Perhaps the best evidence of the revolutionary change that has taken place in the objectives of economic policy can be found in the stated purposes of the two most important pieces of legislation affecting U.S. economic policy in the postwar period. The purpose of the Employment Act of 1946 is "to promote maximum employment, production, and purchasing power." These goals are to be attained within the framework of a free competitive enterprise system and by means consistent with other national needs, obligations, and objectives. Nowhere is there explicit reference to the problem of inflation. The Council of Economic Advisers has repeatedly emphasized that stability of prices and costs is essential to the achievement of a high level of employment and to the restoration of the balance of payments. But monetary stability is, for all this, a means and not an ultimate objective of economic policy.

The purposes of the International Monetary Fund show the same pointed omission of monetary stability, at least in the sense of price stability. Article I(ii) of the statutes of the IMF states that one of its purposes is "to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy." The IMF is also intended "to promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation." The IMF is, of course, aware of the strategic importance of prices and costs in maintaining stability of exchange rates. Nevertheless, the omission of specific reference to stability of prices and costs in the Articles of Agreement is a reminder of its subordinate position in the objective of the IMF as conceived by its founding fathers.

Gold standard and monetary stability

There are some people who believe that the only way to have monetary stability is through the gold standard; and they argue that the inflationary drift characteristic of our times is the result of abandoning the old-fashioned gold standard. In fact, the gold standard evolved as the basis for national monetary systems in the 19th century without particular consideration for its suitability for maintaining price stability. It is true that the shift from bimetalism to gold after the 1870's was partly due to the fear that the sudden increase in the supply of silver would result in an inflation of prices. But the more practical consideration was that in a world with a growing preference for gold over silver, the bimetallic countries would find themselves drained of gold and swamped with silver. This would have undermined the system of fixed exchange rates which was accepted by the great trading countries as of preeminent importance.

Whatever the reasons for the universal adoption of the gold standard, it necessitated a pattern of economic behavior that could be rationalized as conducive to monetary stability. The concept of monetary stability is generally regarded as embracing stability of exchange rates and stability of prices. Obviously, if all countries buy and sell gold at a fixed price, exchange rates cannot fluctuate by more than the cost of shipping gold from one country to another. But the gold standard was regarded not only as a means of assuring stability in the external value of the currency (i.e., exchange rates), but in its internal value (prices) as well. It is in this latter respect that the gold standard failed to meet the needs of the modern world, particularly as any conflict between the external and internal stability of the value of money was necessarily and invariably resolved in favor of the former.

The classical gold standard involved a close tie between the supply of money and gold. In its purest sense (say, as embodied in the Bank Act of 1844 in England), the gold standard was intended to compel a change in the supply of money, when there was an inflow or outflow of gold, precisely equivalent to what would have occurred if the currency consisted exclusively of gold coin. This was to be accomplished by having a fixed fiduciary issue of bank notes, any amount above the fixed fiduciary issue requiring backing of 100 per cent gold. In other countries, the link between the money supply and gold was somewhat more flexible, the usual method being to require a gold reserve of stated proportions—35, 40, or 50 per cent—against the issue of notes and in some instances against other liabilities (deposits) of the central bank. This did result in a close, although not necessarily rigid, tie between the supply of money and the gold reserves of central banks.

Such a system was believed to give short-period stability in the internal value of money (prices) through the operations of the international payments mechanism. For example, in a country in which incomes expanded and prices rose,