

WHAT IS MONEY? — DOES IT MATTER?

THE VIEW is very earnestly and deeply held by many people that the major cause of economic ills lies in our monetary system, and that the adoption of a different monetary policy is the most important remedial measure.

The first question is what is meant by money. In the widest sense the term is used to denote all kinds of valuable possessions. This is the sense occurring when a wealthy man is described as a moneyed man. In this sense it is easy to assert that the economic troubles of any one are due to lack of money, meaning lack of wealth. But in this sense the term makes no contribution to economic discussion except to mislead. Scientific thought in economics can only proceed upon a correct classification of economic facts and their assemblage into categories which can be reasoned about.

Money is frequently described as purchasing power. This also is a definition which is so wide as to be useless, if by purchase is meant the acquisition of something valuable by giving up something else which is valuable. In this sense every exchange would be a purchase, and everything which can be exchanged would be money. On the other hand if the term purchasing power is restricted to mean power of purchasing with money, the definition is meaningless because it defines money in terms of itself.

Money a Means of Exchange

The essential characteristic of money is not that it can be exchanged, for many things can be, but that its purpose and use is to exchange it for other things. This is the unique characteristic of money: it is a medium of exchange. In certain cases the substance which constitutes money may have other uses. Prior to the last war a gold sovereign in this country was money. In that form gold was used as a medium of exchange, although it could also be used for jewellery and other purposes.

Next arises the question how does some kind of thing come to be money. The answer is that it is money when people are willing to use it as such and do so use it. An article does not become money because the law says that it shall be money, but because people are content to treat it as money. If people are not willing to accept an article as money, the law cannot make it such. History provides numerous examples of this in cases where "inflation" has proceeded to extreme limits. On the other hand it is no doubt true that when the law says that a certain thing is money, and is to be legal tender, it helps to create the frame of mind in which people are more inclined to accept that thing as money.

The Value of Money

The value of any unit of money depends upon the quantity of other things for which it can be exchanged. This is evidently a variable amount. If we measure the value of a pound sterling, for example in terms of wheat, it will exchange for differing quantities at different times. Here arises the difficult question whether the variation is due to change in the value of money or to change in the value of wheat. If at two separate points of time we find that

a pound sterling would exchange for the same quantities of everything else but for more or less wheat, we should be inclined to say that the change was in the value of wheat. Even in that case the assertion would require a slight rectification, for it could hardly be true to say that the purchasing power of money had remained the same, when it bought less wheat but the same quantity of everything else. In practice such a simple case never arises. Changes of taste and desire and of the conditions of production are continuously at work and the values of commodities relatively to one another are constantly changing. It is, therefore, impossible to find any objective standard by which the value of money can be measured and compared from time to time.

Price Indexes

For many purposes the difficulty of measuring the value of money is approximately met by constructing a price index. This is done by ascertaining at various points of time the quantity of money which is needed to purchase certain specified quantities of certain specified articles. It is, however, impossible to include all articles in such an index, neither is it possible to lay down precisely what quantity of each should be used in "weighting" the price index. Hence, although price indexes are useful for certain purposes and over short periods, they are misleading when applied to other purposes or over long periods.

If the price index is formed by taking a wide sample of important commodities, and if, without any wide variation in the quantities of these articles produced, the price index exhibits rapid changes in a short period of time, we may conclude that the variation arises rather from the side of money than from the side of commodities.

Quantity Theory

It is fairly evident that if the quantity of money in circulation increases, the value or purchasing power of each unit will tend to fall. This fact, which has been strikingly exemplified in periods of acute "inflation," is the basis of what is called the quantity theory of money. That theory in its broadest formulation is true, but it is not possible to give it a narrow arithmetical expression, as for example by asserting that the value of money varies inversely to the quantity in circulation. During an acute inflation the value of money falls more rapidly than in proportion to the quantity printed, because it falls in anticipation of the quantity increasing still further. There are also other modifying factors.

Where the substance of which money is made is valuable for other purposes, the value of the money is affected by the demand for other uses, and conversely. Thus, in a gold currency there will be a tendency for its value to rise if there is an increased demand for gold for gilding and other industrial purposes. On the other hand if its value as money began to fall, it would become economical to use more gold for industrial purposes.

Money Substitutes

Another and much more important circumstance which affects the value of

money is the extent to which its use may be economised by other methods of effecting exchanges. Thus, book-keeping and the use of contra-accounts between merchants who have mutual transactions saves the necessity of using money in connection with each individual sale; a periodical adjustment of the balance owing by one to the other is all that is necessary. Similarly the use of bills of exchange and of cheques diminishes the need for actual employment of money.

