

PATRICK COLLINS

CURRENCY
CONVERTIBILITY

THE RETURN TO
SOUND MONEY

CURRENCY CONVERTIBILITY

The Return to Sound Money

Patrick Collins



M
MACMILLAN
PUSTAKA PERDANA



1006110

Contents

<i>List of Figures</i>	x
<i>List of Tables</i>	xi
<i>Preface</i>	xiii
<i>Acknowledgements</i>	xv
<i>List of Abbreviations</i>	xvi
INTRODUCTION	1
1 POST-WAR INTERNATIONAL MONETARY ARRANGEMENTS	6
1.1 The Gold Exchange Standard and its Aftermath	6
1.2 Difficulties of Monetary Control Today	9
2 THE ORIGINS OF MONEY AND OF THE PRINCIPLE OF CURRENCY CONVERTIBILITY	15
2.1 The Origin of Currency Convertibility	15
2.2 The Mechanism of Currency Convertibility	17
2.3 Mistaken Criticisms of Currency Convertibility	21
2.4 Ascendancy of Currency Convertibility	24
3 VARIOUS PROPOSALS FOR THE RESUMPTION OF CURRENCY CONVERTIBILITY	35
3.1 Gold Convertibility	35
3.2 Currency Convertibility Based on Primary Commodities	39
3.3 Counter-Cyclical Influence of Systems of Currency Convertibility	41
3.4 Requirements of a System of Currency Convertibility Based on Primary Commodities	45
3.5 Proposals for Directly Stabilising the Real Value of Money	50
4 CONDITIONAL CURRENCY CONVERTIBILITY BASED ON PRIMARY COMMODITIES: THE GRONDONA SYSTEM	64
4.1 Principles of Operation	65
4.2 Additional Provisions	70

4.3	Factors Relating to Scale of Implementation	73
4.4	Possible Scale of Operation by Different Countries	78
4.5	Objectives that are not those of the Grondona System	90
4.6	Practical Implementation of the Grondona System	97
5	ECONOMIC EFFECTS OF IMPLEMENTATION OF CONDITIONAL CURRENCY CONVERTIBILITY BASED ON PRIMARY COMMODITIES	101
5.1	Influence on Primary Commodity Industries	102
5.2	Effects on Inflation	112
5.3	Effects on Balance of Payments	115
5.4	Effects on Terms of Trade	117
5.5	Effects on Exchange Rates	117
5.6	Effects on Interest Rates	123
5.7	Effects on Level of Economic Activity	124
6	MONETARY EFFECTS	132
6.1	Direct Stabilisation of the Real Value of Money	132
Appendix 6.1	Influence of a Commodities Reserve Department on Commodity Prices and on the National Exchange Rate	137
6.2	Direct Effects of a Commodities Reserve Department's Functioning on the Money Supply	139
Appendix 6.2	Effects on Banks' Balance Sheets of the Operations of a Commodities Reserve Department, and of Offsetting Monetary Policy Measures	148
6.3	Interaction of a Commodities Reserve Department's Functioning with National Monetary Policy	162
7	INTERNATIONAL ECONOMIC EFFECTS	173
7.1	Stabilising Influence on International Trade	173
7.2	Stabilising Influence on International Economic Activity	180
7.3	Multi-national Implementation	183
7.4	Effects on International Monetary Arrangements	187
7.5	Relations with Existing International Trade Organisations and Agreements	190
8	THE GRONDONA SYSTEM CONSIDERED IN DIFFERENT ECONOMIC CONTEXTS	199
8.1	The Business Environment	199
8.2	The Current Controversy in Economic Policy	201

Contents

ix

8.3 International Economic Reform	204
8.4 World Economic Recovery	206
8.5 'There's No Such Thing as a Free Lunch'	209
EPILOGUE	213
<i>Appendix A: Past Response to Grondona's Work</i>	219
<i>Appendix B: Possible British Initiative</i>	227
<i>References</i>	231
<i>Index</i>	237

