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Menger on Money[1]

THIS is the final volume of the collected edition of the works of the founder of the Austrian school undertaken by the London School of Economics. It gathers together practically all of Carl Menger's writings on money, and, to add to the value of the new edition, the editor, Professor Hayek, has included in the present volume a complete bibliography of Menger's known publications.

Menger did not write a great deal on money. The present collection runs to about 320 pages and contains his main theoretical work, the long article *Geld*, first published in the *Handwörterbuch* in 1892 and, in a new edition, in 1909. The remainder consists of a series of articles from the years 1889, 1892 and 1893 on the position of the Austrian currency before and after the reform of 1892, together with Menger's evidence before the Currency Commission of March, 1892, which preceded the reform.

Partly on account of their small volume, partly, perhaps, because of the way in which they were first published, Menger's contributions to monetary theory and policy have had—at any rate, outside their country of origin—less attention than they deserve. The fundamental changes which he introduced in methodology and in the theory of value led to the neglect of his no less important reformulations of the theory of money. Economists everywhere have, it is true, been familiar with the summary of his views on money contained in the *Grundsätze*, but it is in Austria more than anywhere else that his work (with that of Wieser) has been successfully developed. Professor Mises' treatise is based on it; and Vienna's recent work on fluctuations can be directly traced to the ideas of the older Austrians. Now that the concepts of the new Vienna school have begun to influence English economic thought, a re-examination of their origins becomes an exciting and profitable undertaking.

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Menger's article in the *Handwörterbuch* is still one of the best introductions to the modern theory of money. It is written in a pleasing style, dignified, yet free from the excrescences of the *Kanzleistil* common at the time it was written. In 115 pages, it presents most lucidly the main elements of monetary theory, firmly based on the theory of choice and exchange of the Austrian school; and it contains, moreover, stimulating hints for further work.

[1] *The Collected Works of Carl Menger, Volume IV, Schriften über Geldtheorie und Währungspolitik.* No. 20 in the Series of Reprints of Scarce Tracts in Economics and Political Science. (London School of Economics. 1936. 332 pp. 10s. 6d.)

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It is divided into 14 sections of unequal length and unequal interest. The first section gives an elegant formulation of the now accepted (though then still somewhat controversial) explanation of the origin of money out of the inconveniences of barter and the differences in the degree of acceptability (*Marktgängigkeit*) of different goods. The primacy of the medium of exchange function of money is duly emphasised and leads to sharp polemics, in section 2, against the legalistic interpretations of the Jurists and, in the subsequent three sections, against the 'étatists' who were later to find their chief exponent in Knapp. The necessity of this controversy may not have been obvious in England at the time it took place (it is more so now!) but the difficulty with which juristic interpretations die in German economic thought is justification enough for Menger's onslaught even to-day. Thanks largely to him and his successors, the economic definition of money is now much more taken into account in legal theory (as witness, for example, the attitude of Nussbaum) than it was before.

With all his opposition to the 'étatists', Menger does not ignore the powerful rôle of the state in the development of money. In sections 3, 4 and 5, there is a brief but penetrating analysis of the development of the coinage, of legal tender money and of the power of the state in relation to the usage of the market. These pages show Menger to have been more appreciative of the extent to which political intervention can alter economic arrangements than are many of his successors. Menger does not fall into their error of regarding only a liberal society as 'natural' and any departure from it as 'artificial'. He shows that political institutions are changeable and may come into conflict with social practice. Here, at any rate, Menger is eminently true to that 'neutrality' towards politics which he so persuasively urged on all economists.

The next four sections are concerned with the development of the subsidiary functions of money: to facilitate unilateral transfers, to act as a hoard and to facilitate the accumulation of capital. The discussion here follows well-known lines, but the description of the rôle of money in the capital market is, unfortunately very short and not as suggestive of further analysis as other parts of the article.

