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What Gold Reserve Means to Man in Street

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What does the gold reserve mean to the man in the street?

In financial circles the recent Bill introduced by Mr. E. G. Theodore (Federal Treasurer) to give control of the gold reserve to the Commonwealth Bank is causing deep discussion.

Prof. L. G. Melville (professor of economics at the University of Adelaide) endeavors in this brief article to reveal the relationship of the gold reserve to the few shillings which the man in the street rattles in his pocket as he goes jauntily on his way.

THE gold reserve is used with so little display in normal times that many people have come to believe it could be discarded altogether. Some day, perhaps, their dreams will come true; but, in the meantime, we depend upon it to preserve the stability of our financial system.

Fifteen years ago both gold and notes were in common circulation, and it was generally believed that confidence in the notes could be maintained only by making them readily convertible into gold. Today many of us have not seen gold coins for years, and while in theory our notes are convertible in practice our money consists of notes and the token coins.

Notes are legal tender, and must, therefore, be accepted in exchange for goods; but they have no intrinsic value, and there is no law prescribing how many goods they shall buy. What is there to prevent their arbitrarily varying, being now capable of purchasing twice as many goods, now half as many?

In truth our note issue and our whole credit system are in a condition of unstable equilibrium, perpetually tugging at their anchor, ready to be off on a sea of inflation. The anchor which holds them in place is the gold reserve.

When gold circulated internally the stability of paper money was preserved by ensuring that a pound note could at any time be converted into a gold sovereign, so that if people lost confidence in the paper they could promptly secure gold. Today, when gold coins are difficult to secure, stability is preserved by notes being convertible into gold for export.

If the value of the pound note in Australia fell (by a fall in the value of the paper pound we mean a decrease in the quantity of goods it will purchase), the gold into which it could be converted would purchase more in England than the note in Australia. Such conditions would lead to an increase in imports, to unfavorable exchange rates, and finally to the draining of our gold reserves.

With proper qualifications it is as true of money as it is of any commodity, that the more there is of it the less the value of each individual unit. One of the qualifications of money is that the quantity is purely relative. If at any time more notes were issued than were warranted by the state of trade, we should be riding off on a wave of credit, only to be promptly checked by the tugging of our anchor as prices rose and our gold reserves were drained abroad.

For these conditions to arise it would not be necessary for Australia to pursue an active policy of inflation. If other countries were pursuing a policy of deflation, an attempt on the part of Australia to maintain a "splendid isolation" would be followed by precisely the same phenomena.

In recent years there has been a virtual inflation of this type in Australia; while prices have not been increasing, and have even fallen slowly, they have not fallen as rapidly as have prices in other countries. We have been preserved from the consequences for some years, partly by the fact that the price which the world was prepared to pay for wool did not decline with the general price level, and partly by our extensive borrowings abroad. Now, however, it would appear that lower prices for wool and wheat will force deflation upon us.

Already we may have drifted a little from the gold standard; the rate of telegraphic transfer exchange on London is today 35/ per cent., a rate which is dearer than the cost of sending gold. It is necessary to insist that the cure for inflation is not more inflation, although this is the will o' the wisp solution often sought, with disastrous consequences.

The days of preserving the stability of the paper pound by making it convertible into gold for internal circulation are apparently gone. It is upon our regulations for the export of gold that we must now depend. The recent action taken by the Commonwealth Government to centralise the gold reserves of Australia is, in such circumstances, to be commended, although it would have been better if the Commonwealth Bank had first been converted into a central bank. The bank will now have greater power in regulating international gold movements, and, if the power is wisely exercised, this should prove beneficial.

As we depend upon the international movement of our gold reserve to preserve the stability of value of our note issue, and this movement is facilitated by the convertibility of notes into gold for export, it is not so well that the Bill should also propose to place restrictions on the export of gold.

The Bill, as originally introduced, provided that gold could be exported only after application to the Commonwealth Bank and with the approval of the Treasurer. It was, however, amended by the Treasurer to place the control with the Commonwealth Bank. The gold reserve today only becomes really active in abnormal times when there is a danger of it being excessively depleted or unnecessarily swollen. When these conditions arise movements begin to take place in our credit system, which ultimately rectify the abnormality.

If we did not intend to use our gold in normal times for internal circulation, and proposed to prevent its use in abnormal times by gold export restrictions, we should no longer be on a true gold standard. In such circumstances it is possible that the gold reserve might still control our credit system and preserve some stability in the value of our paper money, even if it were never used. For export restrictions might dam back the gold, and yet not prevent it, in seeking to find its own level, from exerting pressure tending to restore equilibrium.

Export restrictions may sometimes be justified when they are intended to ease a difficult situation by preventing the readjustment, due to depletion of the gold reserve, from being too automatic or too rapid. Possibly the present situation is sufficiently serious to justify action of this kind.

To give the Treasurer power to prevent the export of gold, however, would be dangerous; and the power might be abused. To leave the power in the hands of the Commonwealth Bank is less dangerous, but is open to some criticism.

Sufficient publicity should always be given to any departure from the pure gold standard. It should not be spoken about in whispers but shouted from the housetops. The bank therefore, should not be given power to prevent the export of gold as a matter of course, but only in case of emergency by some Act of sufficient solemnity to make it widely apparent that, for the time being, we had strayed from the path of financial rectitude. Moreover, the control, vested in a Government institution and in the hands of a board appointed by hte Government, might still be abused.

For these reasons it would probably be better, either to limit the duration of the measure under discussion, or to repeal it when the present period of stress has passed. The Bill marks a step away from the pure gold standard; we must never forget that every such step makes it easier for the currency to be mangled for political ends.

We should remember, too, that it is the defenceless members of the community who are injured most by inflation—widows with fixed incomes, pensioners who have thriftily contrived to provide for their old age, the unorganised members of the working classes, and even the organised members, whose wages do not rise as rapidly as the cost of living.

When there is added the general instability and the wholesale poverty which inevitably follow in the wake of such financial orgies, the boldest of us will look with some uneasiness at any action tending to weaken the efficacy of our gold reserve.