VIII

Currency Devaluation and International Trade

TRADE BETWEEN THE PEOPLE of different nations has long been bedevilled by protective tariffs. And now understanding of the problem is bedevilled by confusions about currency and its relation to gold.

One of the more widely circulated popular magazines published an editorial, more or less political, entitled "The Whole Story," in an issue that appeared just before the 1944 Presidential election. A passage from this editorial illustrates those confusions:

> Roosevelt said: "We know after this administration took office, Secretary Hull and I replaced high tariffs with a series of reciprocal trade agreements." The historian knows no such thing. For the whole story is that while the Hull agreements increased our imports slightly, Roosevelt reduced the gold content of the dollar, thereby at one stroke raising the effective wall against imports and more than nullifying everything Hull had done since.[1]

Here the writer of the editorial is asserting that President Roosevelt has not told "the whole story." And the editorial seems to be saying, further, that to reduce the gold content of the dollar, *i.e.*, to raise the official Treasury price of gold, has the same effect as to levy a so-called protective tariff. If this is the writer's meaning, then, certainly, it is his editorial that does not tell "the whole story."

I

IN THE EARLY DAYS of the New Deal there was a marked change in our monetary system. Previously there had been a gold standard with free coinage of gold. The gold eagle contained 258 grains of gold, 9/10 fine (25.8 gr. per dollar). This meant that it contained 232.2 grains of pure gold or, otherwise expressed, that pure gold was worth, at the mint, $20.67 an ounce. By the change made in 1933–1934, sometimes referred to as "devaluation of the dollar," the standard dollar became equal to 15 5/21 grains of gold, 9/10 fine. But no gold was to be thereafter coined for circulation in the United States. The above standard merely meant—and still means—that the United States Treasury price for pure gold is $35 per ounce. No citizen is permitted to have gold in quantity (although this does not mean that he cannot have gold watches or jewelry) but must sell to the Treasury any gold he obtains through importation or mining. However, it is possible to obtain a license from the Secretary of the Treasury

[1] *Life*, New York, Nov. 6, 1944.

permitting a manufacturer to have gold to work, and in this case the gold covered by the license can be purchased for $35 an ounce. Also, it is possible to get a license permitting the purchase of gold for shipment abroad, in which case the licensee—usually a bank—can purchase the gold from the Treasury at the same price of $35 per ounce. If, in case of a "favorable" balance of trade, American banks have unneeded balances abroad, they will bring gold into the United States and sell this gold to the Treasury, also for $35 per ounce.

Since we no longer use gold coins, the essential thing to note is clearly not now the weight of a gold coin but rather the official Treasury price for gold. There is significance in the gradual raising of this price (in 1933 and 1934) from $20.67 to $35 per ounce and there would be significance in a further change in this price, whether it were to be an additional increase or a reduction. But this by no means indicates that any change in the value of money in terms of gold necessarily carries with it a corresponding change in the value of money in relation to other goods.

In general, international trade may be described as an exchange of goods for goods. The people of any country engaged in such trade pay for the goods they buy abroad with the goods they sell abroad.[2] However, the use of gold as a medium for the settlement of balances between countries means that the people of a given country, *e.g.*, the United States, can, for a time, purchase abroad more goods than the goods other than gold which they send (sell) abroad, or vice versa. But such excess purchasing tends to be self-limiting. The more gold we send abroad in payment for excess imports, the less the gold is likely to be worth in the countries we send it to and the less it will buy there. *In terms of the gold* we thus send, *their prices become higher*. But the scarcity of gold here tends to make it more valuable here—to make the price of goods here fall. Thus, in the long run, since our prices are becoming progressively lower to foreigners and theirs are becoming higher to us, they are encouraged to buy more here while we are discouraged from buying so much there.