The tenth section introduces the famous concept of money as a price-index (*Preisindikator*). It is based, as one would expect, on the subjectivist theory of value and rejects any view of exchange value but that of an equivalence which arises in, and through, the act of exchange. Money becomes a unit of account, a convenient way of expressing that equivalence. This section should be read in conjunction with Wicksteed's analysis of the formation of the 'objective scale'. It forms one of the best short statements of the Austrian theory of monetary exchange.

Section 11 is the longest and, theoretically, the most important. It deals with money as a measure of the exchange value of goods: and no reader to-day can fail to be impressed with the extent to

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which much modern work is derived from Menger—how little it has advanced since he wrote. Menger first describes the advantages to which the possibility of a uniform expression of the exchange value of goods and rights through the agency of money gives rise. He exposes, however, the fallacy which often arises through the belief that money is a measure of value in a more definite and technical sense, such as is applied to the measures of weight and physical dimensions. Price must simply be regarded as a *relation* between money and goods which is, moreover, changeable. The exchange value of goods, expressed in terms of money, is subject to numerous influences which vary from time to time and from place to place: it may, therefore, be an inadequate guide to the means or results of economic activity.

The observed inadequacy of money as a 'measure of value' leads, then, to a discussion of the problems of a stable purchasing power (*aüsserer Tauschwert*) of money and of 'neutral' money, or money with a stable inner exchange value (*innerer Tauschwert*). Menger concludes that a good with a stable purchasing power cannot be found. A good of that quality would require stable exchange relations between all goods, *i.e.*, stable prices; and if those could ever be achieved, any marketable good could serve as a measure of value. Even the measurement of changes in the purchasing power of money is shown by Menger to be difficult if not impossible of achievement. He discusses lucidly the theory underlying the compilation of Index-Numbers, shows their limitations, but admits the important practical use to which they may be put.

There follows an explanation of the problem of the inner exchange value of money. Menger shows that while the exchange ratio of any two goods (including money) is determined by influences lying on the side of both, changes in a given exchange relation may be brought about by influences operating on the side of one only. More particularly, prices may vary as the result of changes occurring solely on the side of money. To introduce that distinction is to enquire into changes in the inner exchange value of money.

The occurrence of such changes is seldom recognised. Only in times of violent fluctuations do most people become aware of alterations in the value of money. Economic Science, however, has long since understood that changes occur in the supply and demand relations of money which affect prices from the side of money. Recognition of these influences leads to the search for money with a stable inner exchange value or, in modern parlance, 'neutral' money. Such money would not prevent price fluctuations; but since its own value would be stable, all changes in prices could be regarded as being caused by influences originating on the 'side of goods'.

Menger believes that the problem of the 'neutralisation' of money is both theoretically and practically capable of solution. He emphasises the fact that there is no good in existence which has a stable inner exchange value and which could, therefore, serve as neutral money.

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But the problem of practical policy is that of adjusting the supply of money to the demand conditions, thereby neutralising the influences on price-formation which arise on the side of money.

The first condition for such a policy is to devise some means whereby 'autonomous' monetary influences could be recognised and measured. Menger discusses the attempts made to devise such means. These have generally taken the form of statistical representations of a general level of prices and of the measurement of changes in it. Menger shows clearly the theoretical objections to that concept. He demonstrates that its use is based on the assumption (tacit rather than explicit) that price-movements are compensatory in character. Only if changes in the prices of individual goods lead to completely compensatory movements in the prices of other goods (a condition which can be shown to depend on very exceptional demand-elasticities) can changes in the general level of prices be taken as an expression of changes in the value of money. Thus, if Menger's work had been better known in this country, there would not have been the surprise which greeted the attack on the concept of the general level of prices a few years ago! Menger admits, however, that, for practical purposes, measurement of changes in price-averages may be a useful approximation (since large changes are more *probably* caused by monetary influences) and that, taken together with other evidence, it may form a useful guide for monetary policy.

