INTERNATIONAL FINANCE PROBLEMS

EFFECTS OF UNSTABLE MONEY VALUES

SAVINGS AND STANDARD OF LIVING DESTROYED

What are the consequences of instability in the purchasing power of money? That is one of the problems with which Professor Gregory, the famous economist, who accompanied Sir Otto Niemeyer from London, dealt in the course of his Fisher lecture on economics in Adelaide recently. The first section of this lecture is published below.

I am very conscious of the fact that lecturers on this endowment have in the past been chosen on the ground of their personal distinction, and I cannot hope to address you with that particular qualification; but I can claim at least this, that at no time in the history of Australia did those eminent men have to discuss problems more immediate and more urgent than those which form the material of what I have to say this evening. What I want to discuss I have labelled "Some Current Problems of International Finance," but what I really want to deal with are the problems which arise, and have been arising in the last ten years, out of the peculiar monetary organisation of the modern world.

Now it has long been held up against economists of all schools that they are unnecessarily abstract in dealing with the problems of life, and in particular of business organisations. If we have been abstract, it is nothing in comparison with the actual abstractness of the monetary systems of the modern world. We are all of us in a way the creatures of an illusion. We see around us, even in Australia, magnificent cities and still more magnificent buildings. Wherever we go we are faced by the tangible and by the concrete, and we naturally think that a body of men who spend their time reducing these great realities to abstract ideas are not in touch with the realities which they describe. But that, ladies and gentlemen, is a complete illusion. The real world, the world which matters in modern business, is not the actual physical structure at all. The real world which matters in business, as in economics, is the balance-sheet, which those physical structures actually represent. In other words, whether we like it or not, in every state of society in which money is used all those concrete phenomena—farms and farmhouses, and human beings, and buildings, and equipment of one kind and another—are in the final analysis plotted down in a balance-sheet.

Monetary Units

And that balance-sheet involves a conception of a monetary unit. It may be the pound sterling, it may be that object of worship the American dollar, it may be the franc, or it may be the mark, but, nevertheless, whatever the particular symbol we care to employ in the modern world, the whole of the economic activities of mankind presuppose and rest upon a monetary symbol and upon a monetary system. Not only that, but all business, the business of the small peasant farmer, as well as the business of the greatest banking firm in the world, is based upon the assumption that these symbols have a certain stability of value; that is to say, that the local unit of money, whatever it may be, will purchase both over space and over time a certain fixed quantity of goods. If it does not do so, some very important consequences follow. All business, I repeat, the business of a socialist community as well as the business of an individualistic community, is based upon the inherent assumption that the standard of value and the unit of account represent over time and over space a certain fixed quantity of goods, or, if not absolutely fixed, at any rate fixed to the extent that their purchasing power does not vary very much over reasonable periods of time. If their value in terms of goods does alter very much over space and over time, all business, the largest to the smallest, becomes simply a gamble with the future value of money.

How All Are Affected

Let me begin, therefore, by making quite clear what an enormous significance all changes in the value of money has, even to the humblest individual in any part of the world. We all of us have to make provision for the future, and that provision takes the form of setting aside out of our income, voluntarily or compulsorily, certain sums of money. Whenever you and I are invited by any insurance company to take out a policy on our own life, or for a fixed number of years, we are gambling unconsciously, and in some cases consciously, on the future value of money. I constantly keep worrying as to what the value of money is going to be in twenty years' time, when some of my insurance policies begin to mature, whether the pound sterling is going to buy a larger or smaller collection of commodities compared with what it would have bought when I took out that particular policy; and every banker and every business man who makes any investment, the return from which accrues over future periods of time, ought, although a large number of them do not, to be taking into account the fact that, as things actually are, he does not know what the purchasing power of money is going to be in the future. Most of the problems which form the content of modern international finance arise from, and are determined by, the instability of money in the past, the instability of money in the present and the pound in Australia has been very much slower than the increase in the purchasing power of the pound in almost any other part of the world, and a great many of your problems at the present time are derived from the fact that alterations in the purchasing power of the unit of account outside Australia have been proceeding much more rapidly than they have been inside Australia. But that is by the way. The point merely is this, that since the outbreak of the Great War, the unit of account—the pound sterling, or the dollar, or the franc—has never in any two succeeding years bought exactly the same quantity of goods. What follows? In periods in which the purchasing power of a particular currency has risen, the distribution of the national income alters in favor of those particular groups, and of those particular institutions that have fixed rights in terms of money. If I am a bondholder at a time of falling prices, I get the same quantity of money, and each unit of my income buys more than it did before. If I am a bondholder in a period of rising prices, each pound that I get buys less than it did before. Now, if you make the enormous assumption because it is an enormous assumption that the real things which are produced remain the same, whether prices are rising or whether they are falling, it is easy to see, is it not, that in periods of rising prices those particular people who have fixed income rights of any kind suffer, and in periods of falling prices those people who have not got fixed income rights suffer. Economists express that by saying that in periods of inflation, in periods in which the price level is rising rapidly, the recipients of fixed incomes suffer, and that in periods of deflation the residual recipients of income suffer, that is, all people without definite legal right to a fixed amount of income.