By far the most important economy in the use of money is the use of cheques. As a cheque is immediately payable in terms of money, its value is the same as that of the money it represents (provided that the drawer's banking account is in credit, and no one as a rule accepts a cheque except in that belief). A cheque may therefore be described as a money substitute. It will be evident that an extension in the use of cheques for settling transactions will, other things being equal, diminish the value of money in circulation.

Cheques and Banking

The use of cheques depends upon the existence of a banking system, and the extent of their use depends largely upon the nature and extent of the banking system and upon the habits of the business community. Every discussion of money necessarily includes some reference to banking, and particularly to the oft quoted, but not always well understood, proposition that banks create money or credit.

If the term money is used in the general sense in which it is understood above, banks do not create money but they do create money substitutes. If banks were obliged to hold money to the amount of each individual customer's account, then the use of cheques would be little more than a means of transferring (or earmarking) money from one account to another. It was early discovered by bankers that this is not necessary. All their customers do not ask for money at the same moment. The bank merely requires to hold a sufficient amount of money to enable it to meet normal demand and keep a surplus above that for a margin.

In actual practice the amount of money which the banks hold is only a fraction (in this country something of the order of ten per cent) of the deposits made by their customers. This fact is the essential characteristic of a banking system. So long as the banks can meet the demands for money which are actually made upon them, they can continue to function. They possess sufficient liquidity, but no bank in modern practice is solvent in the sense that it could at any point of time meet all its obligations to all its depositors in cash. It is thus the primary characteristic of modern banking that it does bring into existence a large volume of money substitutes, and the purchasing power of money is influenced by the extent to which this is done.

Bank Loans

The fact that not all its customers require money at the same time enables the bank to lend to its customers. The interest so obtained enables the bank to pay interest to those who give it their money on fixed

deposit, and to pay for the staff and organization which is necessary to operate the cheque system and the general expenses, and out of the balance to pay interest to its shareholders.

It is frequently said that the loans or credits given by the bank to its customers cost nothing—that they are created by the mere stroke of a pen. This is far from true. The transaction is effected by an entry in the books of the bank showing that the borrower is entitled to draw up to a certain amount, but that entry could not be made if the cheque system and the whole elaborate organization of the bank did not exist. It is largely that which the customer has to pay for, and the credit he receives is not costless.

If the loans made by a bank cost it nothing, then it would seem to be perfectly easy for the banks to undercut every other lending agency and absorb the whole business of lending money. In fact many other organizations, such as insurance companies and building societies, and private individuals lend money. There is no evidence that the banks are taking away all the business of such competitors.

Nevertheless, it is true that banks, if they pleased and if they disregarded the solvency of their borrowers and of themselves, could lend much more money than they do. In that event they could cause such an increased use of money substitutes as would lead to inflation. The decline in the purchasing power of money would lead to an increased need of money on the part of all their customers, and either the bank would cease to be able to meet all the demands made on it (would lose its liquidity) or the demand would be met by more loans and more inflation until the ultimate collapse occurred.

"Costless" Credit

The idea of costless credit exercises a perennial fascination for those who will not take the trouble to examine the essentials of the problem. The word credit is itself question-begging. Sometimes it means the possession of wealth and a good financial standing. An individual whose credit is good in this sense is recognized as being able to fulfil his obligations, and in particular to be able if he borrows money to repay it. Sometimes the term credit designates one side of the process of granting a loan which makes one party to the transaction a creditor and the other a debtor. In this sense there is no credit without a corresponding debit—a fact which often seems to be forgotten! Sometimes the word credit is used as if it meant money. This use arises from the manner in which bank loans are granted, for this enables the borrower to draw cheques which otherwise he could not have drawn and thus in effect adds to the volume of money substitutes in the form of cheques. This kind of credit, however, creates a debit or debt which the borrower owes to the bank.

F. C. R. D.

[The second part of this article follows next month, paragraphs dealing with inflation and its evils, that money is not wealth, money and production and the gold standard and concluding that monetary changes are not likely to improve the distribution of wealth.]

3d. THE TRUE NATIONAL DIVIDEND. Pros and Cons of Social Credit. By W. R. Lester, M.A.

LORD WEDGWOOD'S WARNING

[In the House of Lords on 22nd October, Lord Reith raised discussion on the reports of the "Uthwatt" and the "Scott" Committees, not on the merits of their proposals but calling attention to the "machinery of planning advocated" and urging that some action be taken. Lord Wedgwood's speech was in our view the most pertinent.]

