The Value of Money

HANS F. SENNHOLZ

(continued)

The Quantity Theory of money demonstrates the connection between variations in the value of money and the suppply of money. Of course, it is erroneous to assume, as some earlier economists have done, that changes in the value of money must be proportionate to changes in the quantity of money, so that doubling the money supply would double goods prices and reduce by one-half the value of money.

Changes in supply always work through the cash holdings of the people. When the government resorts to a policy of inflation, some people may react by delaying their purchases of certain goods and services in the hope that prices will soon decline again. In other words, they may increase their cash holdings and thereby counteract the price-raising effect of the government policy. From the inflators' point of view, this reaction is ideal, for they may continue to inflate while these people through their reaction may prevent the worst effects of inflation. This is the reason why the U.S. Government, through post office posters, billboards, and other propaganda, endeavours to persuade the American people to save more money whenever the government itself resorts to inflation.

When more and more individuals begin to realize that the inflation is a wilful policy and that it will not end very soon, they may react by reducing their cash holdings. Why should they hold cash that depreciates, and why should they not purchase more goods and services right now before prices rise again? This reaction intensifies the price-raising effects of the inflation. While government inflates and people reduce their money demand, the prices of goods will rise rapidly and the purchasing power of money decline accordingly.

It may happen that the government may temporarily halt its inflation, and yet the people continue to reduce their cash demand. The central bank inflators may then point to the stability of the money supply, and blame the people for "irrational" behaviour and reaction. The government thus exculpates itself and condemns the spending habits of the people for the inflation. But in reality, the people merely react to past experience and therefore anticipate an early return of inflationary policies. The monetary development during most of 1969 reflected this situation.

Finally, the people may totally and irrevocably distrust the official fiat money. When in desperation they finally conclude that inflation will not end before their money is essentially destroyed, they may rush to liquidate their remaining cash holdings. When any purchase of goods and services is more advantageou than holding rapidly depreciating cash, the value of money approaches zero. The money then ceases to be money, the sole medium of exchange. When government takes control over money, it not only takes possession of an important command post over the economic lives of the people but also acquires a lucrative source of revenue.

Under the ever-growing pressures for government services and functions, this source of revenue—which can be made to flow quietly without much notice by the public—constitutes a great temptation for weak administrators who like to spend money without raising it through unpopular taxation. The supply of money is not only the best indicator as to its value, but reflects the state of the nation and the thinking of the people.

DEBAUCH THE CURRENCY

LENIN is said to have declared that the best way to destroy the Capitalist System was to debauch the currency. By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. By this method they not only confiscate, but they confiscate *arbitrarily;* and while the process impoverishes many, it actually enriches some . . . As the inflation proceeds and the real value of the currency fluctuates wildly from month to month, all permanent relations between debtors and creditors, which form the ultimate foundation of capitalism become so utterly disordered as to be almost meaningless; and the process of wealth-getting degenerates into a gamble and a lottery.

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The Economic Consequences of the Peace (1920)