It is on the basis of a similar line of reasoning that it is contended that a country cannot stop or greatly reduce its purchases abroad, through the levy of a protective tariff, without stopping or reducing to as great an extent its sales abroad. Thus, a high tariff levied by the United States on imports from abroad, by directly blocking American purchases abroad, may bring about a flow of gold into the United States. In other words, foreigners, though unable to pay for our goods by sending anything (or

[2] Borrowing and lending between countries do not change the picture in its essentials and to discuss them here would involve unnecessary digression.

much) else, may continue for a time to purchase our goods with gold. But this tends to make gold progressively less valuable here and more valuable there. Foreigners therefore find the cost to them of American goods growing continually greater and, eventually, *must* decrease their purchases of us to whatever extent we permanently curtail our purchases of them.

A protective tariff, therefore, although levied for the purpose of restricting only imports and although its protagonists often express an interest in and a desire to promote large exports, actually works to reduce *both* imports *and* exports in (ultimately) about an equal degree.

In pursuing our inquiry further, let us suppose circumstances such as steadily falling prices in Europe consequent on restriction of bank credit there, or such as a considerable reduction in the tariff rates levied by the United States on European goods, which would induce larger purchases abroad by Americans. Temporarily we would purchase more goods abroad than we were selling abroad, paying the balance in gold. Such an excess of purchases could work—and, unless a policy of stabilizing the general price level were followed, probably would work—in the direction of monetary deflation in the United States and falling prices. It will be worth while to note just how this would come about under our present currency system.

If thus we are purchasing abroad more than we are selling abroad and these purchases are not being made on credit, settlement must presumably be made in gold. Since international obligations are balanced or cleared, ordinarily, through banks and since, in our assumed case, there is an excess obligation for goods purchased, owed by Americans to foreigners, the banks will take care of these obligations by sending gold. Thereby American banks can build up their deposit balances in European banks, on which they can sell bank drafts to Americans who need them to pay for goods they are importing from Europe.

But the banks which thus send gold abroad must first purchase this gold from the United States Treasury. Consider, for example, the case of a large metropolitan bank which is thus purchasing gold and paying for it to the Treasury by check. Such a check will be collected from this bank, via the Federal Reserve bank of its district, through subtraction from the deposit of the national bank in its Federal Reserve bank. But that deposit in the Federal Reserve bank *is the national bank's reserve.* Thus such purchasing of gold to replenish the foreign balances of American banks decreases the lending power of these banks through decreasing their reserves.

In my "Basic Principles of Economics" I have described the situation as follows:

. . . Those whose purchases abroad in excess of their sales abroad cause the export of gold, have to pay for the excess of purchases by giving up checking accounts on their banks. The banks then buy the gold from the government (the checks for the gold being collected through their respective Federal Reserve banks) and send the gold abroad to provide credit balances in foreign banks, from which payment may be made to the foreign sellers of the goods. Or a Federal Reserve bank (or banks) may send over the gold and sell its resulting credit balance on the foreign bank or banks, to a member bank or banks. In either case, certain individuals or business firms in the United States have, as a result of their purchases abroad, smaller bank deposits; each of the member banks which serve them by transferring funds to the foreign sellers of goods, has smaller reserves in its Federal Reserve bank, for each member bank has to make settlement with or through its Reserve bank; and the Federal Reserve banks (with which or through which the United States Treasury finally collects for the gold) have decreased gold certificates. Since payment for the gold comes, finally, from the reserves of the Federal Reserve banks, this will cause sharp restriction of credit, dull business and falling prices, *unless* the Federal Reserve banks have, as they usually have had, reserves *much larger than the law requires.* In that case, they can allow their reserves to decrease while not restricting credit and even, if desirable, while expanding credit.[3]

Advocates of free or freer trade have stressed its long run advantages, and these are great. They have emphasized the fact that in so far as we thus buy more goods abroad—instead of from domestic producers—by just so much, in the long run, can we expect to sell more abroad. The fact has been brought out, too, that in so far as foreign trade enables us to get needed goods much cheaper than before, consumers are able to buy at home goods and vices which they previously could not afford, thereby giving opportunity for employment producing such goods and services. And if an outflow of gold does decrease the volume of circulating medium, we have only to adjust ourselves to a lower level of *monetary* prices, wages and rentals; while the actual goods and services enjoyed are definitely larger and may be very much larger.

