

Chapter XVII.Of The Distribution Of The Precious Metals Through The Commercial World.

§ 1. The substitution of money for barter makes no difference in exports and imports, nor in the Law of international Values.

Having now examined the mechanism by which the commercial transactions between nations are actually conducted, we have next to inquire whether this mode of conducting them makes any difference in the conclusions respecting international values, which we previously arrived at on the hypothesis of barter.

The nearest analogy would lead us to presume the negative. We did not find that the intervention of money and its substitutes made any difference in the law of value as applied to adjacent places. Things which would have been equal in value if the mode of exchange had been by barter are worth equal sums of money. The introduction of money is a mere addition of one more commodity, of which the value is regulated by the same laws as that of all other commodities. We shall not be surprised, therefore, if we find that international values also are determined by the same causes under a money and bill system as they would be under a system of barter, and that money has little to do in the matter, except to furnish a convenient mode of comparing values.

All interchange is, in substance and effect, barter; whoever sells commodities for money, and with that money buys other goods, really buys those goods with his own commodities. And so of nations: their trade is a mere exchange of exports for imports; and, whether money is employed or not, things are only in their permanent state when the exports and imports exactly pay for each other. When this is the case, equal sums of money are due from each country to the other, the debts are settled by bills, and there is no balance to be paid in the precious metals. The trade is in a state like that which is called in mechanics a condition of stable equilibrium.

But the process by which things are brought back to this state when they happen to deviate from it is, at least outwardly, not the same in a barter system and in a money system. Under the first, the country which wants more imports than its exports will pay for must offer its exports at a cheaper rate, as the sole means of creating a demand for them sufficient to re-establish the equilibrium. When money is used, the country seems to do a thing totally different. She takes the additional imports at the same price as before, and, as she exports no equivalent, the balance of payments turns against her; the exchange becomes unfavorable, and the difference has to be paid in money. This is, in appearance, a very distinct operation from the former. Let us see if it differs in its essence, or only in its mechanism.

Let the country which has the balance to pay be the United States,(276) and the country which receives it, England. By this transmission of the precious metals, the quantity of the currency is diminished in the United States, and increased in England. This I am at liberty to assume. We are now supposing that there is an excess of imports over exports, arising from the fact that the equation of international demand is not yet established: that there is at the ordinary prices a permanent demand in the United States for more English goods than the American goods required in England at the ordinary prices will pay for. When this is the case, if a change were not made in the prices, there would be a perpetually renewed balance to be paid in money. The imports require to be permanently diminished, or the exports to be increased, which can only be accomplished through prices; and hence, even if the balances are at first paid from hoards, or by the exportation of bullion, they will reach the circulation at last, for, until they do, nothing can stop the drain.

When, therefore, the state of prices is such that the equation of international demand can not establish itself, the country requiring more imports than can be paid for by the exports, it is a sign that the country has more of the precious metals, or their substitutes, in circulation, than can permanently circulate, and must necessarily part with some of them before the balance can be restored. The currency is accordingly contracted: prices fall, and, among the rest, the prices of exportable articles; for which, accordingly, there arises, in foreign countries, a greater demand: while imported commodities have possibly risen in price, from the influx of money into

foreign countries, and at all events have not participated in the general fall. But, until the increased cheapness of American goods induces foreign countries to take a greater pecuniary value, or until the increased dearness (positive or comparative) of foreign goods makes the United States take a less pecuniary value, the exports of the United States will be no nearer to paying for the imports than before, and the stream of the precious metals which had begun to flow out of the United States will still flow on. This efflux will continue until the fall of prices in the United States brings within reach of the foreign market some commodity which the United States did not previously send thither; or, until the reduced price of the things which she did send has forced a demand abroad for a sufficient quantity to pay for the imports, aided perhaps by a reduction of the American demand for foreign goods, through their enhanced price, either positive or comparative.

Now, this is the very process which took place on our original supposition of barter. Not only, therefore, does the trade between nations tend to the same equilibrium between exports and imports, whether money is employed or not, but the means by which this equilibrium is established are essentially the same. The country whose exports are not sufficient to pay for her imports offers them on cheaper terms, until she succeeds in forcing the necessary demand: in other words, the equation of international demand, under a money system as well as under a barter system, is the law of international trade. Every country exports and imports the very same things, and in the very same quantity, under the one system as under the other. In a barter system, the trade gravitates to the point at which the sum of the imports exactly exchanges for the sum of the exports: in a money system, it gravitates to the point at which the sum of the imports and the sum of the exports exchange for the same quantity of money. And, since things which are equal to the same thing are equal to one another, the exports and imports which are equal in money price would, if money were not used, precisely exchange for one another. (277)

§ 2. The preceding Theorem further illustrated.

Let us proceed to [examine] to what extent the benefit of an improvement in the production of an exportable article is participated in by the countries importing it.

The improvement may either consist in the cheapening of some article which was already a staple production of the country, or in the establishment of some new branch of industry, or of some process rendering an article exportable which had not till then been exported at all. It will be convenient to begin with the case of a new export, as being somewhat the simpler of the two.

