THE GOLD PROBLEM

Mr C.H.Kisch

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NOT TO BE TAKEN AWAY

RECORD OF SECTION MEETING HELD

AT

CHATHAM HOUSE

on

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Subject: **THE GOLD PROBLEM**

Speaker: **Mr C.H.Kisch, C.B.**

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Address at Section Meeting held on
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BY MR. C.H. KISCH, C.B.
Sir Robert Hadfield, Bart., in the Chair.

It is now for about twelve months that the Gold Group of Chatham House has been considering the gold question. During that period a Committee of the League of Nations, on which various countries have been represented has also been considering the same problem. Meanwhile the subject of gold has acquired increased interest and absorbs more columns in the press nowadays than ever before.

The object of this meeting is to inform a wider circle than attends the Gold Group Meetings as to the line we have taken in surveying the question, and to bring to your acquaintance some of the results of thought and discussion that have been devoted to the subject during the year. I need hardly say that without the advantage gained from these discussions, in which leaders of finance and business, economists and others have taken part, it would scarcely have been possible for me to open up all the ground we hope to cover this evening.

The Chatham House Group discussions have, of course, been severely technical. Tonight I hope to avoid the more abstruse and technical side of the question. I have been asked to try to make this address a popular one - not a very easy task, as the subjecy of gold does not lend itself to popular treatment. Nevertheless gold is an important subject for each of us and enters into all our lives, affecting the purchasing power of our income, and influencing the trading relations between nations. Nobody who wishes to keep abreast of important current topics can afford to pass over the difficult and controversial gold question.

During the year in which we have been considering this matter in the Chatham House Group, the gold problem has taken on rather a new aspect. We began thinking of it as a long-view problem. We wondered whether gold was going to do all required of it in the future, having regard to the production of gold, the growth of population, the increase of trade, and similar considerations. But in this period of economic stress the gold question has become a practical question. How far is gold a player in the tragedy of the price collapse?

The question is asked on all sides, - is gold the culprit? I should say there are many culprits and we must be careful not to impute the crime to a catch-word. Gold is in danger of becoming a catch-word. Its proceedings are mysterious; it is difficult to get hold of and to put in the dock; it is easy to make it the scape-goat.

In tackling the problem we must be very careful to distinguish between two different questions; Is there a gold shortage? Has the handling of the credit question been prejudiced by gold shortage or gold maldistribution? The other question is: Has the credit question been mishandled despite adequate gold? These are the problems which one must consider when one wishes to assess the part that gold has played in the world depression.

I am going to set out for your consideration a number of points which have to be examined in answering these very important questions. I do not propose to attempt a conclusive answer. I wish to draw you and to hear the different suggestions from the hall. I am not at all sure that gold has yet deserved all the accusations that are levelled against it. We must put to ourselves a number of questions, and, if we answer them right, we shall probably understand what is the gold problem, its present reactions and its future possibilities.

First, what is the part played by gold in our modern structure of society? We must then come to some conclusion as to what we want gold to do. Then we must consider what gold is actually doing; whether what it is doing is due to an insufficiency of gold, either present or prospective. If we find it is, we must then consider what methods there are of making gold go further than it is doing at present - in other words, the question of gold economy.

That will take us on to the question of non-monetary uses of gold in the arts and for social purposes in India; the question of reserve requirements of Central Banks, the methods by which their policies can be modified or requirements changed in order to reduce their gold demand; and, in connection with that, the most technical aspect of the problem which I shall deal with, the question whether Central Banks could not improve the methods by which they work out their gold requirements.

That will lead on to the international aspect of the case, and the part of great industrial countries can play by working together and controlling the demand for gold - that is the co-operation of Central Banks. The Bank for International Settlements, created last May, introduces us to the question of the world management of currency. In this connection we shall refer, in conclusion, to the part that confidence must play in the solution of the question.

A difficulty which characterises this formidable examination paper which I am setting, is that the problem is regarded differently in different countries. The United States with the equivalent of over nine hundred million pounds of gold and France with over four hundred million pounds, take a different view from this country with under a hundred and fifty million pounds. The Americans and French are not predisposed to regard gold as a serious culprit in the matter of the world depression. Mr. Warburg, whose views on a question of this kind command great attention, emphatically holds that gold has played a very small part in causing the slump. He ascribes the main trouble to the desire to maintain production at an excessively high level of prices. The French say they cannot help gold coming to them; they are, relatively speaking, passive, and the Bank of France is obliged to receive the gold offered to it. Against that we

have

the British view, stated by Sir Henry Strakosch and Lord D'Abernon who hold that gold has played a large part in precitipating the catastrophic price fall in recent years. They are combated by another Englishman, Mr.Arthur M.Samuel, who in a letter to "The Times" took much the same line as that taken by Mr.Warburg. But in England we are doing what the Americans and French are not: we are working the gold standard with a quantity of gold which is small, relative to that held by the other great international centres - New York and Paris. In that matter appreciation is due to the enlightened attitude taken by the Bank of England. It has never shrunk from allowing its gold holding to diminish, and has only taken protective measures when it has suffered long provocation. The British are thus well qualified to take the lead in this matter. Theirs is the only Central Bank which is practising anything that can be called gold economy.

