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THE GOLD STANDARD AND INTERNATIONAL EXCHANGE

by Major Clifford Hugh Douglas

It must be within the experience of most people who have endeavoured to popularise the idea of finance with which this review is associated, to find that the question of international exchange forms a stumbling block. In the case of those persons of whom, perhaps, it is most important to make converts, such as business men and others who deal practically with the everyday transactions of commerce, it is frequently possible to obtain an admission that some new conception of finance, besides being desirable, does not appear to present insuperable difficulties in regard to internal business, but is ruled out of the sphere of practical politics because of (what seems to them) the insurmountable difficulty of international trade on a basis other than that of the gold standard.

It is relevant to observe in the first place that this is exactly the idea which the upholders of the gold standard would wish to disseminate. It is fairly obvious that if you can imbue an effective majority with the idea that nothing can be done for the financial system except as the result of world-wide and international agreement, you are going to put off any considerable action for a long time. It is convenient, though not necessarily accurate, to say that the length of time required to obtain action in regard to any fresh idea, varies directly as the square of the number of people required to be convinced, and inversely as the simplicity of the proposal, and is unaffected by its essential soundness.

But while, I think, there is reason to suspect conscious assistance to the idea that finance can only be treated as a world-wide problem, and that reform on any other basis is impracticable, there are doubtless genuine difficulties in the apprehension of the fallacy involved in this idea; difficulties which in the main arise from the conception of money, and more particularly gold, as having some fixed value in itself.

Now the theory, if theory it may be called, of a gold exchange standard is that if two articles, A and B, have prices attached to them in different currencies, those prices will vary inversely as the amount of gold which the currencies in question will buy, varies. That is to say, if the price of gold in English currency is £4 per ounce, the price of gold in American currency is \$20 per ounce, and the price of two articles, A and B, in the respective countries is £1 and \$5, a rise in the price of gold in Great Britain to £5 per ounce would mean a fall in the price of article A, if bought by United States currency, by 25 per cent., and a rise in the price of article B, if bought in British currency, by a similar amount. That is the theory, although it is very far from being what actually happens.

The first point to observe is that we are considering the interplay of two kinds of credit systems. The national currency depends for its validity on the fact that, if tendered inside the country of origin, goods will be delivered in exchange for it. Gold, in the post-war world, has been artificially elevated into a super credit system of a peculiar kind. For the individual, gold is an effective demand for currency of any country at the gold exchange rate. For the banking institutions, however, gold is not merely an effective demand for currency at the gold exchange rate; it is an effective demand for international credit to the amount of several times the face value of the gold. These considerations may enable us to get a firm idea of the tremendous power given to banking institutions by persistence in the use of gold, and on the other hand, to realise that its use is essentially unnecessary. In regard to the first, we have the astonishing situation that an ounce of gold in the hands of John Smith is worth only £5, but in the hands of the Bank of England it is probably worth £50—a situation which cannot fail to keep John Smith where he belongs, from the point of view of the Bank of England. In regard to the second point, we can see from the proposal enunciated above, to the effect that a national currency derives its validity from its effectiveness as a demand for goods and

services, that the problem of maintaining the exchange value of a national currency, while eliminating the use of gold, depends on the validity in a foreign country of the given currency as a demand for the currency of the second country in question. It is easy to prove that this is ultimately dependent on the ratio of unit prices to unit purchasing power in the same country. If we exclude the trade in money as a commodity in itself, the only object in buying a currency of a foreign country is in order that one may, with a currency so bought, buy goods or settle an account. If this be borne in mind (and an astonishing number of people seem to lose sight of it) the value of that currency depends solely on what it will buy. In other words, if we untie a currency from the gold standard, its exchange value is inversely proportional to the relative price level of commodities in the countries concerned. The lower the price level, the higher the exchange value of the currency. This is fundamentally incontestable, and I have never, in fact, heard it seriously contested.

If, as is suggested in the ideas that I have put forward, a considerable proportion of the credits created in the country are applied to the reduction of prices, then it is quite obvious that a given unit of, let us say, English currency will buy more than it would before: the ratio unit purchasing power/unit prices is raised. Consequently a given unit of currency will find a purchaser in foreign currency at a higher price than it would before, assuming that the ordinary influences of the market were allowed free play. I do not think that if such a scheme were put into operation these influences would be allowed free play, and the first result would possibly be a wholly artificial depreciation of, say, the British unit of currency in the world exchange market--a matter which the exchange brokers could quite easily arrange. But the result of this would be that the British unit of currency, bought at less than its true exchange value in some foreign currency, would, in terms of that foreign currency, buy still more goods than even it ought to under the proposed change. The result of this is easy to foresee. In the first place, it would result in an enormous yet temporary export trade, against which competitors would have no effective weapon other than to apply the same modifications to their financial system. Secondly, in the language of the stock market, the money "bears" would be caught short of British currency, and caught short without the least possible chance of ever buying to cover, except at a ruinous loss. I am inclined to grant them sufficient intelligence to enable them to see this very quickly, and I have no doubt at all that the almost immediate result of the application of credits to the reduction of prices in, for instance, Great Britain, would be to send British exchange above par.
