and coins.

TOTAL SUPPLY OF MONEY : Coins not used as backing for notes; *plus* notes not used as backing for bank deposits; *plus* transferable bank deposits, i.e., current or demand deposits as distinct from fixed or time deposits.

N.B.—In the supply of Money, I, of course, include bank credit as well as legal tender, just as when I talk of Traffic I include motors, even though they are merely a "convenient substitute" for horses.

THE DEMAND FOR MONEY : (a) The amount required as a medium of exchange for effecting expected expenditure before the next anticipated replenishment of monetary income; plus (b) the amount required for hoarding purposes either so as to keep "liquid" or as a speculative investment against an anticipated general fall in prices.

The demand for money thus arises from two separate motives: (i) for use as a medium of exchange; (ii) for use as a store of value.

INFLATION : A quantitative increase in the supply of money (as defined above), regardless of the immediate effect on prices.

DEFLATION : A quantitative decrease in the supply of money (as defined above), regardless of the immediate effect on prices.

REFLATION : A quantitative change in the volume of money aimed at restoring the price level to a former figure either upwards after a price deflation, as in America in 1933; or downwards, after an inflation, as in England in 1920.

PREFACE.

A warning to Bulls of Gold Shares and Bears of Sterling.

In this pamphlet I have argued that the present influence of the dollar on sterling is to make the pound decline, because the dollar is some 15 per cent. undervalued, whereas it ought to be overvalued because America is not only a creditor nation but also has an export surplus on trading account.

But does undervaluation of the dollar really exist as supposed ?

On page 470 of *The Economist* of March 2nd will be found a table showing that American internal prices have risen 18 per cent. since mid 1933 (and that French internal prices have fallen 10 per cent.) while those of Great Britain have been virtually stationary.

Thus the recent decline in the pound plus the rise in American internal prices *may have* largely wiped out the undervaluation of the dollar on which the optimistic *immediate* forecasts for gold shares in this pamphlet are based.

The influence of tariffs must not be forgotten. The British 10 per cent. import tariff tends to make sterling dearer than it otherwise would be (see page 3), but this is probably more than cancelled out by the even higher tariffs of America and the Gold Bloc; so that on the score of tariffs *alone* sterling should probably show undervaluation rather than overvaluation in relation to the gold currencies, as measured by purchasing power parities.

Similarly, on international debt and trading account^d the dollar should, other things equal, be *over-valued*.

* Yet, on internal price "prospects" the dollar should probably be *undervalued*, because of the declared reflationary policy of the Administration aiming nominally at a further 25 per cent. rise in prices.

My net guess at the present position, particularly in view of the fugitive capital now in London, is that the pound should depreciate a little further, even before France devalues.

Sterling, however, does not move solely with English internal prices and with the English export-import balance; but rather with the Sterling Area's prices and foreign trading balances, because other countries have linked their paper currencies to sterling. Consequently English index numbers are not a true guide to the correct international value of sterling and of the currencies linked to it.

If, however, the undervaluation of the dollar has *already* disappeared, as *The Economist* figures suggest, the *immediate* prospects for gold shares are not so bullish as the trend of this pamphlet suggests.

PART I.

CONDITIONAL FORECASTS

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INTRODUCTION.

Since the distributable profits after taxation of the gold mining companies in South Africa are only about 25 per cent. of the present price of gold, a 10 per cent. change in the price of gold is, in its effects on *distributable* profits, equivalent to roughly a 50 per cent. change in dividends. The future price of gold is therefore crucial to all holders of gold shares, especially the high cost producers.

At the time of writing England is off the Gold Standard and the price of gold is about 143/-. If England returns to gold at a permanently fixed parity, the selection of this permanent parity will settle the price of gold in England. If however England remains off gold, the price of gold in London will be determined by the exchange rate of sterling with the on-gold countries.

The actual forces which govern paper exchange rates are dealt with fully in my forthcoming book *The Problem of the Foreign Exchanges*, but broadly speaking the chief influences are as follows :—

Currencies in terms of each other are relatively worth roughly what they will relatively buy internally. For instance if a pound will buy eighty times as much as a franc and five times as much as a dollar, the rates of exchange "should be" approximately 80 to the pound and 5 to the pound. This is the theory of purchasing power parity.

If current exchange rates are *not* at the levels represented by the figure for purchasing power parity, then they are said to be either over- or under-valued. The currency of the country whose domestic prices are lowest as measured over the exchanges has the under-valued currency; the other currency by contrast is over-valued.

Other things equal, undervaluation stimulates exports and checks imports, thus causing a country's exchanges to improve. Overvaluation has the opposite effect. Thus rates are always tending, other things equal, to return to purchasing power parity.

It is true that the existence of purchasing power parity does not absolutely guarantee an exact equation of imports and exports (direct and triangular); differences in international tastes may cause an excess one way or the other. If this is the case, exchange rates will normally have a tilt to one side of purchasing power parity so as to allow for the differences in tastes.

Tariffs may also play a disturbing part. For instance, if Germany puts on a 42 per cent. all round export tax, as she did in 1922, the tax has the effect of making the net external prices of her goods 42 per cent. dearer to foreigners, and is similar in its influence on exports to a 42 per cent. higher internal price level. The mark in fact tends to become more depressed. Export bounties have an opposite effect.

Similarly if England puts on an all round import tax of 10 per cent., as she did in 1931, its influence is to make foreign goods dearer to Englishmen and tends to improve sterling in relation to other currencies. Remove the tariffs and there "ought to be" a relapse.

Another cause of deviation away from purchasing power parity, both under paper and gold, is the existence of old international debts. If England is a debtor to America, and is paying regularly, her exchange rate tends, other things equal, to be below purchasing power parity, i.e., undervalued,* so as to stimulate that excess of exports needed to earn the surplus dollars so as to settle the debt (over and above the dollars required for normal import account).

Additional causes of deviation, such as new loans, flights of capital, movements of speculative funds, etc., are dealt with in Chapters X and XI of my forthcoming book, *The Problems of the Foreign Exchanges*.

But although relative internal prices are not the only factors† which, by influencing exports and imports or the international balance of payments, affect the exchange rates, they are undoubtedly the dominant factor. Changes in the price level in England, therefore, and in the other important on-gold countries, are the chief influence on sterling rates of exchange and therefore on the price of gold in England.

In making forecasts for gold and gold shares the following considerations should be borne in mind:—

* If both countries are on gold the deviation takes the form of lower gold prices in the debtor country than in the creditor; for gold is exported by the debtor to the creditor and credit is deflated in the debtor country, whereas it ought to be inflated in the gold-receiving country.

† For a bird's-eye view of the problem as a whole, see Chapter XXII of my earlier pamphlet, *The Coming Collapse in Gold*.

CHAPTER I.

THE INFLUENCE ON THE PRICE OF GOLD OF CURRENCY OVER-VALUATION ABROAD.

If *all* the on-gold currencies were *over-valued* in relation to off-gold sterling, as in the latter half of 1933,* the undervaluation of sterling would tend to increase British exports, check British imports, and cause a rise in the pound in relation to the on-gold currencies. The price of gold in London would thus tend to fall.

CHAPTER II.

THE INFLUENCE OF UNDER-VALUATION ABROAD.

If on the other hand *all* the important on-gold currencies were *under-valued* in relation to sterling, sterling would tend to slump in relation to them, and the price of gold would rise in England.

• • • •

The above two fundamental propositions I and II are the key to our problem.

CHAPTER III.

A MIXTURE OF OVER- AND UNDER-VALUATION.

To-day, February, 1935, a half-and-half condition exists; and two opposite magnetic pulls are at work. The Franco-Flemish group of on-gold currencies is some 15 per cent. over-valued in relation to sterling and the American dollar is some 15 per cent. under-valued.

If it were not for the undervalued American dollar the over-valuation of the Franco-Flemish group would tend to lower the price of gold in London by some 15 per cent., i.e., to about 120/- (see Chapter I) and, other things equal, to cause sterling area gold shares to collapse.

On the other hand, if to-day it were not for the existence of the over-valued Franco-Flemish group, the undervaluation of the American dollar would tend to cause sterling to relapse in relation to the dollar and the price of gold to rise some 15 per cent. in London towards 170/-.

* Anyone who held sterling-area gold shares in November, 1933, when I published my *Coming Collapse* was foolhardy, unless he *knew* that America would return to gold at an *under-valued* rate. For if the on-gold franc, which was then some 15 per cent. over-valued, had returned to its proper rate with sterling the London price of gold would have fallen 15 per cent., i.e., 20/-, and the average dividend yield on South African shares would have fallen to less than 4 per cent.

Indeed it was the return of America to gold on January 30th, 1934, which turned the prospects for gold and gold shares in London from an unfavourable to a favourable nature. (See my remarks published in the *Financial News* of February 3rd, 1934, saying that in consequence of the American decision, disturbing as it would be to Continental currencies, I then looked for "a rapid and substantial rise in Kaffir shares." Indeed the Index for Gold Shares in London has risen 25 per cent. since my revised forecast of February, 1934.)

The present position of sterling, however, is that there are two opposite magnetic influences. Under-valued on-gold America is tending to push sterling down* and the price of gold up in London towards 170/-. The overvalued Franco-Flemish group is tending to pull sterling up and the price of gold down in London towards 120/-.

What then are the bull and bear factors as regards the future price of gold in terms of sterling ?

CHAPTER IV.

ACTIONS BY ENGLAND WHICH WOULD MAKE GOLD SHARES RISE.

Anything which depresses the pound in relation to *all* the on-gold currencies is obviously good for the London price of gold. Therefore inflation in England, or an adverse trade balance, or a flight from the pound due to political or other forms of fear, would cause the price of gold to rise in London.

