TOWARD AN INTERNATIONAL COMMODITY STANDARD?*

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Determination of the basis for a national currency is one of the foremost attributes of national sovereignty. At irregular intervals over the past half century, countries have been urged to link their currencies by more or less rigid formulae to a variety of commodity baskets, with contents varying from one (gold) to several dozen commodities, and even beyond to an index of prices of goods and services, with varying intermediate combinations. Usually the stated aim is to ensure stability of the real value of money or, what is not the same, to reduce uncertainty in the real value of money. These objectives are typically assumed to be sufficient unto themselves, but sometimes they are justified as reducing uncertainty for business and household decisions that involve allocation of resources over time, and thereby as contributing to national well-being.

This paper will discuss the desirability of basing an international monetary system, which encompasses the formal rules and conventional practices governing payments among residents of different nations, on a basket of commodities. To anticipate the conclusion, the paper finds that such a move, while technically workable (though difficult), would not have much to recommend it. The paper offers an alternative suggestion for improving the international monetary system: a common currency among the industrialized democracies, with a common, jointly agreed monetary policy, which might well be targeted on some measure of price stability.

But as background it will be helpful first to review briefly the various suggestions that have been made over the years to tie a given national currency to commodities, that is, to tie money to the real economy so as to “anchor” the price level in some way.


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National Commodity-Based Monetary Systems

Commodity Money

The most straightforward way to link a national currency to the real side of the economy is to have a commodity be the currency or, closely related, to require the money-issuing authority to buy and sell the currency for the commodity at a fixed price (perhaps with a mint charge between the buying and selling price), as was done under the metallic standards (usually based on gold or silver, occasionally copper) of bygone times. But unless the commodity in question is an unusual one, which is representative of the whole collection of goods and services in which producers and consumers have an interest, this procedure will lead both to fluctuations over time in the growth of the money supply and to fluctuations in the general price level measured in terms of currency and of the monetized commodity. These fluctuations are simply a manifestation of changes in the commodity terms of trade, for any commodity in terms of others, that will occur in any economy undergoing continual changes in technology and in the level and composition of final demand. If $P$ is an index of money prices of a broad and relevant collection of goods and services, $P_C$ is the money price of the monetary commodity (e.g., dollars per ounce of silver), and $T$ is an index of the terms of trade between the monetized commodity and the other goods and services, then

$$ P = P_C \times T $$

A commodity standard fixes $P_C$ by law or convention, but that is not sufficient to ensure the stability of $P$, the widely accepted objective, so long as $T$ is not also fixed. However, $T$ will vary in response to variations in the supply and demand for the monetized commodity relative to other goods and services. If $P_C$ is fixed, $P$ will vary with $T$. Moreover, not only will $P$ be variable, but it will also be unpredictable except insofar as future movements in $T$ can be predicted with confidence. More will be said below about the stability and the predictability of $P$ under the historical gold standard.

Commodity-Convertible Money

The foregoing problem can be mitigated by enlarging the contents of the monetized commodity basket. Alfred Marshall (1926) suggested a century ago that a basket comprising fixed weights of gold and silver, with the price between them free to vary, would offer a more stable monetary medium (measured in $T$ or $P$) than would gold or silver alone. Francis Edgeworth dubbed it a symmetallic standard (to differentiate from a bimetallic standard) based on gold and silver.