Inflation or Deflation

What are the ultimate social consequences of this state of affairs? We in Europe have been privileged to see an enormous economic experiment carried out upon a vast scale, because throughout the greater part of Europe, between 1919 and 1925, we saw the purchasing power of money falling literally not only from day to day, but almost from hour to hour. I have been in at least three countries in which one did not know at the end of the day what to-morrows' rate of exchange would be, nor, therefore, what to-morrow's purchasing power of money would be. Consequently what I am about to describe is no figment of the economist's imagination, because international economists are not allowed to possess imaginations. What I am about to describe are the actual facts, as they have been experienced by the whole group of European and extra-European countries. If the purchasing power of the unit of currency keeps on falling, which is the same thing as saying that if the price level goes on rising, you ultimately get to a state of affairs in which production breaks down completely. If you ask me why this is so, the answer is perfectly simple. If I possess something, namely, money, the value of which is being reduced not only from day to day, but even from hour to hour, the time will come when I will refuse that money, or, what is even more important, the time will come when I cannot pass this money on to anybody else, when I cannot use it to go into a shop and buy anything with it, for the very simple reason that the shopkeeper will not accept my money, and will say—"Oh, no; I do not know what the future value of this money will be; I prefer to hold my goods, and, if you like, you can hold your money." When the stage comes where nobody is willing to accept the local currency, the production system breaks down, because we live in an extraordinarily complicated world based upon the division of labor, based upon private property. If nobody is willing to accept local money the entire productive mechanism breaks down. But the same result will also follow, not only if money is constantly falling in value, but also if money is constantly rising in value. In other words, the ultimate effects of deflation are very much the same as the ultimate effects of inflation. Put yourself in the position of somebody who possesses a piece of property, the value of which rises day after day and hour after hour. The longer you wait the more valuable your property becomes. Under these circumstances you refuse to part with it as long as you can. In other words, if prices are constantly falling, production breaks down, because everybody says—"Prices are going to continue falling, and therefore I will not do anything until they have fallen some more." If everybody says that, no one can sell anything at all, and prices will go on falling; in which case the production machine breaks down just as it broke down in the case of inflation. In the case of inflation it breaks down because no seller is willing to sell, and in the case of continuous deflation it breaks down because no buyer is willing to buy. In both cases the whole cash nexus of society entirely disappears.

stability of money in the present, and the probable or possible instability of money in the future. I want to drive these points home if I possibly can, because you will not understand the preoccupations of modern finance unless it is perfectly clear that modern economic society rests upon a monetary foundation, and that this monetary foundation rests upon the almost unconscious assumption on the part of everybody that money is not going to differ in its purchasing power in the future very violently from the purchasing power of money in the past.