Conversely a fall in commodity prices in England, or a rise slower than that which was occurring in the on-gold countries, or a flight *to* the pound, would tend to depress the value of gold in London.

CHAPTER V.

ACTIONS ABROAD WHICH WOULD MAKE GOLD IN LONDON FLUCTUATE.

Now let us consider the relevant factors operating in other countries, for in some of them commodity prices may rise, while in others they may remain unchanged or fall. Relativity with England is the factor at issue.

* In relation to the dollar and to the other currencies which are rigidly tied to gold.

(i) *Reflation in On-gold America.*

Obviously if a rise in commodity prices occurred in America faster than in England the undervaluation of the dollar would diminish and the magnetic pull of America would decline so that the residual magnetic pull of the Franco-Flemish group would dominate sterling, and the pound would tend to appreciate in relation to both dollars and on-gold francs. A rapid rise in American internal prices must therefore be feared by English hoarders of gold and by holders of sterling area gold shares.

(ii) *Continental Deflation or Reflation.*

European influences are not so obvious; but clearly if the Franco-Flemish group deflated their internal prices so rapidly as to make their on-gold currencies as under-valued in relation to sterling as the American on-gold dollar is at present, sterling itself would tend to collapse and the price of gold would rise in London.

Conversely if internal commodity prices in the Franco-Flemish group rose rapidly, thus making their on-gold currencies still more over-valued in relation to the pound, the magnetic pull of this group in London would increase, and the pound would tend to improve in relation to *all* the on-gold currencies, and the price of gold in London would therefore tend to fall. Thus any policy in France of staying on gold at the present pre-depression parity, and at the same time of reflating prices internally by a cheap money policy, is a bearish factor for gold and gold shares in London.

• • • •

Thus we see from (i) and (ii) that reflation in either America *or* on the Continent (at a rate *greater than* any reflation in England) is a bear factor for gold and gold shares in London.

If either group reflates faster than England it is bad for sterling area gold shares; if both groups reflate faster than England it is even worse.

(iii) *Digression concerning Reflation in America.*

The reasons why the American industrial revival hangs fire, despite all the physical and monetary foundations having been laid, is because Mr. Roosevelt has given business men the impression that even if they do make profits they will not be allowed to retain them. Such a belief under capitalism is disastrous, because it makes business men afraid to show enterprise. Thus labour remains unemployed; incomes are low, and prices fail to rise. Money in fact, although redundant, is hoarded in America as fast as it is inflated, because Business is frightened of Roosevelt's *apparent* hatred of Profits. If Roosevelt would show a pro-profit tendency, the American boom would at once begin. Votes might be lost by pro-profit proclivities, but unemployment is cured (under capitalism) by a policy of raising profits *first*. This may seem unfair to the workers; it is however sound economics

under capitalism. You cannot act like a Socialist, with success, under a capitalist economy. If you do, the poor suffer most.

Moreover business men must believe, not only that they *will* make profits, but that they will be allowed to *retain* them.

Mr. Roosevelt's recovery psychology *at present* is quite wrong from the point of view of capitalism. He is therefore forced to spend thrice as much public money on public works to keep revival going as would otherwise be necessary.* An early change of attitude on the part of Roosevelt would, with only a short time lag, raise commodity prices in America (and lower the price of gold in London).

* Some day this credit currency expansion, which results from the banks largely financing the new public works, will, when it "catches," cause an on-gold inflation which Roosevelt himself may find it hard to control. He should, I think, make less use of borrowed bank money and more of psychology.

As regards gold in London: Eventually when the inflation "catches" in America it will probably make the dollar *overvalued* in relation to the other on-gold currencies, and cause gold in off-gold London to fall (although there may be an appreciable rise first).

CHAPTER VI.

POSSIBLE MAINTENANCE OF MINING PROFITS DESPITE A FALL IN THE PRICE OF GOLD.

Although it has been *implied* that the shares in South African gold mining companies will fall in price with any fall in the London price of gold *because* their profits will fall, such an eventuality is not inevitable. The enormous recent reduction in the grade of ore being mined on the Rand gives the mining companies ample scope to increase the grade more or less *pari passu* with any decline in the South African price of gold, so that even if the latter falls, profits may not fall appreciably owing to the policy of higher grade mining. Time lags, however, are likely to occur, and share markets would in consequence be temporarily upset.

CHAPTER VII.

EFFECT OF UNLINKING THE BRITISH AND SOUTH AFRICAN POUNDS.

Throughout the foregoing argument I have assumed that the South African pound will remain linked to sterling. If the South African pound is unlinked from sterling, then, so long as other important countries remain on gold, the profits of

the South African mines will depend on the price of gold in South Africa, as distinct from in London. And if it so happens that the high exports of South Africa lead to an improvement in the South African pound in relation to both sterling and the on-gold currencies, the price of gold will fall in South Africa and the profits of the mines will, other things equal, diminish.

In this connection it is to be noted that since *distributed* profits in South Africa, as distinct from gross profits before special South African taxation, are only 25 per cent. of the selling price of the metal, a 10 per cent. fall in the price of gold in South Africa is equivalent to a much larger proportional change in distributable profits. South African exchange movements are therefore of vital importance to distributable profits.

Certainly the prices of South African shares *in London* would, under the above unlinked conditions, tend to fluctuate with the sterling/South African exchange rate; but the *chief* determinant of the prices of Rand shares in London and all over the world would be the Capetown exchange rate with the on-gold countries—not with sterling.

CHAPTER VIII.

EFFECT OF STERLING RESTABILISATION.

Anxiety on the part of Rand shareholders regarding the future price of gold will, at all events temporarily, be removed if sterling is restabilised on gold and if the South African pound is kept linked to it. Or, alternatively, if the South African Government goes back to gold at a fixed rate of its own.

Thereafter profits will largely depend on costs, which will vary with South African internal prices.

The position in fact is similar to that extant in America where the values of American gold shares are now determined by the (variable ?) American statutory price of gold and costs of production within America.

CHAPTER IX.

EFFECTS OF A WORLD DEVALUATION RACE.

This chapter is bound to prove puzzling because there are so many variables at issue.

As regards the possibility of a world gold Devaluation Race: If this occurs, as is likely, it will be a bull point for the price of gold in London, particularly if England takes part; and also for South African gold shares (*unless* the South African Government refuses to take part in the race).

The question of taking part in the race is vital; but to see the matter clearly we must isolate our phenomena so as to get a succession of unconfused pictures. To start with, therefore, let us imagine the franc as it is at present, i.e., on its pre-depression parity, and over-valued in relation to sterling.

Under these conditions, if America devalues the dollar further in relation to the at present rigidly fixed franc, England, although off gold, can by means of her Exchange Equalisation Fund, keep the pound moving roughly parallel with the dollar; thus the price of gold in London will rise owing to the pound declining in relation to the on-gold franc—the decline in the dollar/franc and sterling/franc rates merely equalling the rise in the price of gold in America.

If, however, the off-gold English Government decides not to take part in the race, any raising of the price of gold in America will depress the dollar in relation to both the franc, *and* to sterling (though probably not to quite an equal extent), so that the price of gold in London will *not* rise (appreciably) as a result of the dollar devaluation. The decline in the dollar/sterling exchange rate will for the most part merely cancel out the rise in the dollar price of gold.

If, however, the off-gold sterling group takes part in the race by means of Equalisation Funds, the outlook for gold and gold shares in London is decidedly bullish *unless* the raising of the statutory price of gold in devaluating America merely keeps pace with, and does not exceed, the rise in her internal commodity prices. For instance:

(i) Further Devaluation by America in Advance of France.

If America devalues further, the undervaluation of the dollar will, assuming prices in England remain stationary, be increased *unless* American internal commodity prices rise as fast as the American statutory price of gold is raised.

The point is that if America devalues *faster* than her internal prices rise gold should, other things equal, rise in London; whereas if her internal prices rise faster than she raises her internal price of gold, the price of gold should fall in London. The vital question is whether undervaluation is increased or decreased.

Current American policy should perhaps here be noted. Mr. Roosevelt may legally devalue the dollar from the approximate present level of 59 cents to 50 cents, i.e., raise the internal price of gold from 35 dollars to 41.34 dollars, i.e., 18 per cent. His declared aim, however, is to get commodity prices up to about the 1926 level, which implies a further rise of over 25 per cent. in commodities. He is in fact aiming, apparently, at a greater proportional rise in internal commodity prices than in the American internal price of gold.* This is a bearish factor for gold shares. (Personally I rather anticipate a rise in American commodity prices unaccompanied by further external dollar devaluation. If this occurs the outlook for sterling area gold shares is still less promising. But see the next section.)

(ii) Devaluation by France in Advance of America.

If, with England still off gold, and with the dollar still undervalued, France devalues to a new (perhaps only temporarily fixed) rate this will at once reduce the over-valuation of the franc; for although certain internal French prices will undoubtedly be marked up *pari passu* with the external slump in the franc, numerous costs of production will certainly lag behind prices and some of the existing over-valuation of the franc will therefore undoubtedly be wiped out. This will tend to reduce the magnetic pull of the franc on the pound, and to allow the pound to find a more correct level in relation to the undervalued dollar (if it still remains undervalued). Going off gold by France, therefore, with or without repegging at a new rate, will under present (February, 1935) Anglo-American conditions cause a rise, not a fall, in the price of gold in London. Although quite possibly gold shares might temporarily slump in the market owing to nervousness concerning the future of gold as currency.