Reverting to the examination paper, we are aware that the Central Banks are all, when working the gold standard, under an obligation to maintain the convertibility of their local currency in gold; they must pay notes either in gold or in international money convertible into gold - usually pounds sterling or dollars. We have now a large circle of Central Banks round the world, maintaining convertibility into gold. Paper money, is representative of gold, and prices in the gold standard countries are gold prices. Gold works unseen as the basis of currency and credit, which we may regard as the purchasing power created by the banking system and represented by banking deposits. Gold convertibility is enforced on the Central Banks by law, and in almost every country Central Banks are obliged to hold certain quantities of gold, or currencies convertible into gold, or a combination of the two. In this way the money used throughout the world is firmly fastened to gold.

When you come to examine the basis of the credit structure, the amount of gold actually held in relation to the total deposits in money, is comparatively small. In the United States the most recent figures - those for 1929 - show that the gold ratio held by the Government and the Federal Reserve Banks was 6.8 per cent. of the total deposits and currency. In this country it is 5.8.per cent. On these small proportions of gold an enormous credit structure is raised. We believe there is a definite connection between currency, credit, and the price level, and as regards the gold basis of the system, we believe that importance attaches to all countries having sane views as to the amount of gold required to maintain the credit structure.

The United States since the War has been in the predominant position in the whole matter. It is the only country which has remained effectively on the gold standard without intermission. Their credit policy has/had reactions on the credit policy of all other countries linked together by the gold standard, and the American bank rate policy has possibly been the most fundamental factor in the price level since the world has returned to the gold standard. We returned to it in 1925 and other countries followed rapidly after. This whole question is explored very fully in Mr. Keynes' new book, "A Treatise on Money", the second volume of which especially would interest everybody here.

Mr.Harold Cox recently had a letter in "The Times" in which he drew attention to the amount of gold held in the Bank in 1920 and the amount held to-day. He observed that the price level in 1920 was much higher to-day, and argued: what is the connection between the two? But in 1920 this country was not on the gold standard; there was no gold obligation on the Bank of England, and therefore there was no necessary relation between its gold holding and the price level. The position is entirely different when countries are on a gold basis.

We may now consider the problem from the aspect of prices. Prices either rise, fall, or remain stable. The question is: What do we want prices to do? Are we in a position to influence the price level? - not the particular price of, say, jute or sugar, but the general price level as measured by index numbers such as are now produced by all the leading countries or banking authorities throughout the world. The price tendency is of the greatest importance to the community. We have to distinguish between the long-term movement of prices and the short-term movement. We can all see the disastrous consequences of a rapid fall in prices, but it id a different question if the fall is protracted over a couple of generations. There you have as a counter influence, scientific improvements and advance in the methods of production, which act as a set-off and may enable a unit of production to be produced at a lower real cost. This presents a different factor from the rapidly falling price problem of to-day. Some people take the view that there is a good deal to be said for slowly falling prices. It stimulates the effort to avoid waste in production and thus helps economy in manufacture. The classes with fixed salaries and wages benefit from a slowly falling price. They get the benefit without having to go on strike or engage in violent argumentation: it comes automatically.

The argument for slowly rising prices is that it stimulates production by bringing profits more easily to the entre-preneur classes. Fixed salaries and wages are able to get their share of improvdment by negotiations and the usual Trades Union machinery. The process offers an advantage to producing classes by reducing the real burden of fixed charges, such as debenture interest. From the point of view of the country as a whole, a rising price level reduces the net weight of the National Debt and in that sense relieves the present from the burden of the past.

It is not possible for me tonight to attempt to give you a full presentation as between these various alternatives.

It would lead to a complex discussion of the causes of rising and falling prices - how far non-monetary, fow far monetary causes, how far improved organisation and scientific resources, may influence a view. We must tonight make the definite assumption that there is serious evil in a rapid and substantial change in price. We must dissociate ourselves from a policy of inflation or deflation intended to raise or reduce prices, and assume that from a money point of view stability is the desideratum in the price level. So far as monetary measures are concerned, we should not do anything deliberately to disturb the price level.