LORD WEDGWOOD said: We have the astonishing spectacle of the pillars of the Conservative Party urging State dictatorship in the user of land and the pillars of the Socialist Party urging the righteous rival claims of the local authorities. Well, that shows openness of mind on both sides, which is most useful. We do want time to consider where we are going and even what we want. In the eloquent opening speech of the noble Lord, Lord Reith, he said those terrible words which we have had re-echoed ever since in every speech—"get something done." Everybody thinks getting something done is what we want. If that is all you put your mind to you will get the wrong thing done. A friend of ours, known to most noble Lords here present, President Nicholas Murray Butler, of Columbia University, has said that the greatest danger to democracy is the people whom he calls "the for-God's-sakers"—the people who cannot think for themselves, who are always saying to those in authority "for God's sake get something done." The business of Parliament, I need hardly tell your Lordships, is to stop the Government doing foolish things, not to urge it. It is most necessary that in this case we should reflect before we try to "get something done."

What do we want to do? I gather that the great aim and object of the new Planning Minister or Commission, or whatever it is going to be, is the preservation of rural amenities and, above all, the preservation of our existing form of agriculture; that the land of England should be divided into two classes—agricultural land and developed land. If that appears a desirable course to your Lordships, to me it is a perfect abomination. It is the development of Fascism so far as agriculture is concerned. It means the crystallization of the existing system of tenure and the existing system of agriculture. You are going to preserve part of England for agriculture and refuse to allow industry or workers to live in that part of England.

LORD BALFOUR OF BURLEIGH: Hear, hear.

LORD WEDGWOOD: You are going to Ghetto-ize the industrial population of this country. Lord Balfour of Burleigh may approve of that. All Fascists will approve of it, but nobody who loves liberty can possibly approve of confining the industrial classes to the towns and keeping the agricultural portion of England in pristine beauty. It is not only the Ghetto-izing of the industrial population I am thinking of. This crystallization of land ownership and land tenure means that the agricultural labourer must say good-bye for all time to any ideal of three acres and a cow. He will not be allowed to buy. He has got to remain for ever an agricultural labourer. The Guild system in the Middle Ages had the same idea. Messrs Chesterton and Belloc would have

liked to see the Guild system introduced for agriculture, I suppose, as well as the retention of every man in that state of life to which God has pleased to call him. Just as we have passed Acts of Parliament preserving the interests of dentists, doctors, nurses, and perhaps lawyers, by preventing fresh people from coming into their professions, so you are going to do it for the agricultural industry as well—crystallize, ossify. It may succeed, but it will be the ruin of our Empire and the destruction of all possibility of recovery of our trade and prosperity. In these circumstances no new industry can develop. The user of land depends on getting rid of the idea of preserving the existing system, preserving agricultural land as it is to-day. The only hope from these discussions and Reports that I can get is that we have had Lord Phillimore who used to be the principal supporter of the landowners in this country, accepting the ideal of a ceiling for the price of land—the 1939 ceiling. But let noble Lords consider for one moment the impossibility of determining now what the 1939 valuation should be. If you are going to deal with the user of land in this country the essential thing is a valuation of the land as it is to-day. We must have that valuation if we are going to buy pieces of land for anything. If you are going to dictate the user, you must know what you are going to pay. When you have your valuation, then you can reconstruct back from that your ceiling valuation for 1939. You have only got to consider the inflation that has taken place since, and make the percentage deduction. It is easier to make your valuation of what it is to-day than to start trying to value property which has changed hands dozens of times, perhaps and been broken up.

Whether you are going to deal with that problem of the user of land by purchase, which I do not recommend, or by the rating and taxation of land values, which I do recommend, valuation is the key to both. Valuation is essential. When you have that valuation you might remember the incidence of taxation. When people recommend that there should be an increment duty on land instead of a tax on land value, they seem to be completely ignorant of the well-established fact that the incidence of an increment duty falls upon the user of land, upon the purchaser, whereas the incidence of a tax on land values falls on the landowner. One is a burden on industry for all time, the other tends to make land cheaper and easier of access for the people who want to use it.

The crofters movement has lost a notable champion in the death of Mr R. M. Bone, retired teacher, who was a member of the Ross and Cromarty County Council. He was a gifted orator and used his talents on many public platforms pleading the cause of land reform. For the past twenty years he was member of the Highland League for the Taxation of Land Values.

2s. 6d. THE THEORY OF HUMAN PROGRESSION, by Patrick Edward Dove. Abridgement by Julia N. Kellogg. Published by the Robert Schalkenbach Foundation, New York.

1d. CITIES HELD TO RANSOM. By M.