* * * *

N.B.—Looking at (i) and (ii) together, the short run effects of either devaluation in France (which I expect eventually) or further devaluation in America (which I do not expect at all events until France has devalued), or both, are highly likely—though not quite certain—to cause a rise in gold and gold shares in off-gold England.

On the other hand, reflation in America is, other things equal, a bearish factor for gold shares.

(iii) Partial devaluation on the Continent.

If only some of the Franco-Flemish countries devalue instead of all of them, the influences just discussed in (ii) will be reduced.

(iv) Competitive devaluation by England on gold.

Having discussed Franco-Flemish and American behaviour in isolation, always under the assumption that England remained off gold, let us now return to

the question of England, and consider what would happen if she herself took part in a world *on-gold* devaluation race.

If England re-pegs on gold, and South Africa accompanies her, that will *temporarily* settle the price of gold in both London and South Africa; but if England subsequently joins in the world devaluation race and raises the price of gold still further, sterling area gold shares should enjoy a boomlet, for costs of production in South Africa will lag behind the price of gold. (But remember the companies *might* mine an even lower grade of ore, and taxes on profits *might* be increased.)

(v) A World Devaluation Race with Off-gold England not taking part.

This section, I feel, will require at least an hour's study.

Having considered what would happen if a world on-gold Devaluation Race occurred and England *did* take part, now let us consider what would happen if such a race occurred, but if England stayed *off* gold and did *not* take part.

This is certainly the most difficult problem in this book.

Under such conditions the variable factors at issue would be these:—

1. Changes in the statutory prices for gold in the on-gold racing countries.
2. Commodity price movements in the on-gold racing countries.
3. Commodity price movements in off-gold England.
4. Exchange rates between England and the on-gold racing countries.

This supplies us with a dismaying network of variables, since in every country prices can either remain stationary, rise or fall; while movements in the new prices for gold in the on-gold countries may occur either faster or slower than their internal commodity prices rise; while finally the existing under- or over-valuation of the various currencies may be either increased, decreased, or disappear altogether.

All these matters must be carefully considered before what might be termed The Residual Differential can be arrived at, i.e., the net change, or rather changes, in over- or under-valuation which will, other things equal, influence the price of gold in London.*

• • • •

If then a devaluation race takes place between the on-gold countries, with sterling still off gold, the dominant factor at issue, in arriving at the net residual

* It is amazing, and amusing, how, despite the existence of these numerous variables, so many people talk as though the future of sterling depended merely on one or two factors. Incidentally despite the array of factors which we have mentioned, we have *not* mentioned the other variables such as tariffs and flights of capital, which are capable of tilting exchange rates a considerable distance away from true purchasing power parity. These factors, I repeat, were outlined in Chapter XXII of the *Coming Collapse in Gold* and are explained in full in Chapters X and XI of my forthcoming *The Problems of the Foreign Exchanges*.

influence on sterling of any given change, will be this: Does the rise in the price of gold in the foreign country exceed the rise in its commodity prices; and is the *net* difference, if any, wiped out by any concomitant change in commodity prices in England.

For instance, if the French currency is at present 15 per cent. over valued in relation to sterling, and if France devalues by 35 per cent. in relation to the dollar, then, other things equal, French currency will become 20 per cent. undervalued in relation to sterling. If however French internal prices rise 25 per cent. immediately, the devalued gold franc will still be 10 per cent. over valued in relation to sterling. But if sterling prices rise 10 per cent., this over valuation of the new gold franc in London will be cancelled out.

The factors at issue are certainly numerous, and unfortunately they are capable of moving in many opposite directions; consequently the problem of assessing net changes in under or over valuation by means of Residual Differentials must inevitably prove complex. Actually however the problem is not difficult, although considerable care is needed in its treatment.

Having disposed of the elementary theory, now let us get down to actual practice.

* * * *

If a world gold devaluation race occurs, with England still off gold, the price of gold and of gold shares in London will move as follows:—

If English internal commodity price indices and those of the racing countries keep *parallel*, and **IF** in consequence sterling retains its original exchange relationship to the racing on-gold countries, the price of gold itself in London will be determined by the extent to which, if any, the price of gold in the racing countries is raised *faster* than internal commodity prices rise in these on-gold racing countries.* The bigger the spread between the price of gold and gold prices the greater will be the rise in the price of gold in London.

Conversely, if foreign commodity prices in the on-gold racing countries rise *faster* than their statutory prices for gold are raised, the price of gold in London will fall (always assuming, as we assumed initially, that sterling and foreign currencies keep near their true purchasing power parities).†

* * * *

Actually of course commodity prices and prices for gold within *all* the on-gold racing countries will **NOT** keep strictly parallel (as we have hitherto assumed in the footnote). Some of these on-gold currencies will become undervalued in relation to

* The reader can assume, *for the moment only*, that all the various on-gold racing countries are *all* reciprocally keeping (a) their internal commodity price movements parallel on the one hand, and (b) their statutory prices for gold parallel on the other. Variations as between the different on-gold countries will be dealt with in a moment.

†Any deviations away from purchasing power parities introduces another variable and will, of course, have to be allowed for by forecasters as far as is possible.

the others, just as the on-gold dollar is undervalued to-day in relation to the on-gold franc.

As regards the influence of such deviations on the price of gold in off-gold England, the first two propositions in this book must now be carefully remembered, namely :—

- I. That if *all* the on-gold currencies are *over*-valued in relation to sterling, the price of gold in London will tend to fall; whereas
- II. If *all* are *under*-valued the price of gold in London will rise.

The influence on the price of gold in London, therefore, of **UNEQUAL** speeds of devaluation and of internal price reflation on the part of the different on-gold countries taking part in the devaluation race,* will depend upon the extent to which sterling remains either :—

1. Over-valued in relation to all of them.
2. Somewhere midway between the different on-gold currencies, under-valued in relation to some of them, and over-valued in relation to others (as to-day, February, 1935).
3. Under-valued in relation to all of them (as in November, 1933).

These three separate points will now be considered :—

ALTERNATIVE 1.

As regards point 1: Actually if all the on-gold countries of the world were taking part in a devaluation race, and if the British Government were refusing to take part, I am inclined to think that flights of capital would take place from the racing countries; that London would be chosen† as a receptacle for floating international funds (though not for gold); and that sterling would in consequence tend to become over-valued in relation to *all* the on-gold currencies. In other words that the exchange rates of the on-gold currencies would decline in relation to sterling even faster than their internal prices for gold were marked up. The result would be a *general* over-valuation of sterling and a fall in the price of gold in London.

But this is only a long run point of view. In my opinion a condition of general over-valuation of sterling is *unlikely* to occur until a good many heats in the on-gold devaluation race have been run off, and people have begun to lose confidence in the commodity value of gold, owing to it being successively depreciated by the various racing governments.

ALTERNATIVE 2.

In the short run, therefore—and this brings us to point 2—a much more likely situation is that sterling, as regards its over- and under-valuation, will hover

* Assuming always that sterling is off gold, and that the British Government is *not* using its Equalisation Fund to take part in the race.

† Eventually, though not to start with. See Chapter XII, Section 2.

somewhere *between* the most over-valued on-gold currencies and the most under-valued on-gold currencies (as to-day); with the result that every time a heavily over-valued on-gold country takes the decision suddenly to devalue once more, the price of gold will *suddenly* rise in London; while in so far as there is a pause between the heats, during which internal commodity prices in the *undervalued* on-gold currencies are gradually rising *without* them altering their prices for the metal, sterling would *gradually* begin to improve (see Section (i) of Chapter V), and the price of gold would *decline* in London. Alternate sharp rises and slow falls are thus likely.

ALTERNATIVE 3.

As regards point 3: I personally find it impossible to imagine a condition where off-gold sterling remained *under-valued* in relation to *all* the racing on-gold countries, unless she herself was pursuing a price inflation on paper at a speed even greater than the on-gold countries were inflating on gold abroad.

• • • •

N.B.—Throughout the foregoing remarks I have, of course, repeatedly omitted the phrase “other things being equal,” but I think that the reader will appreciate that I have been isolating the successive phenomena and merely stating the influence of single factors, other things being imagined equal.

CHAPTER X.

COMMENTS ON THE FOREGOING DISCUSSION.

The Reader might skip this purely personal chapter.

The whole of the foregoing Section (v) is I fear rather complex; indeed I ought to have made it even more complex, for there are other factors besides relative internal price levels which can influence exchange rates. For instance, tariffs, debts, loans, changes in the relationship between domestic and foreign interest rates, flights of capital, etc., can all make exchange rates deviate from purchasing power parity by an appreciable percentage.

Unfortunately it is impossible to reduce the problems of the prospective gold devaluation race to one of easy reading, since there are so many alternatives and variables at issue. It is impossible moreover to dismiss the question of a coming boom in gold or a coming slump, merely by a wave of the hand coupled with some trite remark that it depends *in the main* on so and so.

I shall certainly try in the next chapter to reduce the problem to its simplest

terms; but simplification runs the risks of inaccuracy. Moreover experience tells me that one may be assured in putting anything on paper that one will often be quoted *ex contextu* in the future, and at the same time accused of not having envisaged the various alternative possibilities. For instance, in my *Coming Collapse in Gold*, although Chapter XXX was devoted *specifically* to an analysis of what would happen to gold shares if any important country, e.g., America, manipulated its internal price of gold so as to make its currency *under-valued* in relation to sterling, i.e., that this *would* cause a boom in gold shares; most of my critics, reading only the rather ill-chosen* title of the pamphlet, have ever since in the Press accused me of "continuous pessimism as regards the gold share market." This has happened even in letters to the *Financial News*, despite that particular paper having published my "recantation" four days after Mr. Roosevelt regilded the dollar on 30th January, 1934. I should have called my last pamphlet *Ifs and Buts in Relation to Gold*. Having failed to do so I have been suitably castigated.

