

there would be a resultant increase in imports relative to exports, the balance of payments would become adverse, the exchange rate for the currency would fall, and gold would flow out to the countries with a payments surplus. The outflow of gold would necessitate a contraction of the money supply and in business activity in the countries with a payments deficit, and the inflow of gold would result in an expansion of the money supply and in business activity in the countries with a payments surplus. If the response of the money supply to the balance of payments, and of the economy to the money supply, were prompt in the deficit and surplus countries, a moderate rise or fall of prices and income would quickly restore the balance of payments. Thus, the alternation of balance of payments surpluses and deficits would prevent an excessive expansion or contraction of the money supply in any country and a large rise or fall in prices, at least relative to the general level of prices that prevailed in other large trading countries.

Whatever may be said about the effectiveness of gold flows in adjusting the balance of payments and in limiting short-period fluctuations in prices, it could not prevent long-sustained inflationary and deflationary trends in the price level, and it gave no assurance against occasional breakdowns that resulted in monetary crises. Furthermore, the gold standard could not and did not prevent an enormous inflation in time of war or the destructive deflation that inevitably came after a great war. The view that the old-fashioned gold standard brought an era of monetary stability, in the sense of price stability, is an illusion resulting from the distorted perspective of distance and a natural reaction to the ineffectiveness of the present international monetary system in preventing a steady and seemingly endless inflationary drift.

If we may believe the data, the U.S. wholesale price index was about the same in 1796 and in 1926, the terminal years of a period of 130 years. But within this period, prices rose and fell considerably for many years at a stretch, with intermittent monetary crises that brought the economy close to disaster. For example, from 1896 to 1920, U.S. wholesale prices rose more than threefold; and from 1920 to 1932, U.S. wholesale prices fell by more than half. And even then, the fall in prices and the world-wide depression were terminated only by breaking the existing tie between gold and money in every country in the world. It may be said that the more extreme movements in prices were the result of war inflation and postwar deflation; but there were long periods of peace in which prices rose and fell by 25 to 50 percent in the course of 20 or 25 years. The rise in prices from 1897 to 1913 (50 percent) was at about the same rate as the inflationary drift in most countries since 1950.

The gold standard could not provide a mechanism that would avoid an upward or downward drift of prices for relatively long periods. Under the gold standard, the growth of the money supply was dependent on the production of gold, its world-wide distribution through international payments, and its absorption in national monetary systems. By its nature, the production of gold each year could not precisely match the needs of the world economy. At times, with new gold discoveries, the growth in monetary gold stocks, and in the money supply of the great trading countries, was far greater than was required for maintaining stability of prices. And at times, when gold production rose too slowly, the growth in monetary gold stocks, and in the money supply of the great trading countries, was far less than was required for maintaining stability of prices. The inflation and deflation from 1815 to 1914, a century of relative peace in Europe, were not the result of monetary policy, but of the accidents of gold discoveries and gold production.

The view that we can somehow solve the problem of inflation by returning to the old-fashioned gold standard—that is, through the rigorous limitation of the money supply by the amount of gold reserves—is no more than a wish. The average rate of growth in the world's stock of monetary gold in recent years would not be enough to provide a token gold base for even a nominal increase in the money supply of the Group of Ten, even without adding to the gold reserves of other countries. To restore the old-fashioned gold standard today would be to invite a drastic deflation. And to those who fear inflation so much as to regard deflation as a welcome change, it should be pointed out that in this age of scientific miracles there can be no assurance that the production of gold may not increase to inflationary levels within a decade or two. Those who advocate the restoration of the gold standard want this to be preceded by a rise of 50 per cent or 100 per cent in the price of gold. But such a large and sudden increase in the value of existing gold stocks would compound the risks of inflation.

If we are to have monetary stability in the world economy, it will not come from a return to the gold standard, but from cooperative efforts on the part of