WHAT IS MONEY? — DOES IT MATTER?

(*Continued from last month*)

Inflation and its Evils

It is frequently suggested that the State by some method which is seldom explained could obtain costless credit, that is to say borrow money without paying interest upon it. There is not the slightest doubt that if the State controls the issue of money, as it does completely where the money consists of notes printed by or under the direction of the State, it can issue more money whenever it pleases. It can use that money for purchasing the supplies it needs or paying the State employees. The pursuit of that policy involves a constantly increasing quantity of money in circulation. This inflation lowers the purchasing power or value of the money with the result that the people into whose hands it passes can buy less with the same amount of money. The extent to which various classes of people are affected by this policy is a complex problem. Broadly speaking those most adversely affected are those whose incomes are fixed and those least affected are those who are engaged in trades in which they can rapidly readjust the price of what they have to sell to meet the altered circumstances. The mass of wage and salary workers usually find it impossible to get their rates of pay altered so as to keep pace with the rise in prices. On the other hand some classes may gain in an inflation if they can discharge obligations which are fixed in terms of money by selling or hiring their assets for increased prices. Thus the attempt of the State to obtain costless credit in this fashion is by no means without cost to many citizens although it may confer an unmerited and unearned gain upon some.

The adoption of an inflationary policy also introduces an element of speculation and uncertainty into all business transactions which is not calculated to lead to steady investment and production of wealth nor to an equitable distribution of wealth.

Loans without Interest

The evils of inflation are so evident that most of those who think that the State can obtain costless credit recoil from the direct method of unlimited issue of money. Many, however, seem to think that the result could be achieved if the State controlled the banking system. It could then of course issue as many cheques as it pleased without levying taxation or borrowing to place itself in funds, but the ultimate result would be much the same as if the State printed notes without limit. Either the banking system would collapse or the purchasing power of money would fall owing to the increased use of money substitutes and all the evils of inflation would result.

Sometimes it is said that the State could raise loans without interest. If the State could persuade any one to lend money in exchange for a piece of paper which promised to pay the lender the same amount of money, but without interest, what would be the result? If the promise was to pay money on demand, these documents might circulate like notes and become an additional form of money. In that case the value of money would fall, and we have the case previously discussed. If the promise was to pay money at a future date, then these pieces of paper could only be sold at a discount depending upon the length of time which was to elapse before the redemption and the strength of belief that they would then be redeemed.

Money and Wealth

Nearly all fallacies with regard to money arise from forgetting that it is merely a generally accepted medium of exchange. Its purpose is to facilitate the exchange of goods and services. It makes transactions much easier than they would be if mankind only used barter, and indeed may make some transactions possible that otherwise would not have been possible. By assisting exchange and the division of labour it helps to increase the production of wealth. It is, however, a mistake to think that there is some specific quantity of money needed in order that wealth shall be exchanged. Within wide limits any quantity of money can do the same amount of work as a given quantity. All that happens is that its value is adjusted in the market according to the work it has to do. Thus, although money is necessary for the functioning of a developed economic system, there is no particular and definite amount required. This can readily be seen when the possibility is admitted of a country having gold money, silver money or some other kind of money. The quantities in each case would have been different, and so would the value of each unit, but there is no reason to think that one would have been more advantageous than another. (This is apart from the advantage of using gold in a world in which many other countries do so, and thereby establishing rates of exchange which are stable within narrow limits.)

Another cause of fallacious reasoning with regard to money is the assumption that because one individual can be made better off by giving him money, all could be. If one person makes a present of money to another, the one gains at the expense of the other, and there is no increase in the amount of wealth in the community. Sometimes it seems to be thought that if the State presents money to some individuals, it can make them better off without making others poorer; but this cannot be so because the amount of wealth in existence has not been added to. It makes no difference to the argument, whether the State obtains the money by taking (or taxing) it from some and giving to others, or whether it prints some more money. In the latter case there is a rise in prices which deprives some of the existing holders of money of some amount of goods which they would have bought, and these goods are bought instead with the new money.

Money and Demand

At the back of these suggestions for improving the condition of the people by issuing more money lies the idea that more demand will cause more goods to be produced. Once the truth is firmly grasped that money is merely a means of facilitating the exchange of goods and services, this notion goes by the board. The issue of more money does not lead to the provision of more goods and services; in the long run it merely leads to a revaluation of goods and services in terms of money. If, however, the new money somehow is distributed to certain classes it may mean an increased demand for the things that those classes desire with a curtailment of the demand for other things. It does not follow from this that there will be either an increased production of wealth or a better distribution of wealth.

In particular if the new money is put into the hands of persons who will use it for creating new industrial enterprises, it is frequently thought that this will lead to an increase in total production and employment. This idea lies at the root of most plans for combating industrial depression by monetary means. But as the increase in the quantity of money will lead to an increase in prices, and therefore in the end to an increase in costs, the ultimate effect would be a diversion of effort from enterprises which yielded the greatest results to others which yielded less results for the same outlay of labour and materials. Thus in this case, as in others, the final results of inflation are injurious.

Conclusions

Similar observations may be made about deflation. In short, all violent changes in the purchasing power of money have ill effects. It is impossible to keep the value of money stationary, but it is desirable that it should vary as slowly as possible. Herein lay one of the advantages of the gold standard as it was operated by the leading commercial nations prior to the last war. The mass of gold used for monetary purposes was so large that any additional amounts which became available year by year were a relatively small fraction, and the effect on prices during short periods correspondingly small. The other advantage of the gold standard was that it conduced to a stable functioning of international trade. The adoption of insulated and independent national moneys of which the quantity is determined by national policies means inevitably that exchange rates will be subject to much more severe fluctuations. The uncertainty thus caused restricts trade. As international trade, that is to say international division of labour, is an essential for the prosperity of every country, the argument in favour of a common form of money is extremely strong. If a sufficiently powerful and respected super-national authority could be created, it is conceivable that such an authority could bring into use a new form of paper money acceptable to all nations. Although this is conceivable it does not follow that it would have any appreciable advantage over the gold standard, and in any event the day appears to be far distant when such a course could be feasible.

The conclusion of this examination is, therefore, that monetary changes are not likely to improve the distribution of wealth. The distribution of wealth in fact is governed by the way in which the ownership of the resources by means of which it is produced is divided. It is desirable that the value of money should be as stable as possible. It is also desirable that the same money should be used by as many peoples as possible. The most satisfactory means of achieving this so far tried is the use of gold as money. F.C.R.D.