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The Prospect of Rising Prices from the Monetary Angle

By Edwin Walter Kemmerer

IN THE depression which has followed the economic collapse of November 1929, wholesale prices and the cost of living in the United States reached their lowest figures during the fore part of the year 1933, and since then have been moving upward most of the time. From February 1933, the last month in which we were actually upon the old gold coin standard, to the present time (autumn of 1935) wholesale prices have risen 35 per cent, the prices of farm products in general 94 per cent, and the cost of living 16 per cent. House rents and clothing have lagged behind food in this cost-of-living advance. Many important items of food have shown spectacular rises during this period. The retail price of round steak, for example, has risen 52 per cent, rib roast 43 per cent, pork chops 122 per cent, bacon 123 per cent, lard 188 per cent, hens 39 per cent, bread 30 per cent, and wheat flour 76 per cent.

Where Will Prices Go?

The public, and particularly our women folks, are becoming increasingly concerned over these continued advances in the cost of living, and consumers' strikes against rising prices are being frequently reported from different parts of the country. Everyone nowadays is talking about inflation and rising prices and is wondering where the present upward movement in the cost of living will end. Meanwhile, through processing taxes and crop restrictions, rising taxes, dollar devaluation, inflationary borrowing from the banks, and other means, the Government is exerting a strong upward pressure on commodity prices and the cost of living, which, however, are still substantially below what they were during the years immediately preceding the depression. What is likely to be the result of all these forces? Prophecies are dangerous but they are none the less necessary for all of us who would intelligently plan for the future.

A price is the value of a particular commodity in terms of the value of the monetary unit. It is an expression of the number of units of money for which a commodity is bought and sold. The price level represents a composite of individual prices. Prices fluctuate, therefore, with the changing values of goods and also with the changing value of money. The other speakers this evening are discussing the commodity side of the so-called price ratio. My task is the money side.

In order to have a basis for discussion I shall assume that the United States will continue on some form of the gold standard, with a dollar of the present weight and fineness (13.71 grains), namely, our so-called fifty-nine-cent gold dollar, and that slowly but surely the principal countries of the world that are now on paper money standards will return to gold. While the gold standard is far from being a perfect standard, it is the best standard with which the world has so far had any extensive experience, and it is the only standard which offers any hope, for the immediate future, of being a successful international standard on a broad scale.

The basic characteristics of the gold standard that relate to our subject

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may perhaps best be made clear by a simple, hypothetical illustration. Assume a group of islands among which there is ready communication. Assume that on each of these islands there are streams in which there are considerable quantities of placer gold which the natives obtain by the crude means of panning. Assume that the only money of these islands consists of nuggets of pure gold each weighing one gram [1] and that all transactions of purchase and sale are made by means of these nuggets. Assume that gold is used for crude ornaments such as rings, bracelets, and necklaces as well as for money.

MONEY SUPPLY REGULATES PRICES

If the supply of goods to be bought and sold is large while the number of nuggets of gold in circulation is small, commodity prices will be low and the value or purchasing power of gold will be high. If, on the other hand, the streams yield an abundance of gold so that the supply of nuggets is large in relation to the supply of goods to be bought and sold, commodity prices in terms of nuggets will be high and the value or purchasing power of gold will be low. When the streams are yielding such an abundance of gold that the number of nuggets in circulation increases faster than the volume of commodities to be bought and sold, nuggets will decline in value relative to goods, and commodity prices rise. On the other hand, when the gold yield of the streams is so niggardly that the supply of nuggets in circulation does not increase so rapidly as the physical volume of goods to be bought and sold, there will not be enough nuggets to go around at the old commodity prices, and prices will fall. In other words, the value or purchasing power of gold will rise. If the demand for ornaments increases rapidly, resulting in the flow into the manufacture of jewelry and ornaments of an increasing proportion of the total gold, the supply of gold available for money nuggets will tend to be reduced and commodity prices will tend downward, and vice versa.

If the population moves from the rural districts to the cities and business becomes more active, each nugget of gold will circulate faster than before, and the increase in the velocity of circulation will act like an increase in the supply of nuggets.

If the supply of gold produced on one of the islands increases, relatively to demand, more rapidly than that produced on the other islands, the value or purchasing power of a nugget of gold in the island producing the increased supply will fall, commodity prices will rise, and nuggets will flow in trade from this island where gold is cheap and commodity prices are high to the islands where the purchasing power of gold is higher and commodity prices are lower. This reduces commodity prices in the island exporting the gold and increases them in the islands importing the gold. The gold will always tend to flow from the place where it is cheap to the place where it is dear, just as water tends to seek its own level, and the values which determine this flow are those expressed in commodity prices. Increase the supply of gold nuggets relatively to demand, and commodity prices rise; decrease the supply of gold nuggets relatively to the demand, and commodity prices fall; and these changes are in time transmitted, through the flow of gold and of goods, among all the connecting islands.