The first effect is that the article falls in price, and a demand arises for it abroad. This new exportation disturbs the balance, turns the exchanges, money flows into the country (which we shall suppose to be the United States), and continues to flow until prices rise. This higher range of prices will somewhat check the demand in foreign countries for the new article of export; and will diminish the demand which existed abroad for the other things which the United States was in the habit of exporting. The exports will thus be diminished; while at the same time the American public, having more money, will have a greater power of purchasing foreign commodities. If they make use of this increased power of purchase, there will be an increase of imports; and by this, and the check to exportation, the equilibrium of imports and exports will be restored. The result to foreign countries will be, that they have to pay dearer than before for their other imports, and obtain the new commodity cheaper than before, but not so much cheaper as the United States herself does. I say this, being well aware that the article would be actually at the very same price (cost of carriage excepted) in the United States and in other countries. The cheapness, however, of the article is not measured solely by the money-price, but by that price compared with the money-incomes of the consumers. The price is the same to the American and to the foreign consumers; but the former pay that price from money-incomes which have been increased by the new distribution of the precious metals; while the latter have had their money-incomes probably diminished by the same cause. The trade, therefore, has not imparted to the foreign consumer the whole, but only a portion, of the benefit which the American consumer has derived from the improvement; while the United States has also benefited in the prices of foreign commodities. Thus, then, any industrial improvement which leads to the opening of a new branch of export trade benefits a country not only by the

cheapness of the article in which the improvement has taken place, but by a general cheapening of all imported products.

Let us now change the hypothesis, and suppose that the improvement, instead of creating a new export from the United States, cheapens an existing one. Let the commodity in which there is an improvement be [cotton] cloth. The first effect of the improvement is that its price falls, and there is an increased demand for it in the foreign market. But this demand is of uncertain amount. Suppose the foreign consumers to increase their purchases in the exact ratio of the cheapness, or, in other words, to lay out in cloth the same sum of money as before; the same aggregate payment as before will be due from foreign countries to the United States; the equilibrium of exports and imports will remain undisturbed, and foreigners will obtain the full advantage of the increased cheapness of cloth. But if the foreign demand for cloth is of such a character as to increase in a greater ratio than the cheapness, a larger sum than formerly will be due to the United States for cloth, and when paid will raise American prices, the price of cloth included; this rise, however, will affect only the foreign purchaser, American incomes being raised in a corresponding proportion; and the foreign consumer will thus derive a less advantage than the United States from the improvement. If, on the contrary, the cheapening of cloth does not extend the foreign demand for it in a proportional degree, a less sum of debts than before will be due to the United States for cloth, while there will be the usual sum of debts due from the United States to foreign countries; the balance of trade will turn against the United States, money will be exported, prices (that of cloth included) will fall, and cloth will eventually be cheapened to the foreign purchaser in a still greater ratio than the improvement has cheapened it to the United States. These are the very conclusions which [would be] deduced on the hypothesis of barter.(278)

The result of the preceding discussion can not be better summed up than in the words of Ricardo.(279) "Gold and silver having been chosen for the general medium of circulation, they are, by the competition of commerce, distributed in such proportions among the different countries of the world as to accommodate themselves to the natural traffic which would take place if no such metals existed, and the trade between countries were purely a trade of barter." Of this principle, so fertile in consequences, previous to which the theory of foreign trade was an unintelligible chaos, Mr. Ricardo, though he did not pursue it into its ramifications, was the real originator.

On the principles of trade which we have before explained, the same rule will apply to the distribution of money in different parts of the same country, especially of a large country with various kinds of production, like the United States. The medium of exchange will, by the competition of commerce, be distributed in such proportions among the different parts of the United States, by natural laws, as to accommodate itself to the number of transactions which would take place if no such medium existed. For this reason, we find more money in the so-called great financial centers, because there are more exchanges of goods there. In sparsely settled parts of the West there will be less money precisely because there are fewer transactions than in the older and more settled districts. So that there could be no worse folly than the following legislation of Congress to distribute the national-bank circulation: "That \$150,000,000 of the entire amount of circulating notes authorized to be issued shall be apportioned to associations in the States, in the District of Columbia, and in the Territories, *according to representative population*" (act of March 3, 1865).

§ 3. The precious metals, as money, are of the same Value, and distribute themselves according to the same Law, with the precious metals as a Commodity.

It is now necessary to inquire in what manner this law of the distribution of the precious metals by means of the exchanges affects the exchange value of money itself; and how it tallies with the law by which we found that the value of money is regulated when imported as a mere article of merchandise.