II

NEVERTHELESS, A DECREASE in circulating medium, if and to the extent that prices, including wages, are rigid or "sticky" (*i.e.*, do not quickly and easily become adjusted to the requisite lower level), may involve a degree of dullness of business and employment. And this fact may sometimes be seized on by opponents of tariff reduction as an excuse for their opposition.

The truth is, however, that this evil—in so far as it is to be considered as an evil—is brought about *through monetary influences* and *is not at all*

[3] *Op. cit.*, Columbia, Mo., Lucas Brothers, 1942, pp. 115–6.

a necessary consequence of tariff reduction. We can have credit restriction in foreign countries with resulting fall of prices in those countries *or* we can have reduction or even abolition of our protective tariff, and we can have a definite and advantageous increase in our trade with foreign countries, and yet suffer no decrease of our own circulating medium and, therefore, no unhappy consequences from such decrease. How can this be managed?

One way to do this is to raise the official Treasury price for gold, not to raise it excessively but to *raise it just enough* so that our purchases abroad will not exceed, but will be merely equal to, our sales abroad. That, as we have seen, is the long run tendency anyhow. Any temporary excess of purchases abroad over sales abroad, which causes an outflow of gold, must, in time, come to an end. To raise the official price of gold in the way just indicated merely brings us at once to this equalization of purchases and sales to which we must in any case come eventually. How does it do this?

If the Treasury raises the price it charges for gold from $35 to (say) $36, a bank that ships gold to England or some other foreign country, in order to have a balance there and so be able to sell bank drafts to its customers who are purchasing goods there, *must charge more for such drafts.* The American purchasers of foreign goods, for whose convenience the gold is shipped, will find, unless the goods they are purchasing have actually fallen in price in the country of their production, that these goods are more expensive *to them,* since the gold which must be sent for payment *costs more in terms of American money.* This tends somewhat to restrict American purchases abroad.

On the other hand, the higher price charged for gold—and presumably, also, paid for gold—by the United States Treasury, means that, *to the foreigner,* American goods are cheaper than before. For the foreigner's gold—and, therefore, his money if its value is based on gold—is worth more in American money, and for a given sum in his money he can buy more American goods.

Thus a slight increase in the U. S. Treasury's official price of gold may be a means of re-establishing the balance between imports and exports. And such an increase of the official price of gold restores the balance *without* there intervening a period of decrease of circulating medium with the consequences likely to follow such a decrease.

Here I would like to emphasize again that such an equalization of sales and purchases *before* disequilibrium has been allowed to disturb the general price level or bring any other untoward condition is to be sharply distin-

guished, as regards the effect produced, from a protective tariff. For, as I pointed out at an earlier stage in this discussion, a protective tariff necessarily, in the long run, decreases *both* purchases abroad *and* sales abroad. It interferes with a specialization and a trade that would benefit both or all the countries concerned. But such a raising of the price of gold as has just been described does *not* prevent or decrease specialization and exchange. It merely prevents us from buying abroad more than we can pay for with the goods and services (other than gold) which we sell abroad. It merely serves to end quickly, and without waiting for it to force down the general level of prices, a disequilibrium which cannot, in any case, continue indefinitely.

It should be clear, therefore, I believe, that the passage quoted from the current editorial at the beginning of this article does *not* tell "the whole story." More than two years before the editorial was written I anticipated this confusion, pointing out in my book:

> It may appear, on a superficial view, that such raising of the price of gold interferes with foreign trade as much as would a protective tariff. *But this is not the case.* A protective tariff, as we have seen, in the long run necessarily *prevents*, or at least decreases, *both purchases abroad and sales abroad.* But an official raising of the price of gold, sufficient to stop an outflow of gold, *merely prevents us from purchasing abroad more than we can pay for by our sales abroad* (exports) of goods and services other than gold. It does not prevent us from buying abroad as much as we can pay for with the goods we produce to sell abroad (or from buying abroad on credit, if foreigners will extend us credit).
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> To have a wisely managed currency means, in this regard, merely that any temporary disequilibrium between a country's imports and exports does not have to wait for correction until the country's price level has been lowered by a decrease of its currency resulting from an outflow of gold, but is corrected as quickly as desired and without serious unsettling effects on the country's business or price structure.[4]

With such handling as I have described, any decrease of tariff duties which would result in Americans *buying* more abroad would also and to an equivalent degree increase American *selling* abroad—and this not after the lapse of several years but quickly.

III

SUCH CONSIDERATIONS, it would seem, ought to cut the ground from under any last lingering objection to removal or substantial reduction of tariffs, based on fear of possible temporary effects in decreasing the circulating medium and lessening the demand for the products of domestic industry.

[4] *Ibid.*, pp. 165–6.

But it does not necessarily follow that whenever and as soon as our purchases abroad exceed our sales abroad, whether from tariff reduction or any other cause, we should raise the Treasury price of gold to stop the resulting gold outflow. There can be, on occasion, a very great advantage, at least for a while, in purchasing more than we are selling; and it may be possible to maintain such an "unfavorable" balance of trade for some time *without* subjecting ourselves to any deflation whatever.

This may be possible, for example, if the Federal Reserve banks have, at the beginning of such a movement, reserves much larger than they need. In that case, even though part of their reserves in gold certificates are relinquished to the Treasury in payment for gold, they may still have large enough reserves remaining so that they can help out member banks of the system and also, if desired—through open market purchase of securities—keep up the lending power of nonmember banks. Thereby they can maintain a circulating medium sufficient to hold a stable price level.

But even should the reserves of the Federal Reserve banks, along with reserves of other banks, be threatened with depletion because of purchase of gold from the Treasury, there need still be no restriction of bank credit, no decrease of circulating medium, no general decrease of demand for goods and no fall in the general level of prices. For as money is paid *in* to the Treasury for gold, an *equal* amount can be paid *out* in redemption of government bonds or otherwise, by the Treasury. Thus, the gold which has been hoarded by the Treasury can be used to purchase desired and useful foreign goods; while yet the paying out of the same *or new money* for bonds makes available as much domestic spending power for the purchase of American goods as if the gold were *not* being sent abroad. In other words, the American people can enjoy, during such a period, as much as they are able to produce *and also* all the foreign goods that can be purchased with the exported gold. Since we have, stored at Fort Knox, Ky., upwards of $20,000,000,000 in gold which we cannot very well eat or wear or use as productive capital, is there not something to be said for getting rid of a good bit of it if we can obtain, in exchange, useful capital and serviceable commodities?

There seems to be a fear, even among some economists, of a rivalry of nations in lowering the value of their currencies in terms of gold, *i.e.*, in raising the price of gold. There seems to be a fear that each country will seek thus to export more and import less. But if the argument herein presented is at all justified, any country which already *has* a large hoard of gold can gain greatly by releasing much or most of it for goods to any country

or countries which thus stand ready to give goods cheaply for it; and yet the country which is so redeeming its currency in gold to be used for the purchase of goods abroad does *not* need to suffer deflation and it does not, therefore, have to suffer the evils of deflation.

Such an outflow to foreign countries of a vast hoard of gold will tend, of course, to a lowering of the value of gold—a rise of the prices of goods in terms of gold—in the countries to which the gold is flowing. This may bring the outflow to an end while the country having the large hoard of gold has some of the gold still remaining in its hoard. If, however, it appears that *all* the gold so stored is likely to flow out and if it is desired not to lose all of the gold, there remains the device discussed earlier in this paper, *viz.*, the raising of the official Treasury price of gold.