This present book is, I admit, again a mere series of "Ifs" and "Buts." But an analysis of the gold position at present can be nothing else. An economist should, of course, be able to say definitely what will happen *if* certain important eventualities take place, but any *sensible* economist will always bear in mind, and also tell his readers, the factors which may in future upset his published argument.

I certainly did not think in 1933 that Mr. Roosevelt would go back to gold *before* he had completed his reflation, for, as I argued in Chapter XXXI of my pamphlet, I did not think he would be so careless of the harmful effects of such action on on-gold Europe. In other words, I misjudged the Roosevelt Administration, giving it credit for more international responsibility than it possessed.† But I do emphatically lay claim to having definitely pointed out to my readers what would happen, i.e., that gold shares would rise, if America or any other important country devalued on gold to an *undervalued* rate.

Now let us return to less personal matters.

CHAPTER XI.

CONCLUSIONS.

Concentrate mainly on the cross headings. In fact, read them through first.

1. The Dollar-Sterling-Franc Triangle.

To-day, February, 1935, the undervalued dollar is pulling the London price of gold up towards 170/-; the overvalued Franco-Flemish group is pulling it down

*Ill-chosen from the short-run point of view.

†Another blow has been given by America to the world's currencies, for by recently raising the world price of silver America has forced China like France into deflation, and hundreds of millions of people are being made to suffer. The American Administration, from the world currency point of view, is like a bull let loose in a china shop.

towards 120/-. Remove, or increase, either of these magnetic pulls and the price of gold in off-gold London will find a new level.

Reflation in *either* America or France should cause gold in London to fall. Deflation in either group should cause it to rise.

Devaluation by either group will tend to make gold rise in London. Because (i) Further devaluation by America, if it occurs *faster* than internal prices rise, will, by increasing the under valuation of the dollar, cause London gold to rise. While (ii) Devaluation by France will, by reducing the existing over-valuation of the Franco-Flemish group, or by producing under-valuation, similarly cause a rise in London.

2. Further Rises in Gold in Off-gold England will depend mainly on Undervaluation in Other On-gold Countries.

Broadly speaking the future price of gold and gold shares in off-gold London depends on whether or not there still remains some important on-gold country whose currency is *under-valued* in relation to sterling. Every increase in the number of such under-valued on-gold countries makes gold shares safer; every decrease, or every diminution of the undervaluation, makes gold for English residents*, and South African gold shares for anyone, more dangerous.†

3. Reflation in America will Probably Cause a Fall in Gold in London unless the Franco-Flemish Group Devalues or rapidly Deflates.

The chief cause for *medium-term* pessimism in regard to gold shares is that a rapid rise in internal American commodity prices will make the dollar *less* under-valued in relation to the off-gold pound. This will reduce the magnetic pull which at present *alone* is keeping the London price of gold up to 143/-.

If however France devalues, or deflates rapidly, the downward pull on the London price of gold will diminish, so that even if there is *some* price reflation in America, the *net* effect of this reflation on sterling and on the London price of gold, may not be depressing—particularly if England reflates parallel with America.

The existing under-valuation of the dollar *ought*, however, in any case, gradually to disappear; for actually the dollar should be over-valued in relation to sterling, not under-valued, since America has an export surplus and is also a creditor nation. See Chapter XI of *The Problem of the Foreign Exchanges*.

* To a foreigner a rise in the London price of gold will be useless if washed out by a parallel decline in sterling.

† There are, of course, other minor factors which may affect the price of gold and the value of gold shares, but these, e.g., mining costs, etc., were dealt with fairly fully in *The Coming Collapse in Gold*.

4. Extensive Devaluation by France Might Cancel the Depressing Influence of American Reflation.

The complete disappearance of the undervaluation of the dollar will inevitably make the prospects for sterling area gold shares unfavourable *unless* some other important on-gold country devalues to such an extent as to make its currency almost as under-valued in relation to sterling (and the dollar) as the dollar is at present under-valued in relation to sterling. Indeed, at the risk of redundancy, I must repeat that it is only the magnetic influence of the under-valued American dollar which *at present* is pulling the price of gold up in London—i.e., away from 120/- and towards 170/-. Remove the upward American pull,§ and a new level for gold in off-gold London will be found, unless (i) the downward pull of the Franco-Flemish group is reduced by deflation; or unless (ii) some other important Continental on-gold country devalues sufficiently to replace the influence of the disappearing on-gold American undervaluation.

The above remarks, however, refer only to the *complete* disappearance of American under-valuation. Half and half conditions may arise. Indeed, as explained in Sections 5 and 7 in this Chapter, certain events in France or England are capable of making the pound decline in relation to the dollar so that if these events occur *at the same time as* American commodity prices are rising, the reflation in America might be cancelled out, and might not, in practice, cause a *net* decline in the London price of gold.

5. Gold should Boom in London if France Devalues before America Reflates.

Gold might quite well go to about 170/- an ounce in London if on-gold Europe devalues* *before* America reflates, for the removal of the Franco-Flemish pull would allow a 15 per cent. collapse in sterling *vis-à-vis* the dollar, i.e., a rise in gold of some 20/-.

But *subsequently* a reaction in the sterling price of gold (say from about 170/-) is likely owing to gradual American reflation, unless off-gold England reflates as fast as America. This latter contingency, however, I do not expect.

Indeed if on-gold Europe *soon* comes off gold *before* the present American under-valuation disappears, thus removing the upward magnetic pull on the pound,† then later, when the pound (along with the franc) has fallen to its proper level in relation to the dollar, and a boomlet in gold has occurred in London; prospective subsequent reflation within America will *thereafter* cause the dollar, and with it all the other on-gold currencies, eventually to decline again gradually in relation to the pound. A reaction in fact will follow the boom.

Only one exception to this particular slump-after-boom rule is likely, and that is if off-gold England reflates her commodity prices equally fast as America in future, which seems to me rather unlikely under the present Government, which, although

§ Either by American reflation, by marking down the American statutory price of gold, or by coming off gold once more in America. (See Section 8 of Chapter XII.)

*There may of course be a temporary scare in the share market lasting some weeks.

†Which is a downward pull on the London price of gold.

paying much lip-service to a rise in prices, does little to bring it about artificially. Policy however is capable of changing.

6. The Adverse Influence of a Boom in American Trade.

As regards America: A trade revival may, indeed will, shortly occur ~~in~~ America, and American internal prices and costs will rise; although the rise will probably not be great until factory plant has become fairly fully employed. After that prices will rapidly rise and the undervaluation of the American dollar, which *alone*, at present, is keeping the price of gold up in London, will disappear. (But see Section 3 of this Chapter.)

The test question as regards this is: Can France hold out and avoid devaluation until American internal prices have risen? If so, gold will *not* rise much further in London, other things being equal, i.e., assuming that England does not revalue at a high rate for gold, and assuming no violent deflation in France and no further violent reflation in England. But see the next section.

7. Nervousness or Rapid Inflation in England would cause Gold in London to Rise.

Two *short-run* factors (apart from early devaluation by the Franco-Flemish group, or revaluation by England at a high price for gold) which might prevent a fall, or cause a rise, in the price of gold in London are:—

- (i) A flight from the pound owing (a) to a policy of over-cheap money or (b) to the advent of a revolutionary government. [Even factor (b) would not be a continuing influence unless the new government inflated the paper currency]; and
- (ii) Violent inflation in England.

8. A World-wide On-gold Devaluation Race would cause a Boom in On-gold London.

The chief *long-run* hope for gold shares is undoubtedly an (economically futile) world on-gold devaluation race, with England taking part either by means of her Exchange Equalisation Fund; or, better still (for gold shares), by her adopting a Variable Gold Standard herself.

If, however, South Africa and England do not take part in the race, the other on-gold countries can devalue to their hearts' content without the price of gold in South Africa or England rising appreciably; for except in so far as the internal commodity prices of the on-gold racing countries lag behind the internal upward movements of their prices for gold, the on-gold currencies of the racing

countries will depreciate in relation to the South African and English pounds and the price of gold will not rise in Capetown or London.

9. Long-run Dangers Ahead.

Whatever may happen over the next few years, the ultimate tendency will (I think) be for gold to go out of practical monetary use and for it to become merely an industrial luxury; its fate in fact may be similar to that of horses, despite 4,000 years of widespread economic use by mankind. Such an idea is at present not taken seriously by those who are not in close touch with political and economic thought on this subject; but the advent of managed paper and the supersession of gold is perhaps much nearer than on the surface appears likely. See Part II. for the case at issue.

10. The Influence of Temporary World-wide Suspension.

It is, I know, often contended that even if all the governments of the world temporarily suspended the gold standard, both as regards buying and selling, there would be a boom in the price of gold owing to the metal being regarded as the only safe form of currency. A powerful argument supporting this case is contained in Dr. Einzig's *The Future of Gold*. But personally I disagree. A general suspension of the gold standard both on the buying and selling side would mean that no government or central bank was any longer a buyer of gold at a statutory price, and that the monetary outlet for gold had (temporarily) disappeared—since the central banks were no longer buyers. This, I think, would so shake the nerves of all gold hoarders that they would compete to unload on to each other and there would be a rapid collapse in the market price of the metal. (Even general suspension on the selling side only, would, I think, shake the share market, although the metal might not fall.)

11. The Influence of Permanent Abandonment.

Certainly if the suspensions occurred solely because the on-gold countries were in temporary difficulties, and, although not willing to let gold be exported, were unwilling to add to their hoards, there might be some slight measure of support for Dr. Einzig's theory that private hoarding would increase during the period of suspension. But if the countries of the world were suspending gold solely because they were coming round to the belief that managed paper was more satisfactory as a currency than gold, confidence in the future of gold as currency would diminish and the metal might become a drug on the market.

