GOLD AND PRICES

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BY

W. J. ASHLEY

M.A., PH.D.

PROFESSOR OF COMMERCE IN THE UNIVERSITY OF BIRMINGHAM
SOMETIME PROFESSOR IN HARVARD UNIVERSITY

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PREFACE

The articles now reprinted were originally written at the request of the Editor of the *Pall Mall Gazette*, and appeared in its issues for March 21, 22, 25, 26, 28 and 29, 1912. By the kind permission of that journal, they are here put together in a more convenient shape.

A preliminary popular survey of the subject had been previously taken by me in a series of articles in the *Evening News* in October, 1910. These were subsequently translated into German and Swedish; and they were reprinted in pamphlet form in January of this year, by the *Evening News*, under the title "The Rise in Prices and the Cost of Living."

The extent of the rise of prices has recently been indicated by an interesting return issued by the great Co-operative Wholesale Society. This shows, for certain years from 1898 onward, the cost to the Society, at wholesale prices, of what it calls "an average weekly family grocery order." The order consists of 1 lb. bacon, 2 lb. butter, ½ lb. cheese, 12 lb. flour, ½ lb. lard, 1 lb. meal, 4 lb. sugar, ½ lb. tea. The secretary has been good enough to furnish me with additional figures for 1895 and 1896; and the whole series is as follows:—

	d.		d.
1895	58·38	1908	70·21
1896	59·48	1910	72·38
1898	63·85	1911	71·00
1906	67·28		

The figures, it will be seen, for 1911 are 19 per cent. above those for 1896; and this tallies exactly with the estimate of the Board of Trade as to retail food prices in London.

But the main object of the present publication is not to adduce further evidence as to the fact or the amount of the rise of prices. Nor is it, really, even to prove that the underlying general cause is to be sought for in the vastly greater gold supply of recent years. Financiers and business men generally have now got to the point of allowing that "gold has had something to do with it." What I want to direct attention to is the problem of the *modus operandi*; the exact way in which, under the present conditions of trade, the taking of gold out of the earth does, in fact, touch prices. I have here tried to give a version of the process, which has high authority in its support, in such a way as to make it seem reasonable to men of affairs. But I am very conscious that, to those personally engaged in monetary operations, it is apt to seem inadequate. May I not appeal to our leading bankers and financiers, if the explanation here given strikes them as incorrect or insufficient, and they, nevertheless, still think that somehow "gold is at the bottom of it," to give us their own alternative version of the sequence of cause and effect?

One line of argument, followed by economists of earlier generations from Ricardo onward, I have been unable to test for lack of evidence. These found the starting-point of the series of changes produced by an increased output of gold in the effect on prices in the country where the gold is mined. Cairnes in a well-known essay described the Australian discovery as "an occurrence by which a common labourer was enabled, by means of a simple process requiring for its performance little capital or skill, to obtain about a quarter of an ounce of gold—in value about £1 sterling—on an average in the day. . . . The immediate result was a general rise of money wages throughout the country." But the conditions of gold mining have so altered since Cairnes' time, that we can no longer picture things in quite this simple way. Prices (of food, at any rate) in South Africa do not seem to be now any higher than in the United States, if we may rely on the figures presented in the recent Report of the Union Commission on Trade and Industries (1912). By this time, however, we may suppose the effect of the new gold to have been pretty generally diffused over the commercial world. Accordingly I have endeavoured, with the kind assistance of Mr. Aiken of Johannesburg, to collect some evidence as to prices and cost of living during the last three decades. I have found apparently reliable figures for 1897, 1902 and 1907. But from these no clear conclusion can be drawn. Whatever rise of prices there may have been, it is not yet evident that such rise was distinctly earlier or distinctly greater than in other countries. But on the subject of South African prices, especially before 1897, we need further information.

EDGBASTON,
September 25, 1912.

GOLD AND PRICES

I

INDEX NUMBERS AND WHOLESALE PRICES

I HAVE been asked to give an account of the present state of the problem of the rise of prices. It is a task which I enter upon with a good deal of trepidation. Economists have often been accused, and with only too much reason, of a certain doctrinaire dogmatism; and I am afraid that I shall be expected to live up to the evil reputation of my profession. Yet there is no subject on which dogmatism is more out of place. It is one in which the growing complexity of modern life makes it increasingly difficult to bring the simple theories of a century ago to any satisfactory test; one in which men of apparently equal ability have differed widely as to effects, even when they agreed as to causes; and one on which the statistical evidence is far from complete. What I want to do, therefore, is not so much to expound my personal views as to put the reader in a position to arrive at a judgment of his own. There is, indeed, no reason why I should not at once state my provisional conclusions. These are: (1) that there has been a considerable upward movement of the general level of prices during the last fifteen years or so; (2) that this general upward trend, as distinguished from fluctuations in particular commodities or particular years, has been the result of the vastly increased output of gold; (3) that the economic results have been both good and bad; and (4) that there is reason to believe that the most considerable part of the effect of the new gold supply has already been produced. But I assert none of these propositions dogmatically; and I hope to be able to state the pertinent arguments in such a way that the reader may readily perceive just how much, or how little, I have to go upon.

First, then, let us be clear that what we are now concerned with is a general *trend* of prices—a movement, on the whole in one direction, in the average *level*. That there is such a thing as a general trend of the price level it has taken us long to learn: it has been the slow result of the statistical inquiries of a century. What business men first notice—and usually they notice nothing more—is a marked change in the price of some particular commodity; and they have commonly no hesitation in explaining it by some obvious change in demand or supply. Sometimes, when trade happens to be remarkably good or remarkably bad, business men realize that prices have a way of moving together; that there are times of "generally" high or low prices. But what is much harder to grasp is that there are not only fluctuations year by year, but that these fluctuations take place around a certain level, and that the level may be stationary or ascending or descending for quite a long period.