Since there is a ready flow of gold back and forth between the money

[1] At the present time in the United States a gram of gold has a value of about $1.09.

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nugget uses and the jewelry uses, the value of an ounce of gold in the two uses tends always to be the same.

HOARDING AND DEVALUATION

If the people in the islands at any time should become scared because of a threatened invasion or for other reasons and should withdraw large quantities of nuggets from circulation and hoard them, the supply of nuggets in circulation would decline and, unless the supply of commodities to be bought and sold declined at least as rapidly, commodity prices would fall. When the fear subsided and the nuggets were withdrawn from the hoards and put back into circulation, commodity prices would tend to return to their previous level.

If in such a simple community the government at any time should decide to cut in half the gold content of the nugget, declaring that thereafter every nugget should contain only a half gram of gold instead of a gram, commodity prices would move upward and, when the change had become fully effective, prices in terms of nuggets would be double what they otherwise would have been. This would be because the government had decided to do what in practice would amount to calling "a dollar" the amount of gold that formerly had been equivalent to fifty cents. On the same principle, if the gold content of the nugget were cut down to one third of a gram, prices in time would be tripled; and if it were cut to one fourth of a gram, they would be quadrupled. Meanwhile, if the streams were pouring out increasing quantities of gold, commodity prices might rise still faster than the above mentioned rates, because, while the gold content of the nugget was being reduced, the value of the gold itself would be depreciating by reason of the fact that the supply of monetary gold (by weight) was increasing more rapidly than the demand.

The fundamental principles here expressed would not be changed by the introduction of paper notes that were convertible into gold nuggets on demand, or by the introduction of banks having bank deposits that circulated through checks that were likewise payable in gold on demand. So long as the notes and deposits were convertible into gold on demand, and as gold could be obtained readily from the streams, converted into nuggets, and imported and exported without appreciable expense, all the different kinds of circulating media would be kept at a parity with a fixed quantity of gold in a free market, and a gold standard would exist.

ACTUAL SITUATION

With this digression into the field of abstract economics let us return to our specific problem, which will be clarified, I believe, if the principles of this simple illustration are kept in mind.

Between 1896 and 1913, largely as a result of the enormous increase in the world's supply of monetary gold coming out of the newly discovered gold mines in South Africa, wholesale commodity prices in gold standard countries rose on the average something like 50 per cent, representing a depreciation in the value or purchasing power of gold of about 33⅓ per cent. During the period of the World War and the two years immediately following, practically all the world gave up the gold standard and resorted to various paper money standards. The demand for gold accordingly fell off and the value of gold in terms of commodities at wholesale declined enormously, the decline in value in the United States between May 1913 and May 1920 having been over 60 per cent. During that period no country in the world

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remained strictly on a gold standard, but the United States came nearer to doing so than any other important country.

After peace had become established, the leading countries of the world soon became dissatisfied with their various managed paper money standards and undertook to return to the gold standard. There was, of course, nothing like enough gold "to go around" at the inflated price levels of the period 1914 to 1920, so that when the movement to return to the gold standard began to get under way, there was a great slump in the inflated commodity price levels of the war and early postwar periods. For example, in the United States between May 1920 and July 1921, wholesale commodity prices on the gold standard basis declined 44 per cent, the general price level declined 19 per cent, and the cost of living 17½ per cent. In its purchasing power over goods and services in general, the American gold dollar increased 24 per cent in fourteen months.

During the war, while gold was becoming cheaper, the world's production of gold fell off substantially; but after the war and beginning in 1923, the rising value of gold began to stimulate gold production, and since that time the world's production of the yellow metal has increased every year but two down to the present time. It is now by far the largest that it has been at any time in history, the average during the last five years having been approximately 20 per cent greater than during the five years 1914–1918.

Stable Price Levels

During the years 1923 to 1929, contemporaneously with this large increase in the world's gold production and with many improvements in currency and banking systems involving large economies in the use of gold, most of the leading countries of the world returned to the gold standard. Gold supplies were ample to meet the demand, and as a result the commodity price levels in gold standard countries during the period of eight to nine years ending in 1929 were remarkably stable. In the United States wholesale commodity prices during these years ruled between 40 and 50 per cent above what they were in 1914 when the war began, and averaged just about what they would have averaged had there been no war and had the upward movement of prices which began in 1896 continued uninterruptedly until 1929. For the nine years ending 1929 the range of variation in the purchasing power of gold as measured by the New York Federal Reserve Bank's index number of average annual general prices was less than 10 per cent. From 1921 to 1929 the average annual index numbers for the cost of living prepared by the National Industrial Conference Board were likewise unusually stable, exhibiting a range of fluctuations for the entire nine years of only 6.5 per cent, and excluding the figure for 1922, a range of only 3.8 per cent. There is good reason to believe, therefore, that the level of commodity prices prevailing during these eight to nine years ending 1929 was a reasonably normal one for postwar conditions.