But before this happens—and it probably will happen ultimately—some further heats in the gold devaluation race will almost certainly be run off. And each successive devaluation will almost certainly be a temporary bull point for the metal in England, regardless of whether she herself is on or off gold.

The devaluation race at present, of course, is extremely slow, for countries take time to make up their minds to take any action, and internal prices only move

slowly. The race, however, is of a character likely to gather momentum. Some years hence, after the complete futility of competitive devaluation has been proved (see Chapter XX of *The Problems of the Foreign Exchanges*) gold may possibly be abandoned for paper. As yet, however, it is too early to make any definite forecasts on this subject. Moreover, the race will be spread over several years. Results in the market will, therefore, depend very largely on the extent to which the causes of good and bad trade are studied by statesmen, and on the speed with which the various problems of "sound money" are thrashed out.

12. A Matter of Prejudice.

Let the reader who believes that I have an unreasoning and innate prejudice against gold remember that it was I who perhaps first emphasised the merits of gold shares in my *Coming Rise in Gold Shares*, when Rand shares were shunned in the market and at their lowest in January, 1931. But booms are sometimes followed by slumps,* and the forces of economic progress give rise to gradual change.

Economic institutions and mechanisms which are found in practice to be unsatisfactory are gradually replaced by more efficient methods. Gold, in fact, may continue to slide out of monetary use, as it is doing, despite it having been generally acceptable throughout the past ages.

The remarks which follow in Part II. show the trend of events, and of thought, on the particular subject of abandonment.

13. The Immediate Outlook.

As I write, however (February, 1935), the going for gold and for gold shares in London is good; even though there are subterranean forces at work which may soon blow the top off the monetary volcano. Then the lava will cause much distress and uncertainty while it is finding its correct gravitational level. After that a cooling process will begin, and a well balanced and fertile condition will develop.

I deliberately use the word "volcano" because there is gross disparity of purchasing power even within the on-gold Franco-Flemish group. The mark and the Swiss franc are some 15 per cent. overvalued in relation to the French franc;† the French franc is some 15 per cent. overvalued in relation to the pound; and the pound is some 15 per cent. overvalued in relation to the dollar. These are conditions which cannot last. The position is bound, eventually, to "blow up." Then chaos. Then sanity. The terrible birth-pangs of intelligent currency.

* It is a normal feature of every boom that optimism is always greatest near the top; indeed, the conviction that there are virtually no dangers ahead in the gold position is as strong as was the conviction in America in 1929 that Utilities would remain for ever safety-first investments. The Index of American Utilities has, however, fallen from 140 to 16. The collapse, it is true, was partly due to government interference, but there is already much government interference with gold; and the disappearance of that interference is the major potential cause of collapse.

† See Professor Cassel's article in the Quarterly Report of the Scandinavian Credit-Bank of January, 1935, published in English.

CHAPTER XII.

SOME REASONED GUESSES.

My own guess at the immediate future is as follows (February, 1935) :—

1. Mr. Roosevelt will show some reluctance to come out as a pro-profit administrator (see Section (iii) of Chapter V.); there will therefore be some delay in American reflation. Meanwhile gold should retain its high price in London.

2. The ever growing prospect of France, or other on-gold European countries, abandoning gold will have an "anticipatory" influence on liquid capital within these countries. Funds are likely to be transferred either to England or to America.

The fear of a General Election in England (in 1936) may cause America to be preferred as the refuge, particularly as the pound should itself decline in relation to the dollar as soon as France has abandoned; this being so, more will be gained by Frenchmen by speculatively selecting the American currency as a refuge (as against the time when France goes off gold) than the English currency. Frenchmen in fact will appreciate that when the franc goes down the pound will go down too.

In so far as America is chosen instead of England, the pound should not appreciate in relation to the dollar (and the franc). See page 81 of *The Coming Collapse in Gold*.

3. Incidentally the growing anticipation that France will eventually come off gold is already reducing the magnetic influence of the Franco-Flemish pull on sterling and on the London price of gold; and is letting the pound decline bit by bit, as indeed it should, on actualities, in relation to the dollar. Fear concerning what might happen in France (or England) is already having its "anticipatory" effects.

4. Furthermore, in so far as France pursues an internal reflationary policy—and M. Flandin is already toying with the idea of cheap money and credit expansion—this prospective rise in internal French commodity prices, will reduce the prospective over-valuation of the franc, and cause the pound to move down nearer to its proper level in relation to the undervalued dollar "on prospects." Alternate waves of fear on this point are likely to make sterling fluctuate.

5. Election fears in England may cause some positive flight of British and other capital from London. On-gold Europe is unlikely to be chosen as a refuge, even by Continental capitalists, since the Continent itself may shortly devalue. America is much more likely to be chosen as a haven. Transfers from London to New York would depress the pound, and help gold shares.*

6. There is moreover this to be noted: Even though Mr. Roosevelt show no signs at present of deliberately adopting a pro-profit policy (see Chapter V. Section (iii)), he may soon decide to make experiments on these psychological lines. The immediate result would be an active bull market in Wall Street, and although there would be a considerable improvement in American trade, there would be a definite time-lag before commodity prices rose appreciably in America (see Chapter XI. Section 6). During this time-lag there would probably be an appreciable movement of funds from London to New York to take part in the Wall Street Boom; with the result that even though reflation of commodity prices in America was becoming more

* A re-opening of the London capital market to foreign loans should have a similar effect.

likely, the pound would continue to fall instead of rise, because of the capital transfer and Stock Market factors. Sterling in fact might remain depressed until the reflation in America had got well under way.

The fact that shares and bonds in London look dear at the moment is a factor making such a movement of funds, from London to New York not improbable; especially as any revival in American trade, or a change of attitude on Roosevelt's part, would be likely to make Wall Street appear more attractive to British investors, and to Continental investors with funds in London. American funds lying in London would also probably be repatriated.

7. In other words I envisage a rise in the price of gold in London until American commodity price reflation has made some appreciable progress.

This however is a medium run view : The more distant future seems to promise a reaction, if not a crash. (*But see Alternative 1 of Chapter IX; and Section 5 of Chapter XI.*)

8. And do not forget that it is not entirely impossible for Mr. Roosevelt to go off gold in America once more, in the hope that withdrawal of convertibility will reduce the internal Store-of-value or Hoarding demand for money. The point is that although Mr. Roosevelt has financed Public Works largely with borrowed bank money and has inflated the bank credit currency of the country by some 13 per cent.—net demand deposits of the Reporting Member Banks have risen from 12.5 billions last July to over 14 billions—this quantitative credit inflation has been largely offset by a decline in velocity due to the hoarding engendered by the fear among business men of the anti-Profit attitude of the Administration. Mr. Roosevelt, therefore, by unlinking the dollar from gold once more, might hope that the resultant probable cessation of hoarding would immediately mean an increased spending of money on commodities, labour, and securities, i.e., a higher velocity of the legal tender and bank credit currency already in existence; an increased flow of money on to goods; a revival in trade; and then higher prices.

In fact the stagnation which has occurred in American trade since Roosevelt relinked the dollar to gold in January, 1934, is a factor which might induce him to make further Experiments. The result, after perhaps a few days of panic, would probably be an improvement in the dollar in relation to the franc and the pound (below 4.86). At the same time the present upward pull of the undervalued on-gold dollar on the price of gold in London would be removed; and the only residual pull would be that of the overvalued Continental (un-devalued) gold bloc. Sterling would then appreciate in relation to the franc, assuming the franc had not yet been devalued, and the price of gold would fall some 15 per cent., or 20/- in London. Each 4/- fall would reduce the average earnings-yield on Kaffirs by about one per cent., so that a fall of 20/- might halve the value of many Kaffir shares. As Mr. Morgenthau, Secretary of the U.S. Treasury, recently stated: The dollar is only on a twenty-four hour basis.

America, moreover, has an Exchange Equalisation Fund with which to look after a new off-gold dollar. England would then be back in the position which obtained when I wrote my *Coming Collapse*, i.e., with sterling undervalued in relation to *all* the on-gold currencies. See Chapter I.

PART II.

THE DOMINANT RISK

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PART II.

THE DOMINANT RISK.

1. How the Gold Standard should be Worked.

There are seven quite separate forms of gold standard* but the one of prime importance is the "authentic" gold standard.

The theoretical rules of the authentic gold standard are that debtor countries should send gold to their creditors; that the debtors should thereupon deflate† while their creditors inflate; so that the consequential *bilateral* changes in "net external prices" should cause goods to flow in the wake of the gold, thus correcting the previously adverse payment balance.

The prerequisite conditions then for the satisfactory working of the gold standard are threefold:—

- (i) That gold movements themselves should not be impeded.
- (ii) That the movements should be allowed to have their proper *bilateral* economic effects, i.e., that the gold-losing countries should deflate, while the gold-receiving countries should inflate.
- (iii) That tariffs should not be imposed either by gold-losing countries, so as to check imports and thus protect gold; or by the creditor countries, so as to check the influx of foreign goods made relatively cheaper by deflation abroad (and by inflation at home).