That such is in fact the case we have been enabled to perceive by the introduction of what has been justly termed "the powerful method of index numbers." An index number is simpler than it sounds: it is nothing but a number which indicates, in an easily manageable form, the relation of one set of figures, taken as a whole, to some other set of figures which we make our standard. It may, perhaps, be most readily explained as a combined percentage. Take, for instance, the prices of a number of commodities in a certain year; call each 100; express the prices of the same commodities in another year as percentages of the previous prices; add up both sets; and state the latter as a percentage of the former; and we arrive at a proportion which the mind can readily grasp, instead of a bewildering and conflicting set of ups and downs. Such is the plan which has been followed by Jevons, Newmarch, and Mr. Sauerbeck in England, by Soetbeer in Germany, by Falkner and others in America; and, in spite of not inconsiderable differences in the details of procedure, the method, in all competent hands, has shown conclusively that there is such a thing as a trend of prices, a relatively stationary or ascending or descending level around which annual prices do but oscillate.

An ounce of example is worth a pound of explanation; and the process will be made perfectly clear by a chart showing what is, I think, on the whole, the most reliable set of index numbers—those for wholesale prices compiled during recent years by our Board of Trade. But, first, a few words more of explanation. One cannot attempt to collect all prices; some selection is inevitable; and most index numbers represent wholesale prices only. Then it is a question how many commodities shall be represented. Evidently they should be leading commodities; but experience shows that the calculation works out in substantially the same direction, whether twenty or fifty be taken. And, finally, all goods are by no means of the same practical importance. So that, while quite valuable conclusions may be derived from absolutely simple averages, where each commodity counts alike, a more accurate result may be arrived at by "weighting" the figures, according to some scale of relative importance. If there were in a room a number of men just five feet high, and a number just six feet high, one could not get an average height by adding five and six and dividing by two; one would find out how many there were of each height, multiply the heights by the respective numbers of men, and divide by the total number. Similarly, it is easy to multiply the figure representing price by a number, or "weight," representing its relative importance (*e.g.* its relative place in national consumption), and divide by the sum of the weights.

After this introduction, let us concentrate our attention on the accompanying chart, showing the Board of Trade index numbers for wholesale commodities.

It takes the prices of 1900 as its standard, and expresses all the other annual totals as percentages of that year; all the figures being carefully weighted in proportion to the place of the commodity in national consumption. Our chart begins with 1871 simply because the Board's calculations start with that year; the reader need hardly be reminded that the prices of 1872–1874 were the top figures of a boom period. The calculation is based on the prices of forty-five articles, falling into the following four groups: I. Coal and Metals (Coal, Pig-iron, Copper, Zinc, Tin, Lead). II. Textile Raw Materials (Cotton, Wool—British and Foreign, Jute, Flax, Silk). III. Food and Drink (British Wheat, Barley, and Oats; Foreign Wheat, Barley, and Oats; Maize, Hops, Rice, Potatoes; Beef, Mutton, Bacon; Milk, Eggs; Herrings; Sugar, Tea, Coffee, Cocoa; Rum, Wine, Tobacco). IV. Miscellaneous (Cotton Seed, Linseed, Olive Oil, Palm Oil, Paraffin, Petroleum; Bricks, Hewn Fir; Caoutchouc, Hides). On the same chart I have plotted a second line, showing the Board of Trade's index number for employment, or rather for the relative proportion of members of trade unions employed in the several years: the percentage employed in 1900 (which was actually 97·55) being taken as the standard and called 100. There has been a good deal of discussion as to the adequacy of this measurement of employment. It certainly cannot be accepted as a quite accurate indication of the positive amount of employment in any particular year. But as an indication of the relative amount of employment as between one year and another, there can be little doubt of its value. And as the amount of employment is the best test of the state of trade, I propose to use this line as indicating, for comparison with the range of prices, the contemporary state of business.

A very cursory examination of the chart will suffice to make clear the nature of the problem we have to deal with. It shows that from 1873 to 1896 the average prices of raw materials and foodstuffs in England tended very markedly downward, and that

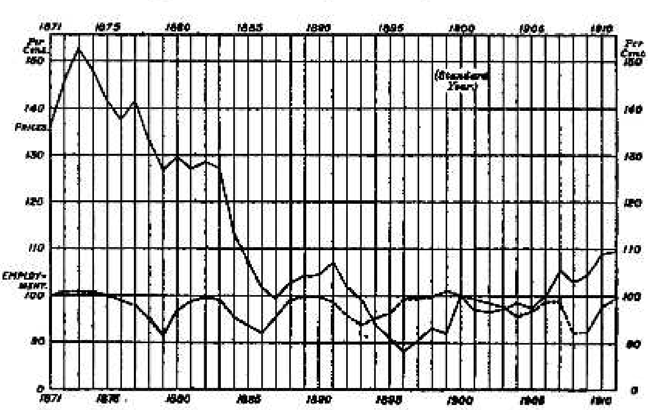

CHART I.—WHOLESALE PRICES AND AMOUNT OF EMPLOYMENT, 1871–1910 (1900 = 100).

since 1896 they have tended, equally clearly, though not so rapidly, upward. It shows that these generally downward and upward directions have been quite consistent with wide fluctuations around the descending and ascending levels. These minor fluctuations will be seen to be in the main identical in time with the trade or credit cycles (covering from seven to eleven years) of alternating prosperity and depression, as indicated by the line of employment. On the whole the price cycles have corresponded with the trade cycles. Prosperity, it is clear, is either the result, or the cause, or both, of high prices within each minor fluctuation or cycle; or else both are the effects of the same