Crisis of 1929

The world economic crisis beginning in 1929 and initiated in the United States by the stock market crash of October smashed business confidence nearly everywhere, caused a catastrophic decline in commodity prices, and led to a world-wide scramble for gold. Gold is a commodity that represents a large value in a small bulk. It is the commodity in which people have the most confidence in times of panic

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and depression, and in such times it performs well the monetary function of a storehouse of value. Charles Dickens' expression "as good as gold" is suggestive of the popular attitude towards the yellow metal. In times of crisis, governments, banks, corporations, and individuals all hoard gold. Nation after nation that is off the gold standard today has more gold than it had when it was on the gold standard. The total stock of monetary gold in the leading countries of the world (in terms of old dollars) was 12.8 billion dollars in August 1935 as compared with 10.3 billion dollars in October 1929 when the economic crisis struck us.

In other words, the world has 24 per cent more monetary gold today when the great majority of the leading countries are off the gold standard than it had when most of them were on the gold standard. The Bank for International Settlements estimated the total amount of gold in private hoards at the beginning of 1934 at over 2¼ billion American dollars (new). Individuals, corporations, banks, and governments throughout the world are hoarding gold.

This hoarding creates an artificial demand for gold and pushes up the value of gold in terms of commodities, or in other words, pushes down commodity prices, in gold standard countries. This great increase in the value of gold or decrease in the commodity price level, being due to a panic-stimulated fear, to a scramble for security, is of a temporary character. When the economic depression is over and confidence is restored, this world-wide scramble for gold for hoarding purposes will disappear. Gold will then flow back into more active monetary use and its value will then depreciate again, in my judgment, at least to as low a level as that prevailing during the years immediately preceding the crisis. In other words, the commodity price level in gold standard countries will rise at least as high as it was during the eight to nine years of comparatively stable commodity prices ending with the crash of 1929.

ADEQUATE GOLD SUPPLY

During those years the world was not suffering from any scarcity of gold. After the World War the demand for gold was materially reduced by the substitution in most gold standard countries of the gold bullion standard for the gold coin standard, thereby eliminating the demand for gold previously represented by the large supplies of gold coin in active circulation and in the vaults of commercial banks.

In some important countries and many minor countries and colonies the gold exchange standard was adopted after the war in place of the gold coin or bullion standard, and this still further lessened the amount of gold required for currency needs. A dollar of gold held in the reserves of our Federal reserve banks has, roughly speaking, according to legal requirements, at least twenty-eight times the monetary efficiency of a dollar of gold coin in hand-to-hand circulation. Under a typical form of the gold exchange standard, a dollar of gold held in the reserve of a foreign central bank has twenty-two times the reserve money efficiency for the country of a dollar of gold under the gold coin standard held in the vaults of the home central bank.[2]

Great economies in the use of gold, moreover, were effected during the period 1921 to 1929 by the increasing number of central banks and the growing use of bank checks in place of currency. During the latter six years of this period, namely, from 1924 to 1929, the United States had an average an-

[2] E. W. Kemmerer, *Money*, pp. 164–166.

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nual circulation of gold coin amounting to nearly 400 million dollars, and of gold certificates backed 100 per cent by gold coin amounting to nearly a billion dollars. By substituting Federal reserve notes with a 40 per cent gold reserve for gold certificates and for gold coins in circulation, the United States could readily have released for monetary purposes approximately 800 million dollars of gold (the equivalent of the world's total gold production at that time for two years) had there been any need for doing so growing out of the alleged world scarcity of monetary gold. During that entire period our Federal reserve banks were carrying large gold reserves—reserves far in excess of legal requirements.

Decline of Gold Value

Under such circumstances it would seem reasonable to assume, as previously stated, that when we once work our way out of this depression and the world-wide scramble for gold ceases, the value of gold will decline to at least as low a figure as that of 1926. I believe that there are strong forces that may very well push the value or purchasing power of gold down to a much lower level. Among these forces may be mentioned the following:

1. There has been a great increase in the world's production of gold during the last few years, prompted in large part by the high value of gold caused by the economic depression and in part by the large amount of labor that the unemployment situation has turned to prospecting for gold and particularly to producing gold by panning the gold dirt of streams containing substantial amounts of placer gold. Noteworthy in this connection is Russia's greatly increased gold production since 1929. The world's gold production for 1934 was 39 per cent greater than for the supposedly normal year 1926, and will probably be about 8 per cent greater for 1935 than for 1934. Every year since 1929 it has increased substantially over the year preceding.