The causes which bring money into or carry it out of a country (1) through the exchanges, to restore the equilibrium of trade, and which thereby raise its value in some countries and lower it in others, are the very same causes on which the local value of money would depend, if it were never imported except (2) as a

merchandise, and never except directly from the mines. When the value of money in a country is permanently lowered (1) [as a medium of exchange] by an influx of it through the balance of trade, the cause, if it is not diminished cost of production, must be one of those causes which compel a new adjustment, more favorable to the country, of the equation of international demand--namely, either an increased demand abroad for her commodities, or a diminished demand on her part for those of foreign countries. Now, an increased foreign demand for the commodities of a country, or a diminished demand in the country for imported commodities, are the very causes which, on the general principles of trade, enable a country to purchase all imports, and consequently (2) the precious metals, at a lower value. There is, therefore, no contradiction, but the most perfect accordance, in the results of the two different modes [(1) as a medium of exchange; and (2) as merchandise] in which the precious metals may be obtained. When money [as a medium of exchange] flows from country to country in consequence of changes in the international demand for commodities, and by so doing alters its own local value, it merely realizes, by a more rapid process, the effect which would otherwise take place more slowly by an alteration in the relative breadth of the streams by which the precious metals [as merchandise] flow into different regions of the earth from the mining countries. As, therefore, we before saw that the use of money as a medium of exchange does not in the least alter the law on which the values of other things, either in the same country or internationally, depend, so neither does it alter the law of the value of the precious metals itself; and there is in the whole doctrine of international values, as now laid down, a unity and harmony which are a strong collateral presumption of truth.

§ 4. International payments entering into the "financial account."

Before closing this discussion, it is fitting to point out in what manner and degree the preceding conclusions are affected by the existence of international payments not originating in commerce, and for which no equivalent in either money or commodities is expected or received--such as a tribute, or remittances, or interest to foreign creditors, or a government expenditure abroad.

To begin with the case of barter. The supposed annual remittances being made in commodities, and being exports for which there is to be no return, it is no longer requisite that the imports and exports should pay for one another; on the contrary, there must be an annual excess of exports over imports, equal to the value of the remittance. If, before the country became liable to the annual payment, foreign commerce was in its natural state of equilibrium, it will now be necessary, for the purpose of effecting the remittances, that foreign countries should be induced to take a greater quantity of exports than before, which can only be done by offering those exports on cheaper terms, or, in other words, by paying dearer for foreign commodities. The international values will so adjust themselves that, either by greater exports or smaller imports, or both, the requisite excess on the side of exports will be brought about, and this excess will become the permanent state. The result is, that a country which makes regular payments to foreign countries, besides losing what it pays, loses also something more, by the less advantageous terms on which it is forced to exchange its productions for foreign commodities.

The same results follow on the supposition of money. Commerce being supposed to be in a state of equilibrium when the obligatory remittances begin, the first remittance is necessarily made in money. This lowers prices in the remitting country, and raises them in the receiving. The natural effect is, that more commodities are exported than before, and fewer imported, and that, on the score of commerce alone, a balance of money will be constantly due from the receiving to the paying country. When the debt thus annually due to the tributary country becomes equal to the annual tribute or other regular payment due from it, no further transmission of money takes place; the equilibrium of exports and imports will no longer exist, but that of payments will; the exchange will be at par, the two debts will be set off against one another, and the tribute or remittance will be virtually paid in goods. The result to the interests of the two countries will be as already pointed out--the paying country will give a higher price for all that it buys from the receiving country, while the latter, besides receiving the tribute, obtains the exportable produce of the tributary country at a lower price.

It has been seen, as in Chart No. XIII, that, considering the exports and imports merely as merchandise, there is, in fact, no actual equilibrium at any given time in accordance with the equation of International Demand. Another element, the "financial account" between the United States and foreign countries, must be considered before we can know all the factors necessary to bring about the equation. If we had been borrowing largely of England, Holland, and Germany, we should owe a regular annual sum as interest, and our exports must, as a rule, be exactly that much more (under right and normal conditions) than the imports. Or, take another case, if capital is borrowed in Europe for railways in the United States, this capital generally comes over in the form of imports of various kinds; but, if our exports are not sufficient at once to balance the increased imports, we go in debt for a time--or, in other words, in order to establish the balance, we send United States securities abroad instead of actual exports. This shipment of securities is not seen and recorded as among the exports; and so we find a period, like that during and after the war, from 1862 to 1873, of a vast excess of imports. Since 1873 the country has been practically paying the indebtedness incurred in the former period; and there has been a vast excess of exports over imports, and an apparent discrepancy in the equilibrium. But our government bonds and other securities have been coming back to us, producing a return current to balance the excessive exports.(280) In brief, the use of securities and various forms of indebtedness permits the period of actual payment to be deferred, so that an excess of imports at one time may be offset by an excess of exports at another, and generally a later, time. Moreover, the large expenses of people traveling in Europe will require us to remit abroad in the form of exports more than would ordinarily balance our imports by the amount spent by the travelers. The financial operations, therefore, between the United States and foreign countries, must be well considered in striking the equation between our exports and imports. As formulated by Mr. Cairnes,(281) the Equation of International Demand should be stated more broadly, as follows: "The state of international demand which results in commercial equilibrium is realized when the reciprocal demand of trading countries produces such a relation of exports and imports among them as enables each country by means of her exports to discharge *all her foreign liabilities*." If we were a great lending instead of a great borrowing country, we should have, as a rule, a permanent excess of imports.