It is entirely possible, of course, given the will to do it and a reasonable understanding of monetary theory, for a country to maintain a substantially stable general level of prices without having any government hoard of gold or any official price of gold; with, in short, an inconvertible paper money. Purchase and sale of gold by government, with a readiness to change the official price of gold if and when circumstances warrant, is only *one* of the techniques by means of which the general level of prices may be kept stable. To quote again from my "Basic Principles of Economics":

> . . . The difference is that the price of gold, in relation to our money, changes by official pronouncement and government purchase or sale in any amount necessary to effectuate the official price, instead of merely unofficially in a general and independent gold market, as it would in case we had an irredeemable paper money with no official gold price at all. But, in either case, the price of gold is subject to change, so that great fluctuations in the world demand for or the world supply of gold need not upset the price level in the United States.[5]

It is to be hoped that the United States will not, now or at any time in the foreseeable future, enter into any currency agreement with any foreign country or countries which commits us to the maintenance of any *fixed* relation between our money and any given weight of gold. More fundamentally, it is greatly to be desired that responsible leaders of opinion in the United States come to understand the *importance* of stability in the general average of prices and the *comparative unimportance* of an unchanging Treasury price for gold. It is greatly to be desired that such leaders come to realize that a stable general price level and a fixed Treasury price for gold may sometimes be incompatible ideals. As I noted in my book:

[5] *Ibid.*, p. 165.

It is not especially important that the dollar should always be worth a given number of grains of gold. It is of primary importance that the dollar shall be stable in its general purchasing power. And so, if and when gold fluctuates in its value in relation to other goods, it may be better that the dollar shall *not* be worth, continuously, a fixed number of grains of gold.[6]

And elsewhere in the same work:

Certainly we ought not to be forever committed to a sacred and unchanging official price of gold. Yet there are still many men prominent as journalists or in public life or otherwise, whose pronouncements are listened to with respect, who seem to have learned nothing from the experience of the United States during the nineteen-thirties and who, when the conversation turns to monetary policy, can think of nothing but that the dollar should, under any and all circumstances, be kept equal in value to a given number of grains of gold.[7]

In truth, not a few such as these—possibly because of an instinctive conservatism—have written or spoken caustically of our "fifty-nine cent dollar" as if somehow the important matter were the amount of *one thing*, gold, which a dollar would buy rather than its *general* purchasing power. They have written or spoken as if the important matter were the change in the price of this *one thing*, gold, from $20.67 per ounce to $35 per ounce rather than what may have happened to the *general average* of prices. The dollar of 1934 and after, it is true, would buy only one thirty-fifth of an ounce of pure gold instead of almost a twentieth of an ounce which was what it would buy in the nineteen twenties and before. But following the high rediscount rates charged by the Federal Reserve banks in 1928–1929 and their open market sales of securities (both of which tended to decrease the volume of circulating medium), there came, from 1929 to 1932, a very great deflation of bank credit and a fall in the general average of wholesale prices in the United States of about a third; and prices remained throughout the nineteen-thirties lower than they were when the deflation began. In consequence, the "fifty-nine cent dollar" would actually *buy more* of goods-in-general than the "one hundred cent dollar" would buy in 1928 and 1929.

And so those conservatively minded commentators on money who can see no significance in its purchasing power over anything but gold seem like a man who, at noon of a clear day, with sunlight beating down on all the landscape for miles around, refuses to look anywhere except at the shadow cast by a tree—or, even, by a single leaf—and who insists against all common sense that the sun is not shining at all!

[6] *Ibid.*, p. 66.
[7] *Ibid.*, p. 118.

IV

WHAT IS NEEDED is substantial stability of money in terms of goods-in-general, to the end that borrowers shall not gain at the expense of lenders from rising prices, nor lenders gain at the expense of borrowers from falling prices and to the end that sharp decrease of circulating medium shall not bring acute business depression nor great and rapid increase bring the speculative mania of inflation. And the thesis of this paper is that there is no incompatibility between such price level stability and the fullest degree of free trade.