List of Figures

3.1	Price Index for South England over seven centuries	37
3.2(a)	Commodity prices and the business cycle	42
3.2(b)	Commodity prices and the business cycle	43
4.1	Reserve price schedule of Commodities Reserve Department based on illustrative figures in Table 4.1(b)	68
4.2	Effective reserve price schedule for several Commodities Reserve Departments expressed in sterling	79
5.1	Influence of Commodities Reserve Department's operation on market price of a particular commodity	106
5.2	Commodity prices and the business cycle	128
5.3	Rates of growth of international trade of major OECD countries, 1965-83	130
6.1(a)	Stabilising effect of CRD's functioning on real value of national currency; influence on commodity prices greater than on exchange rate	140
6.1(b)	Stabilising effect of CRD's functioning on real value of national currency; influence on exchange rates greater than on commodity prices	141
6.2-6.13	untitled	150-8
7.1	Multi-national operation of Commodities Reserve Departments in respect of a particular commodity	186

List of Tables

4.1(a)	Framework of Commodities Reserve Department's reserve price schedule for any commodity	67
4.1(b)	Illustrative price schedule for fictitious commodity with initial 'Index' price of £1000 per ton	67
4.2	Raw material imports of six major OECD countries, 1980	75
4.3(a)	Approximate scale of operation of US CRD based on unweighted average 1978-81 trade values, prices in 1982 dollars	81
4.3(b)	Approximate scale of operation of Japanese CRD based on unweighted average 1978-81 trade figures, prices in 1982 Yen	82
4.3(c)	Approximate scale of operation of West German CRD based on unweighted average 1978-81 trade figures, prices in 1982 Deutschmarks	83
4.3(d)	Approximate scale of operation of French CRD based on unweighted average 1978-81 trade figures, prices in 1982 French francs	84
4.3(e)	Approximate scale of operation of British CRD based on unweighted average 1978-81 trade figures, prices in 1982 sterling	85
4.3(f)	Approximate scale of operation of Italian CRD based on unweighted average 1978-81 trade figures, prices in 1982 lire	86
4.4	Approximate scale of Commodities Reserve Department operations in relation to national money supplies, 1982 figures	88

Preface

This book is concerned primarily with a single aspect of monetary policy, namely the principle of maintaining 'currency convertibility', whereby the real value of a currency is preserved by guaranteeing to convert it on demand into specified commodities. This policy is not a part of contemporary monetary arrangements, which are unprecedentedly inflationary, although the principle of currency convertibility has been supported throughout several centuries by leading economic and political thinkers as being the indispensable foundation of a sound monetary system. It has been a feature of every monetary system that has succeeded in preventing inflation, and continues to be the only system that has ever preserved the real value of money over a timescale of generations. In doing so the system has succeeded both in providing the technical means to achieve this goal, and in maintaining the public support that is necessary in a democracy for the continued acceptance of sound monetary policy. It has achieved this in large part by increasing the role of market forces in the determination of monetary policy, thereby removing it to that extent from the political arena.

Although there are many more or less specialised books which deal with different aspects of monetary systems, the policy of maintaining currency convertibility is not normally treated as a separate subject. (It is rare, for instance, for 'convertibility' even to appear in the index of economics texts.) It is more commonly treated as merely one aspect of the operation of the classical gold standard which was abandoned in its original form in 1914. However, the underlying principle of guaranteeing the convertibility of currency is more general and of wider significance than this particular case. It has important implications for a wide range of economic policy issues. These include control of inflation, stabilisation of the business cycle, instability of exchange rates and primary commodity prices, international trade fluctuations, and the debate over the relative importance of rules and discretion in the operation of monetary policy.

In the following chapters the origins of currency convertibility and the reasons for its universal acceptance in the past are examined. The potential benefits of reintroducing it in some form and the best means of obtaining

these benefits today are then considered, together with the economic implications of such a step for the various aspects of the economic system, both domestic and international. In order that it should be accessible to the widest possible audience, the book avoids the use of specialist vocabulary as far as possible.

London

PATRICK COLLINS