What, now, has gold actually been doing during the last few years? In 1920 the post-war inflation reached its height and gold prices were at anoppressive level, producing social stress in one form or another in almost every country. Then came the great deflation and gold recovered, roughly speaking, 40 percent. of the purchasing power lost in the War. European countries on a paper basis came back gradually to the gold standard when the price level in the United States was approximately 50 per cent. higher than pre-war. That was the level on which the world got back to the gold standard and on which it hoped to remain. The stability of prices was pursued, I think consciously, by the authorities of the United States banking system, and they pursued it fairly effectively until about a couple of years ago, when a marked decline began to establish itself.

Since then the decline has been much more rapid, particularly since the break of the New York Stock Exchange boom in 1929. From the British price level of 1929 - an average of 135 as compared with the pre-war 100 - we are now back to-day to the pre-war wholesale price level. It is an extraordinary thing, though we do not realise it in the purchases we make, that wholesale produce is back on the pre-war level of prices, as shown by the index numbers. Many individual articles are a long way below, others slightly above, but the general wholesale price index for this country is about pre-war level. In America it seems to be sinking towards the same level. The fall since 1929 is in this country about 25 per cent. and in America something like 15 per cent. The disparity between wholesale prices and retail prices adds to the stress that this price catastrophe has caused.

Can monetary measures avoid this kind of disturbance, and what is the part played by gold in this connection? The credit system is the pivot of the problem. We all know that in times of trade depression bank rates are low; at times of boom bank rates rise. But the bank rate in itself does not solve the problem. The bank rate is only a means to a further movement. The object of lowering the bank rate in times of depression is to encourage investment of new capital; that is to say, to encourage the entrepreneur and manufacturer to embark on new capital enterprises, and development, taking advantage of what is called cheap money, employing more labour, producing more goods, and in this way inducing an increase in the credit and currency circulation of the country, so that the price level which had sagged may be encouraged to rise. The converse process is applied when there is a trade boom and an excessive tendency to speculation. Banks then require to put on a curb, which they do by raising the bank rate.

We may ask ourselves why the period of easy money, which we have now enjoyed for twelve months, has had so little effect. That problem would take a whole evening to discuss, and I must leave it to others. We must revert to our examination.

When the Gold Group took up the question, we were asking ourslеves how much gold the world will want in the next generation. Will it have enough? And what are we to do about it? It is held by eminent economists that the world's annual gold requirements are roughly three per cent. compound interest on existing stocks, to maintain a stable basis of currency and credit. This figure was calculated on past experience. Thr problem then is: Has the world any chance of getting this three per cent. compound increase?

In 1915, the record year of output, gold production was equivalent to £96 million. At the present time the figure is about £83 million, of which about half comes from South Africa - the Rand. It is generally held by metalurgists that the Rand is rapidly passing its zenith, and that it is unlikely that new gold fields will be found in South Africa or elsewhere to make up for falling off in the Rand production. It is held by competent estimators that by 1940 the present production of £83 millions will have dropped to £76 millions, by 1945 to £60 millions, by 1950 to £55 millions. Thus a drop of £28 millions may be expected within the next thirty years or so. Although past estimates have proved erroneous, various circumstances have helped the situation, such as improvements in methods of getting the gold out of the rock. Authorities now think that these processes have been fully exploited.

The conclusion reached by the Gold Group is that if the present credit structure is to be maintained, assuming that the arts, trade, and the social requirements of India continue to absorb about the same amount of gold as at present, then there is a prospect of a steady and continuous decline in the price level, with all the disastrous consequences of which we are so painfully aware.

What happens to the gold at present produced? About half is absorbed by the various arts and for social purposes. The balance finds its way into Central Banks and to the currency authorities. In 1928 the Central Banks and Governments held £2,000 millions of gold - about ninety per cent. of the world's gold stock. £400 millions found its way back to the Central Banks as a recall of gold currency from ordinary circulation. But in considering these figures, we have to recognise that a great part of the gold now in the hands of the Central Banks is not functioning as a basis of credit, particularly in the United States and France, which latter country last year took practically the equivalent of the world's total annual production. Taking £2,000 millions as roughly the amount of gold held for currency purposes, with the figure of £60 millions which is the prospective output of gold for 1945, you have a three per cent. increase, but not a compound three per cent. and 1945 does not represent the low point in gold production which is to be expected in the future.

This illustrates the point that, on the present requirement of gold, production is not likely to supply the need of currency authorities. The Gold Group has therefore adopted the view that measures of gold economy are imperative.