2. How the Gold Standard is Worked in Practice.

In practice, however, modern democratic Governments find it politically impossible to apply these three Spartan rules correctly. Creditor countries sterilise gold on arrival so as to prevent the disturbance of internal price inflation, as did Governor Benjamin Strong in America in the mid-1920's. (This imposes a double amount of deflation on the debtor countries, since the gold standard is worked *unilaterally* instead of *bilaterally*.) Debtor countries, moreover, in order to avoid this double dose of internal price deflation and the unemployment which it causes, put on tariffs against the goods of their creditors, so as to check imports and the export of gold. While, finally, the creditor countries, in so far as the debtors succeed in deflating their own internal prices and stimulating their exports, put on tariffs to prevent the competitive damage caused by the recently cheapened foreign goods. In practice, I repeat, democratically elected politicians find themselves unable to play the gold game according to the theoretical rules, mainly because the rules involve, and indeed require, harmful changes in internal price levels. Sound, i.e., *non-fluctuating*, exchanges, in fact, "require" unsound, i.e., *fluctuating* money.

* See Chapter V of *The Problems of the Foreign Exchanges*.

† In response to the alteration in their bank reserve ratios.

3. Consequent Breakdown in International Trade.

Certainly the gold standard does good in that it makes any *single* transaction in international trade or finance much easier than it would be under fluctuating paper exchanges, even with a well-organised forward exchange market. But although it makes each *single* transaction much easier, it eventually reduces their *total number* and kills international trade, either because "practical" politicians ration the exchange market directly, which means rationing imports; or put on tariffs which reduce either imports or exports, or both. The gold standard thus becomes a breeder of tariffs, and international trade and finance *both* break down. The gold standard which looks so attractive on the surface, gives its chief admirers, international traders and financiers, an unperceived stab in the back.

Nevertheless, dazzled merely by mere surface appearances, and unable to adopt a wider perspective, practising bankers and statesmen are still arguing that the gold standard ought to be returned to immediately because it will "enlarge" the scale of foreign trade! This assertion, however, appears to lack practical foundation. Just look at Europe since 1925. The gold standard gets the full credit for its merits; rarely, however, is it blamed for its faults.

4. The Growing Case Against a Return to Gold.

Protagonists of gold frequently assert that since the gold standard is so *obviously* the best form of international currency and since paper has so frequently been inflated, it is safe to say, as Dr. Einzig implies in his *The Future of Gold*, that the gold standard will never be permanently abandoned.

A more critical school of thought, however, is growing up, composed not merely of iconoclastic socialists but also of liberals and practical conservatives, who are questioning the very fundamentals of the gold standard system. Already there exist in the Treasury, in the Universities, on the Boards of the great Banks, and even on the Court of the Bank of England, men who assert that stabilised money is a prime necessity for enduring prosperity. In fact this school is growing so fast both at home and abroad that it is doubtful if investors in gold and the gold mining industry can afford to neglect their not unconvincing contentions. The point at issue is this: If, as these gentlemen assert, a stabilised internal price level is a prime necessity to prosperity, Is internally stabilised money *compatible with* the gold standard? Are not the gentlemen who advocate internal stability, (unconsciously) advocating the abandonment of gold? If this should be the case, the gold mining industry may at this moment be at the cross roads, and faced with a life-and-death problem.

5. Some Popular Fallacies.

It is generally agreed that the problem of the foreign exchanges is of vital importance to domestic and world prosperity. Yet, despite the obvious desirability of solving this problem immediately, there are few subjects upon which there is so

much lack of perspective and hallucination, not only among the masses but also among business leaders, statesmen, bankers and economists.

The problem of the foreign exchanges arises solely because different countries have different banking and note-currency systems, sometimes super-imposed on a common metallic base. The currency medium of the present day no longer consists of gold coins, but of bank deposits and notes based on gold, and these bank deposits and notes do not pass current in the different national areas. If the internal bank money of every country circulated freely within the others, i.e., if there was only one universal bank, the problem of the foreign exchanges would not arise.

As regards the gold standard, although it is usually referred to as being an international "monetary" system, it is not, strictly speaking, an international monetary system at all, for it is merely an international *bank-reserve* system on which the various non-international bank notes and deposit-currencies are based.

At first sight the gold standard seems well worth retaining, for it appears to be a halfway house towards a complete international monetary system—as gold and silver used to be before bank notes and cheques were invented; and certainly the gold standard provides one country with a means of making immediate and direct payments to another—which *per se* is highly desirable. But, unfortunately, this particular advantage is accompanied by a corresponding disadvantage. The bank reserves of one country (on which deposit currency is often built in the ratio of over ten to one) may suddenly be exported—perhaps as a result of some unprofitable foreign loan or the importation of some unnecessary luxury, or as a result of a desire to speculate on some foreign Stock Exchange—with the result that ten times the amount of domestic credit money is deflated, and ten times as much monetary damage is done as would be done *if* there happened to be a universal international currency *proper*, of which only one unit would need to be exported.

Oh, but people say, you must have some form of international money, and you must in any case have a metallic backing for internal currency. This is not so at all. The first contention has been frequently disproved by past and recent history. The fallacy of the latter is exposed in my forthcoming book *The Problems of Money*; it has moreover frequently been refuted both by past and recent experience.

The public however have heard these two orthodox "untruths" reiterated so frequently that by instinct they find it difficult not to regard any other ideas as necessarily unsound and fallacious. Money, they repeat, must be backed by a metal: a stabilised international money is essential.

But the more closely one looks into these matters—and different economists and bankers are doing this in all parts of the world—the more inclined one becomes to accept the unorthodox view. The gold standard undoubtedly looks most attractive on the surface, for it provides a country with stabilised exchanges and maintains a more or less homogeneous international price level. But the gold standard, despite its outwardly attractive veneer, hides, like some people, an unsuspected tendency to do harmful things to its admirers behind their backs, for which it never gets the blame.

Gold is thought to be the foundation of prosperity; but in reality it seems to be the rock upon which modern capitalism is slowly being wrecked. Moreover, it is not merely the direct damage done by the gold standard which makes a change in monetary policy to many seem desirable; the good which its maintenance prevents must also be taken into consideration; for according to a growing school of thought, it is quite impossible under a rigid gold standard to have stable money, or to adopt those economic policies by which alone the trade cycle can be prevented and enduring economic prosperity secured. See my forthcoming *Causes of Unemployment and Trade Fluctuation*.

Let us try to look closely into these problems and see to what extent the "revolutionary" school may be justified.

6. A Short-Sighted View of the Problem of the Exchanges.

Most discussions on the foreign exchanges centre *only* around the problem of how to keep exchange rates stable. People in fact rarely stop to ask themselves whether the attainment of exchange stability will not set up even greater instability in other departments of economic life, and thus do more harm than good.

No intelligent person, of course, will deny that exchange fluctuations, other things equal, make international trade and foreign investment more difficult and costly; nor will anyone in his senses deny that international trade and international investment are important factors in the economy of a nation, particularly a nation such as Great Britain. But, although it is desirable *per se* that the foreign exchanges should not fluctuate, it must never be forgotten (although it is habitually forgotten) that the foreign exchanges have a definite economic function to perform (in the absence of a controlled exchange or import market): and that function is to make exports balance with whatever imports a country fortuitously decides to buy from abroad. This, I assert without fear of contradiction, is the *primary* function of the foreign exchanges.

Chance, it is true, may temporarily make exports and imports (visible and invisible) balance; but chance can never be relied on for long. Consequently if a country is not willing to ration the foreign exchange market, or deliberately to control its foreign trade and investment so as to keep imports and exports in equilibrium, the foreign exchange mechanism must, sooner or later, and more or less automatically, *make* exports balance imports; and thus keep the balance of payments in equilibrium also.*

Hence, instead of approaching the problem of the exchanges in a short-sighted and unstatesmanlike manner, as many people do, merely asking "How can we keep the exchanges stable?" one ought to ask "What is the most efficient and least economically disturbing method of making exports balance imports and of keeping the balance of payments in equilibrium?" Correctors to disequilibrium must be found. Which are the best correctors?

* The international payment balance and the import-export equation are not precisely the same thing, unless you regard receipts for cancellation of debt as imports.

7. Methods of Equating Exports with Imports.

In actual fact there exist three, and only three, ways of securing equilibrium in the payment balance and of effecting the right ratio of exports to imports :—

1. By deliberately controlling imports (perhaps via exchange rationing), and not permitting them unless sufficient foreign exchange to pay for them has already been (or is soon going to be) earned by exports.*
2. By having a fluctuating exchange which will depreciate if the demand for foreign money exceeds the export-earned supply—thus stimulating exports in the future, and checking imports.
3. By having a stabilised exchange, and an internationally transferable gold supply which will alter internal prices, via its reactions on the quantity of bank credit, so as to provide the necessary corrector.

There are no other methods, although it is possible to effect a compromise between these three “correctors.” Methods 2 and 3 can, it will be noted, be made to work more or less automatically, without government intervention. Method 1 presupposes strict government control.

8. The Case Against Exchange and Import Control.

The policy of deliberately controlling imports and exchange dealings may at first sight appear the most effective of the three correctors; but the objections to it are considerable. It is the duty of governments, and of the foreign exchange mechanism which they sanction, to stimulate, not to check, foreign trade. And yet if one nation grants import licences to its nationals only when other foreign countries have *already* bought sufficient of its goods to pay for the licensed imports, other countries will probably retaliate by granting import licences only when their own goods have *already* been bought by the first country: a process which will rapidly bring foreign trade to a standstill.

This leaves us with the two “automatic” alternatives—fluctuating exchanges on the one hand or fluctuating internal prices on the other.

9. The Primary Function of the Foreign Exchanges is to Cause Fluctuations in “Net External Prices.”

The essential function of these two “automatic” correctors to disequilibrium in a country's balance of payments, is to make the goods of the debtor country cheaper to the nationals of the creditor country, so that exports from the debtor to the creditor may be automatically stimulated (possibly triangularly) in order that the previous deficit in exports may be made good. In other words, the function of the foreign exchanges is not to *prevent* fluctuation everywhere, but deliberately

* Exports may, of course, be subsidised.

to cause fluctuation *somewhere*, in order to bring about a change in "net external prices." It is quite impossible to over-emphasise this point, although it is customary for well-meaning persons to advocate both internal price stability and stable exchanges, as well as non-interference by the Government.