Consequences of Instability

That is the first point. Now we may ask what happens if the purchasing power of the pound sterling, the dollar, or the franc varies very much. What are the consequences of extreme instability in the purchasing power of money? In the last 15 years, broadly speaking, the purchasing power of money first fell and then rose. Between 1914 and 1922, roughly speaking, the pound sterling and the Australian pound, and all other units of account, bought each year less than they did before; and since 1922, particularly since about 1925, the pound sterling and all those other units of currency have been buying more each year than they bought the year before. Economists are only just beginning to be aware of the fact that alterations in the purchasing power of money are perhaps the most powerful of all agencies of social change that one can possibly imagine, because until quite recently those alterations which they produce in the social fabric have not been completely understood. The way in which alterations in the purchasing power of money work themselves out is simply this, that any change in the price level produces a most profound change in the distribution of the social income of mankind. In producing changes in the social income of mankind it completely upsets the equilibrium of social classes and the equilibrium of social institutions which are in existence at any particular time.

Effect on Fixed Incomes

These changes in the purchasing power of money can take one or other of two forms. As I said, up to about 1920 the purchasing power of money was falling. Each pound of one's income bought less and less, which is the same thing as saying that the price level was going up. Since 1920 each pound of one's income has bought more. Of course, the speed with which each pound of one's income bought more has varied in different parts of the world, and I may mention in passing that the increase in the purchasing power of

Choice of Two Hells

Therefore, however unwilling one may be to face ultimate consequences, there can be no doubt whatsoever that violent changes in the value of money, either upwards or downwards, do result in very considerable alterations in the distribution of the national income, and do result in inflicting very considerable damage to the entire productive machine. My friend and colleague, Professor Keynes, once said that the average person divided the world up into little inflationists, who believe you should go on reducing the value of money, and little deflationists, who insist on raising the value of money all the time. He did not say why he should belong to either category. I have to face this problem from rather a different angle when I ask the question, "Which is ultimately worse, to go on constantly raising prices and reducing the value of money, or to go on lowering prices and raising the value of money?" I do not know, because I have tried to explain that the ultimate consequences of either are to destroy the productive machine. If you ask me to choose, as it were, between two hells, the hell of inflation on the one hand, and the hell of deflation on the other, I am not sure, being, I suppose, a little deflationist, that I would not choose deflation as the preferable hell to the hell of inflation. When the value of money is altered from hour to hour, everybody is insecure. When the value of money is rising, that is, when prices are falling, at any rate the people who have got the money know they have a good thing, whereas in periods of rising prices people who have money know they have a thoroughly bad thing. The social consequences of inflation on the one hand, and deflation on the other, can be summed up shortly, perhaps rather inaccurately, in this way. An endless period of rising prices destroys two very important social things; it destroys the value of savings, and it destroys the worker's standard of living. On the other hand, deflation, if endlessly pursued, destroys the business man's chance of success, and thereby aggravates the problem of unemployment.

What Happened in Germany

In the country in which prices are constantly going up, what is the use of saving £100 to-day when it may be worth, putting an extreme case, only one penny to-morrow? That is perhaps exaggeration, but let me remind you that the Germany policy which was worth perhaps £50,000 in 1913 was in 1923 worth rather less than the one-thousandth part of an English farth-

ing, because at that time the mark was being quoted, if I remember correctly, at something like thirteen billions to the pound. I never was a mathematician, and could never grasp what thirteen billions was, but it made the £50,000, which was the value of the policy in 1913, look rather small in 1923. Similarly, inflation must destroy the worker's standard of living, because wages in the modern world are paid in terms of money. If you have got an indefinite inflation it must end by destroying the desirability of saving and the desirability of working. On the other hand, if you have an endless deflation, no business man will go on producing; he will not produce something which is worth £100 at the beginning of the morning and only £95 by the end of the afternoon. He will much prefer to keep his capital intact in the shape of a bank balance and to dismiss his workmen. Consequently, if you have to choose, and these choices are sometimes forced on mankind, between inflation on the one hand and deflation on the other, you have to choose between the destruction of savings and the destruction of the worker's standard of living on the other hand, and the destruction of business enterprises and increased unemployment on the other. I do not know which is worse, except that I have a sort of feeling that in a period of rapidly rising prices all sorts of other things, which do not enter into the business man's calculations at all, are destroyed: the ability, for instance, of the middle classes to educate their children, the ability of civil servants to have anything like a decent standard of living. All these elements, which do not enter into the business man's calculations, are more affected in a period of inflation than in a period of deflation.