But if we plan sometimes to use the technique of *raising* the official Treasury price of gold as a means of preventing *deflation* and *falling prices* from an *outflow* of gold to foreign countries, we should be equally willing to *lower* the price of gold as a means of preventing an *inflow* of gold which would bring *inflation* and *rising prices.*

Let us suppose, for example, that new and rich gold mines are discovered abroad and that, in consequence, foreign nations for a time purchase much more from us than we do from them, paying for these excess goods by sending gold. In that case

> . . . *Even though we no longer coin gold in the United States, the same result, viz., increased circulating medium and rise of prices, is realized when the government buys gold with gold certificates.* In practice, those whose sales of goods abroad in excess of American purchases abroad make the importation of the gold possible, dispose of their claims on their foreign customers to American banks, *in exchange for increased checking accounts.* The banks then import the gold and sell it to the government through a Federal Reserve bank; or they may sell to a Federal Reserve bank (or banks) their newly purchased claims on the foreign customers of their depositors, in which case the Federal Reserve bank (or banks) will import the gold and sell it to the government. Thus in the end, in any case, certain individuals or business firms have larger deposits, their banks have larger claims on (reserves in, if they are member banks) a Federal Reserve bank (or banks) and some Federal Reserve bank (or banks) has increased gold certificates.
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> The fundamental relations are the same when, as quite commonly happens, a foreign bank takes the initiative and sends gold to the United States. Thus, suppose the Bank of England ships gold to the Federal Reserve Bank of New York. The Federal Reserve Bank of New York sells the gold to the United States Treasury and thereby secures a larger reserve, in the form of gold certificates. The Bank of England now has a credit claim on, *i.e.*, a deposit in, the Federal Reserve Bank of New York. This claim or deposit can be drawn upon (the Bank of England selling bank drafts—really its own checks—on it) to pay for American goods which are purchased by British firms or, as in the case of military supplies, by the British government. The American sellers of the goods deposit the claims (bank drafts)

they receive, in their banks. These American sellers of goods then have larger deposits. Each member bank sends the claims so deposited in it, to the Federal Reserve bank of its district (which bank, in turn, demands settlement from the Federal Reserve Bank of New York), for credit. Thus the member banks have larger reserves.[8]

Such a flow of gold in return for goods sent abroad must tend to raise the price level in the United States. But, surely, there is no wisdom in sending out to foreign countries, month after month and, even, year after year, the products of American farms, factories and mines and getting in return nothing to use or enjoy but only billions of dollars worth of gold to be stored indefinitely at Fort Knox. And when this increase of gold is the means—through its sale to the Treasury for increase of bank reserves and resulting greater lending power of the banks—to inflation of the currency and rise of prices, then there is not only the general economic loss just referred to but, further, a discrimination against lenders and other recipients of fixed money incomes.

Rather than let such an inflow continue, the price offered for gold by the Treasury should be *lowered* sufficiently to stop its coming. When gold sent from abroad will buy a smaller amount in American money, the prices of American goods, even though no higher in American money, *are higher for foreign purchasers.* A properly adjusted reduction in the Treasury price for gold will serve to prevent foreign purchase of American goods with gold and will encourage American purchase of foreign goods. It will restore the condition which is the long run norm, *viz.,* that *foreigners purchase all the goods and services they can pay for with the goods and services* (other than gold) *which we purchase of them.* And it will restore that normal equilibrium without the necessity of an intervening period of increasing circulating medium and rise of the general price level. Certainly there is no justification for the view that the United States Treasury should stand ready to buy gold without limit, under any and all conceivable circumstances and at a fixed price.

I am not trying to argue here that every slightest inflow or outflow of gold should be the signal for a change in its official price. There are various other controls—*e.g.,* the Federal Reserve banks' rediscount rates, open market operations, raising or lowering reserve requirements of member banks—which may oftentimes suffice and be preferable. But I *am* contending that the official price of gold ought not to be rigidly fixed but, instead, ought to be subject to change whenever this is the only or the best way of assuring price level stability.

[8] *Ibid.*, pp. 113–4.