10. Alternative Methods.

Now the only possible methods of changing net external prices,* i.e., the prices of domestic goods to foreigners, are:—

- (i) By a movement in the exchange rate itself, coupled possibly with a more or less stable internal price level (the paper system); or alternatively
- (ii) By a movement in internal prices, coupled with a stable exchange rate (the gold system).

One of the two is essential*. It is therefore impossible for a modern community to have the dual advantage of *both* stable exchanges *and* stable internal prices. Money *must* be unstable in value (i.e., "unsound") either internally or externally (*unless* the foreign exchange market is to be rationed, or what is practically the same thing, unless foreign trade is itself to be rigorously controlled).

These points, however, are habitually neglected by statesmen and even by bankers. They talk of sound money and seem to think that the exchanges can be freed from restrictions, and that both prices and exchanges can be kept stable by sound monetary policy. This, however, is entirely impossible. These unanalytic gentlemen are crying for the moon. Until there is only one great universal bank some good things in the monetary sphere will have to be sacrificed for the sake of others which are deemed even better. Instability of exchanges is the price of monetary stability; instability of money is the price of stabilised exchanges.

The man in the street can, of course, see that fluctuating exchanges are disturbing, and that, other things equal, they tend to reduce the total volume of international trade and investment upon which the prosperity of Great Britain and other countries so largely depends. He therefore cries out for stable exchanges. But although British prosperity may be *somewhat* upset by fluctuating exchanges, it may possibly be upset *even more* by the fluctuating internal prices which stable exchanges involve.

11. The Various Dilemmas.

Hence the main question at issue is *not whether* fluctuation is good or bad—for there has got to be fluctuation *somewhere* unless imports are controlled—but whether or not it is prudent for the government to sanction *and aim at* a policy,

* *Ex hypothesi* we are excluding the third possibility of import tariffs and export subsidies, and also exchange controls and interferences.

namely, that of the rigid gold standard, which positively requires and presupposes fluctuations in the general internal price level so as to secure equilibrium in the balance of payments.

A paper system permits of (although it certainly does not ensure) internal price stability. A rigid gold system positively prevents it. The political questions at issue therefore are:—

- (i) Are unstable internal prices less harmful for the nation than unstable exchanges, or *vice versa*; or
- (ii) Should attempts be made to secure both desiderata, by a rigid State control of imports, exchanges and international finance ?

The City hardly realises that it must make this choice of alternatives. Nevertheless, these are the vital questions at issue.

Actually, therefore, when a banker pleads for stable exchanges he is indirectly pleading either for "unsound" (i.e., fluctuating) internal money or for State control of international trade and investment.

Similarly when a professor pleads for managed and stable internal money, he is automatically pleading for *unstable* exchanges (unless he simultaneously advocates import control and/or export bounties, coupled perhaps with a rationed exchange market).

Thirdly, if a politician pleads simultaneously for stable exchanges, sound money, and the removal of all exchange and import restrictions, he is merely demonstrating his ignorance of his subject, for he is irresponsibly asking for three incompatibles (unless he expects imports and exports always to balance merely by chance).

In fact any public figure who boldly advocates "sound money" as such, *without* any further qualifications, ought to suffer a feeling akin to shame. And yet that is the state into which British economic life has recently sunk. Monetary questions are not studied except superficially. No wonder we have two million unemployed, living in an age where plenty becomes the cause of want, and where expansion habitually gives rise to reaction.

Nor are the defects of the gold standard appreciated at all accurately even amongst those ardent monetary reformers who state that they wish to abolish the gold standard altogether. They, as well as the gold defenders, are often at fault in their monetary theory, and in their appreciation of the various problems at issue.

Every cabinet minister interested in unemployment certainly ought to have at his finger tips the whole argument both for and against paper, and both for and against gold (even though he may not yet have made up his mind which is best); but the reader will agree that on talking these things over with men who should know, one rarely finds a banker or a member of the House of Commons capable even of

stating the two sides comprehensively—although people abound who will assert with assurance that either the gold standard or paper ought to be discarded.

12. Damage Done to Trade by the Rigid Gold Machinery.

The gold standard, although superficially attractive, is actually one of the clumsiest and most harmful pieces of economic machinery that the Goddess of Evolution has ever devised. It is entirely unsuited to modern capitalism.

Under the gold standard, bank credit has to be manipulated so as to make internal prices fluctuate in order to keep the exchanges stable. This, however, brings about a fall in prices and profits not only in the export industries (whose prices alone it is desired to force down*—*Read the footnote*) but also in almost every other industry as well. The whole country's profit and price level is lowered for the sake of reducing a relatively small number of export prices. To roast the pig a whole house is burnt down.

This internal deflation would not matter so much if wages and costs were not rigid but moved simultaneously with final prices; or if we did not live under a capitalistic economy where profits are the mainspring of prosperity. But the fact is that most costs, including wages, are not elastic; so that if a decline in the price level has to be engineered by a policy of credit deflation, in order to correct the import-export equation, the price level tends to fall *faster* than the cost level, and the profit margin is thus wiped out.

Under a capitalistic system such an eventuality, though of little quantitative importance in terms of actual income, has disastrous psychological consequences. If general profits begin to decline owing to a forced price deflation, brought about by monetary stringency, business men become nervous and refuse to perform their normal speculative function of advancing wages out of capital in the hope that they will eventually be able to sell what the workers produce at a profit. Create fear by credit deflation, or take away the prospect of profit, and enterprise as a whole will languish. Middlemen, obeying the Law of the Falling Market, will let their stocks run off and will reduce their orders to manufacturers; and manufacturers will consequently pay out lower incomes. Production, employment and consumption will decline—solely because the profit margin was contracted by a process of credit deflation, required by the gold standard in order to secure equilibrium in the international balance of payments, *without* any fluctuation in the exchanges.

13. Domestic Money at the Mercy of International Traders and Financiers.

But this is not the only defect inherent in the superficially attractive gold standard. It is bad enough to alter almost all internal prices, in order to change a few export prices, and to depress general profits and trade merely in order to stimulate

* It is curious how exporters, thinking that fixed exchanges positively benefit them, advocate an immediate return to gold. They do not realise that it is their own selling prices and profits which will be specifically attacked every time credit has to be deflated, so as to augment exports.

a few foreign sales (which could much better be fostered by increasing the profits of the export trades, as under a paper standard, rather than by depressing them as under gold). But when one looks at the wanton way in which the haphazard actions of a few international traders and lenders or nervous financiers, leading say to a deficit of £100,000 in the balance of payments, are allowed to drain away the banking reserves of a country, on which credit currency has probably been superimposed in the ratio of about ten to one (i.e., to the extent of £1,000,000), the process passes all human comprehension—for £1,000,000 are virtually taken away from the public when only £100,000 has got to be transferred.

International financiers, of course, particularly like the gold standard because they can transfer large sums from one centre to another without it having any immediate effects on exchange rates. They can therefore continue the process without any hurt to themselves. The public, however, ultimately suffers; which makes the whole process most unfair.

14. The Case for Paper.

The *primâ facie* merits of a rigid gold standard are of course obvious, for does it not provide fixed exchange rates, and a solid backing for the note circulation of the country? Similarly the *primâ facie* defects of fluctuating exchanges on a paper standard seem obvious; for do they not disturb international trade, and has not paper been frequently inflated in times past?

Actually, however, the gold standard has only proved itself a fair weather device. It has nevertheless received all the credit for the smooth functioning of industry, trade and finance in times when it has been subjected to no unusual strain. Meanwhile paper currencies have received the blame for the uncertainty and confusion of those periods of stress when, not being strong enough to weather the storm, the gold standard has *already* broken down. In cases, however, where paper has been scientifically managed, as at present in Great Britain to some extent, there has been no tendency, nor need there ever be, for paper money to get out of control. The spectacular inflations of the past merely indicate that unsound government finance is *always* capable of breaking not only gold but also paper currencies. The merits of gold in fact are habitually over-rated, while those of paper are habitually under-stated. Never have I yet been able to find a writer who presented both cases with fairness.

This pamphlet of course does not contain a full statement of the theory of the exchanges or the theory of money, nor of the monetary diseases from which industry suffers, nor of the potential monetary cures to bad trade. Indeed I can hardly expect the reader to accept in full the views of the anti-gold party merely from what I have written above. But the fact remains that money for internal use does not need a gold backing at all—the fallacious bullionist theory having been repeatedly disproved in practice, nor is a gold backing really essential for international purposes.* Thus, in so far as a rigid international system saddles a country

* These contentions, I think, are fully proved in my forthcoming book *The Problems of Money*.

with a perpetually fluctuating internal price level, and in so far as a fluctuating price level is bad for trade; gold, despite its superficial attractions, may be more harmful than paper, despite the faults usually associated with the latter.

15. How the Future of Gold is Threatened.

The point is this : Since there must be an international corrector which requires fluctuations *somewhere*, the question arises : Would it not be better for the nation, instead of making nearly all internal prices and profits move, merely for the sake of making only a few export prices move, to adopt a fluctuating exchange system, meanwhile continuing to use the present credit mechanism, but with a different end in view ? That is to say, manipulating bank credit so as to keep the internal price level *stable*; and letting the exchanges fluctuate freely, so as to provide the *necessary* corrective changes in "net external prices."