2. There is an enormous outpouring on the world's markets of gold from hoards of India. From 1926 to 1930 India absorbed in net imports of gold, in terms of old gold dollars, an average of 68.1 million dollars a year, representing 18.2 per cent of the world's total gold production of that period. Beginning with the year 1931 there was an abrupt change in this age-long movement, and as the price of gold rose with the depreciation in the gold value of the silver rupee which went off of the gold basis in that year, India began to pour enormous amounts of previously hoarded gold upon the world's markets. From 1931 to 1934 her net annual exportation of gold averaged 138.4 millions in old dollars, or 27.2 per cent of the total world's gold production of that period. The movement is continuing strong up to the present during the year 1935.

3. The movement for economizing gold in the monetary uses, or, stated in another way, for making monetary gold more efficient, which became pronounced after the war, has been further advanced since the depression. The circulation of gold coin has practically ceased everywhere in the world. While in gold standard countries gold bullion in the form of bars is still readily available generally for making international payments, gold is nothing like so easily available as formerly in small quantities, either in coin or bullion form, for persons who wish it for hoarding purposes. In the United States, gold certificates have been entirely withdrawn from circulation and replaced by forms of paper money requiring the use of much smaller gold reserves. These economies in the use

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of gold have probably come to stay.

4. As the proportion of the population in advanced countries living in the cities increases, as the proportion of business done by means of checks in contrast with that done by means of money becomes greater, as central banks increase in number and efficiency and our banking systems improve, a given amount of gold in bank reserves serves as a basis for an ever increasing amount of exchange business. Much of this increased efficiency of reserve gold is effected through the increasing velocity at which bank deposits circulate by means of checks.

RESULTS OF LOWERED GOLD VALUE

If, to be abundantly cautious, we omit any allowance for the influence these forces in their *more recent operation* are likely to have in depressing the value of gold, and merely assume that when the present crisis-stimulated world scramble for gold passes and we work our way out of the present economic slough of despond, the value of gold or its purchasing power over commodities in the markets of the world will return to what it was in the supposedly normal pre-depression year 1926, then our conclusion will be as follows: Commodity prices in those countries on the gold standard that have not changed the size of their gold monetary units since 1926 will return to something like the level of that year. Countries like the United States, which during that period have debased their gold monetary units, will experience increases in their price levels above the levels of 1926 proportionate to the debasement of their respective monetary units. If, for example, between 1926 and the time under consideration the gold content of the monetary unit had been cut in half, commodity prices would be doubled as compared with the level of 1926. In the United States we reduced the gold content of our dollar by 41 per cent, making the new dollar the equivalent of fifty-nine cents of the dollar of 1926. This debasement should give us an increase in the commodity price level of 69.3 per cent above what the level would have been had we retained our old "100-cent dollar."

If we increase the National Industrial Conference Board's cost of living index of 1926 by 69.3 per cent, we have an index number of 175.7 (on the 1923 base), which is 110 per cent above the corresponding index number (83.5) for September 1935. Similarly, if we increase the wholesale price index number of the Bureau of Labor Statistics of the year 1926 by 69.3 per cent, we have an index number of 169.3 for the present time, which is likewise 110 per cent higher than the actual index number of the present time (i.e., that of September 1935). By the same sort of computation applied to the New York Federal Reserve Bank's index number for general prices (covering wholesale commodity prices, wages, rents, and other elements in the cost of living), we arrive at a general price level 97 per cent higher than the present one.

In other words, on these very conservative assumptions which I have made, when the slack we have already created has been taken up, we may reasonably expect that the cost of living, the wholesale price level, and the general price level, will be something like double what they are today.

CONTINGENT RESULTS

Bear in mind that these estimates are made upon the conservative assumptions (1) that the gold standard will be retained in the United States and the other countries that continue

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to have it; (2) that the leading countries of the world that are now off the gold standard will return to that standard; and (3) that we will not further debase our own gold monetary unit but will continue with our so-called fifty-nine-cent gold dollar, representing a mint price of $35 an ounce for gold. This of course means that within a reasonable time we will balance our budget and will thereby avoid any runaway inflation.

If, however, our Government should continue to run heavy deficits of the kind it has been running in recent years and should continue to meet these deficits by increasing inflationary borrowing from the banks, our present fifty-nine-cent dollar or any other gold standard dollar we may establish would break down, and we would be in grave danger of experiencing a flight from the dollar accompanied by a runaway inflation of the type many countries of Europe suffered after the World War.

While a runaway inflation in this country would probably be of the more moderate character experienced by France, Italy, and Belgium, where the depreciation of the monetary unit in terms of gold values varied in the neighborhood of 75 to 85 per cent, there is, of course, no assurance that it could be held within even these bounds. The sky is the possible limit, as it proved to be in Austria, Russia, Poland, and Germany.

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