What are the means of effecting gold economy? We do not think there is much opportunity of influencing the social uses of gold in jewellery and so on. The principal means of economy must be through the Central Banks which provide a permanent market for gold at a fixed price. The Central Banks are obliged to hold a certain proportion of gold, varying broadly from thirty-five per cent in the Bank of France to forty per cent. in the Netherlands and the United States, but they actually hold very much larger proportions in relation to their demand liabilities, that is notes and deposits. I got out the figures for the situation last May. In some cases they are already out of date; France and the United States have each increased their gold holdings since then. The French then held fifty per cent, and the United States something in the neighbourhood of seventy-five per cent ratios, amounts greatly in excess of the legal proportions on the Statute Book.

There is another group of countries which hold at the present moment much smaller amounts of gold, but they are suffering from the bad example of the great international centres like Paris and New York. They naturally think there is something in the policy of increasing gold holdings and do so too. Germany and the Central European countries are all out to get more gold as occasion offers. I am afraid if we did try to adopt Mr.Cannan's suggestion that some of the larger Central Banks should sell gold, it would inevitably be snapped up only too rapidly by other countries, and the total absorption by Central Banks would remain very much as before.

This is the problem of the maldistribution of gold. The League of Nations Committee pointed out that the excess of gold reserves over the 33 per cent. standard which they regard as the average, was at the end of 1928 about £350 million. Fifteen countries held over 90 per cent. of the gold reserves of the world. I had some calculations made for the Gold Group some months ago and at that time, if the French surplus over legal requirements had been redistributed to nineteen other countries, it would have given them an average gold ratio of 51 per cent. against notes and deposits. If the surplus of the United States over 40 per cent. were redistributed, the nineteen other Banks would get a ratio of 55 per cent. If the surplus of both the United States and France were redistributed the ratio of the remaining eighteen Banks would be brought up to 73 per cent. against notes and deposits. This shows the enormous lock-up of gold in particular countries.

The legal ratios to which we have referred are arbitrary, in the sense that there is no scientific basis for them. In the middle of the last century people seemed to think that a note currency was sufficiently protected if Banks of Issue were obliged to hold 33 per cent. in metal. That figure seems to have formed the basis of modern percentages by a process of more or less accidental development. Some of those considering the question in the Gold Group think there is great scope for cutting down the gold ratios. We think it can be done without any risk to currency standards. A substitute for gold backing must be discovered. We use paper notes, and the Central Banks may take in one another's currencies to a greater extent than at present, and support notes by holding dollars, pounds and other strong currencies as substitutes for gold. In this way the demand for gold in the future might be reduced. There would be no question of an insufficiency of gold for at any rate, a generation. The reduction of gold ratios is one of the main recommendations of the League of Nations Committee. At the Gold Group suggestions of wider scope have been made.

The view has been expressed that the Central Banks ought to overhaul the basis on which they arrive at their gold holding, distinguishing carefully between requirements in respect of the internal circulation and in respect of external liabilities. As the former system of a gold circulation is being rightly superseded, the principle of holding gold reserves to secure the convertibility of local currency is in need of reexamination. But countries must remain on the gold standard and must therefore be prepared to meet ultimate international debit balances in gold money. The Central Bank, therefore, has got to examine the position with regard to the particular circumstances of its individual case, forming a view as to what the liability on the international account may be, allowing ample margin for error and security, and in that way it can arrive at a fixed amount of either gold or gold exchanges, which it ought to hold to secure its position against any risk whatever. By such ways as this there is scope for a large amount of gold economy without risk.

A question of that sort is an international question. You cannot expect one isolated country to say: I am cutting down my holding of gold. The other countries may say: We are not following suit; we will take the gold you are giving up. No good will be done that way. It is essentially an international problem and the leading countries of theworld must get together and thrash out the question. If this is recognised there is a possibility for the Bank of International Settlements to play a useful part. It is a Bank under the control of the Central Banks. It is a public authority in the sense of being the servant of the monetary world. The Bank for International Settlements has important privilleges under its Charter. Its assets are free from seizure in time of war, and therefore it is immune from the dangers which beset assets privately held in foreign countries. National Banks may hesitate to hold foreign currencies as backing because they do not know what will happen in the event of war. Because the Bank for International Settlements is not a national body it is in a good position to take the lead in inviting discussion and in focussing opinion on the gold question. As it grows in public esteem it should essay wider tasks. It is at present an infant organisation and one cannot expect too much from it in these early days. There has hardly yet been time for the International jealousies left from the War to cool down. As time advances the world will realise that with this gold question we all stand or fall together. The world depression is not afflicting us alone; Germany and the United States perhaps feel it even more. It is a world calamity and world measures must be employed to ease it, and to inspire confidence amongst the trading communities that everything will be done that can be done in order to reduce, as far as may be, the risk of a recurrence of such a disaster.