Under a gold system the prosperity of domestic trade is, via gold movements and credit policy, largely *governed* by events occurring abroad and by the haphazard action of foreign traders and investors; it might be better to adopt a paper system under which domestic monetary policy could aim at keeping the internal price level stable, so as to cure the business cycle and so as to avoid the subordination of domestic trade to foreign influences.

It is not merely the harm that the gold standard does, but also the good which it prevents, that makes a change of monetary policy to many seem desirable.

If the reader wishes to pursue this subject further he will find a full discussion of the problems at issue in my three forthcoming volumes. Indeed the contents of this pamphlet are merely selected excerpts from these works.

The trend of political decisions upon these points will determine the long run outlook for gold shares.

16. Digression on the Need for Further Enquiry.

(This section may well be omitted.)

As regards policy : Although the reader may have bought this book because of his interest in gold shares or sterling he will, I think, share with its author a strong interest in the problem of unemployment. Personally I feel that the problem of unemployment can be solved; there seems in fact no excuse for poverty. Nature and science shower wealth upon us; want in the midst of plenty must therefore be due either to imperfect monetary arrangements, or to an unscientific method of distribution. The fault is certainly not with the producers; they do their work extremely well. It seems rather to lie in the realm of money and finance, where clear thinking is perhaps less frequent than in the realm of manufacturing procedure. What policy to adopt in the monetary sphere, however, cannot be decided until the problems of trade and price fluctuation have been more thoroughly studied. The

economists should do the primary thinking; statesmen, however, should keep in touch with their work.

The rich, I may add, have as much to gain from a solution of the problem of unemployment as the poor. Unemployment of capital is just as gross an economic anomaly as the unemployment of willing worker-consumers; and it leads to low dividends and general nervousness. More knowledge at the top is what is needed. It is indeed in this spirit that I approach the whole problem of currency.

In my personal view, enduring prosperity can certainly be obtained. The question at issue, however, is, should the gold standard be discarded? To many this seems unthinkable; but to some it seems mere commonsense.

At present much lip service is paid to gold. In practice, however, the gold standards of the world are purely nominal. Even the most fervent on-gold countries have ceased to play the gold rules correctly, because they find in practice that it does not pay them to do so. Clearly there seems to be something at fault. Those therefore who sincerely believe in the necessity for a gold standard should study the recommendations of its antagonists.

All monetary theorists are not necessarily monetary cranks; some of them may even be gradually approaching a solution to the present-day problems of Political Economy. More general enquiry, however, is necessary. Enduring prosperity, without price inflation, is the ultimate goal for which we should strive.

But there are certain dangers ahead. Quite clearly there is at present something radically wrong with the capitalist system. Some people say it is due to the disturbances caused by the war; others say that the system itself is inherently wrong, and that therefore it ought to be changed. Personally I hold neither of these views. Nearly every country has enjoyed prosperity since the war; and during these periods war disturbances have sunk into oblivion. Subsequently, however, depression has re-matured, and the forgotten war factors have again been raked up. War factors, however, I think are comparatively unimportant, and they must not be used merely as an excuse for not thinking further on the matter. There are other less obvious, though more powerful, forces at work; and these seem to be hidden away somewhere in the realm of money.

Many observers regard money merely as a medium of exchange, and of no economic importance in itself. Others, while admitting the importance of money, say that even if money were properly managed the capitalist system still would not work. This is, I think, an erroneous standpoint.

In the capitalist system of individualism, actuated as it is mainly by the motive of private gain, there are obviously certain glaring defects. But these defects are, in my humble view, chiefly the defects of its money. Capitalism, I maintain, has never been given a chance to function successfully; solely on account of its money.

The consequence of this mismanagement of money is that men, money and machinery are frequently thrown into unemployment, for reasons which neither the capitalist nor the socialist can usually analyse. The result is the rapid growth of a political party which, since the capitalists are showing themselves incapable of correcting the defects of their capitalism, cries out for radical changes in the system. Indeed, it seems that unless capitalists themselves solve the problems of capitalism within the next few years, a ballot box revolution may sweep the country; and the voter may be confronted with an experimental system which its managers do not understand any better than they understand the real defects of capitalism. Socialism and capitalism will equally break down unless their leaders understand the theory of money.

Labour and capital, moreover, both depend for their welfare upon business prosperity. But unfortunately the Government possesses no organisation for the continued study of the problems of money, unemployment and business fluctuation. It therefore behoves individualist capitalists in the City themselves to concentrate on the subject, and to put capitalism in working order before it is submerged by the ballot box. It is my personal ambition to help in elucidating the vital problems of money by which alone I believe this end can be attained. Better currency management seems to be needed. That currency may not prove to be gold. Let not a man's judgment of what is best for his country be warped by his purse—from the City must come that leadership in monetary affairs and finance upon which depends the prosperity of England.*

* In an attempt to make some small contribution to the subject I have temporarily withdrawn from the City in order to write three books on the subject, namely, I, *The Problems of Money*; II, *The Problems of the Foreign Exchanges*, and III, *Methods of Preventing Unemployment and Bad Trade (A study of the causes of trade fluctuation)*. The second volume should be ready in April. The others should appear within a few months.

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Germany and Her Debts

These two books published in the early 1920's forecast the subsequent currency collapse in Europe.

Copies still available

The Coming Collapse in Gold

Publishers: St. Clements Press.

Price 5s.

This book was published in November, 1933, two months before America returned to gold. At that time the London price of gold was determined by the over valued sterling/franc exchange, with the result that if the franc declined 15 per cent. to its proper level, the price of gold in London would collapse 20s., which fall would make all sterling-area gold shares at their then prices heavily over valued. It was emphasised, however, in Chapters XIII and XXX that if any important country, say America or England, returned to gold at an undervalued exchange rate (as America has done) there would be a further (temporary) upswing in sterling-area gold shares.

The Coming American Boom

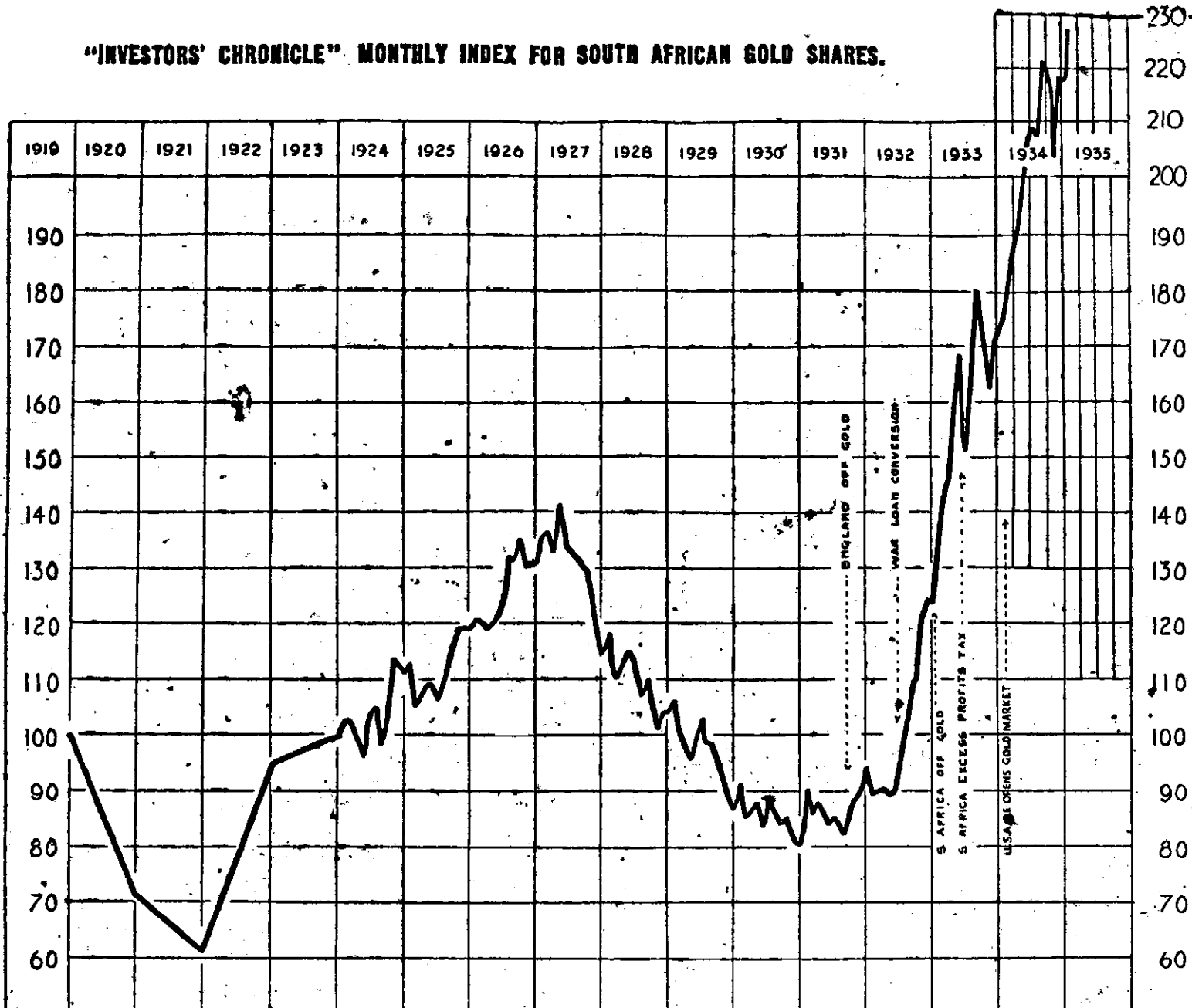
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