The next two sections give by way of summary a definition of money and discuss once again aspects of legal tender money. The concluding chapter, fragmentary though it is, is, perhaps, the most stimulating. It discusses the demand for money and one reader, at any rate, cannot help feeling that recent work would have been much further advanced had it started from the point at which Menger left off. He shows the demand for money to be nothing more than the demand of individuals for money, *i.e.*, for the services which money renders. It should, therefore, be investigated in comparison and contrast with their demand for other goods. It may not be too fanciful to see in the brief mention of the causes which may influence the demand for money (p. 108) some of the seeds of the work of Myrdal, Lindahl and Hicks, to mention only a few contemporary writers in that field. Thus, Menger can be seen as the forerunner both of the neutral money theorists (*e.g.*, Mises, Hayek, Koopmans) as well as of those who are now developing monetary theory by linking it up with the theory of anticipation.

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The reform of the Austrian currency and the problems which led to it form one of the most interesting chapters in modern monetary history. Since 1858, Austria was officially on a silver standard, but convertibility existed only for a short time. Political and financial instability in the earlier years and an over-issue of paper money in the later years of the subsequent period put a premium on silver which, even in 1871, stood at over 20 per cent. In the 'seventies,

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however, there occurred the remarkable fall in the price of silver which diminished the premium and eventually, in 1878, made it disappear altogether. The continued fall in the price of silver led, in that year, to a sharp rise in the imports of the metal for the purpose of coinage on private account.

To prevent a devaluation, the Austrian authorities decided, in 1879, to suspend the free coinage of silver *Gulden*. From that year onwards, as Menger points out in an article written in 1889, Austria was on a limping standard : its silver coins had a greater value than their silver content, due to the 'scarcity value' which the suspension of coinage on private account and the restriction of the public coinage gave them. The measure of 1879 represented, then, a kind of deflation. It was perhaps justified by the possibility of an excessive influx of silver which would have created difficulties at a subsequent date when the demonetisation of silver and the adoption of a gold standard were being envisaged. Nevertheless, as Menger shows, it was a measure which possessed certain dangers : it had been instituted by decree and not by legislation ; and by a similar decree, re-introducing the free coinage of silver, the government was in a position to lower the value of money by one-fifth.

Free coinage remained, however, suspended, and the disparity between the value of the silver *Gulden* and the metal grew constantly until, in 1892, the cost of production of a silver *Gulden* (the price of the metal in London plus cost of transport, etc., plus cost of minting) stood at, roughly, 77 Austrian *Kreuzer* as against a nominal content of 100 *Kreuzer*. The difficulties and dangers of that situation were well described by Menger in his *Beiträge zur Währungsfrage* and in an excellent short lecture, *Von unserer Valuta*. He points out the inconveniences of trade, the isolation of Austria from the international money and capital markets, the constitutionally precarious nature of the suspension of the free coinage, the persistence of an excessive note circulation which might, at any time, lead to a reappearance of the silver premium and, finally, the likelihood of a continued fall of silver which might completely destroy the basis of the Austrian currency. It was this last danger which, influenced by the 1887 Gold and Silver Commission, Menger regarded as the most serious.

A reform of the currency had, thus, become inevitable ; and by 1892 the standard to be adopted had become a subject of intensive discussion. Menger contributed to it a series of articles as well as some very lucid evidence before the Enquiry Commission. After considering at length the advantages and disadvantages of a pure silver standard, of bi-metallism and of a gold standard, he decides in favour of the last.

That was, indeed, the opinion of the majority of experts at the time. The only points of controversy were the effects of an attempt by Austria to adopt the gold standard and the parity which should be established. Menger was strongly of the opinion that large gold purchases by Austria (estimated at between 250,000–300,000 Kg.)

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would seriously raise the price of gold. He believed, nevertheless, in the desirability of the universal adoption of a gold standard and suggested well-known means for economising gold and for diminishing the tendency for its price to rise. For Austria, in particular, he suggested that the probable price-raising effects of the gold purchases should be taken into account when fixing the ratio to be adopted.

His own opinion, strongly expressed on several occasions, was in favour of a ratio which would mean neither a 'heavy' nor a 'light', but a 'just' *Gulden*. In other words, he wanted a parity which would disturb as little as possible the existing distribution of wealth, which would be based on a careful examination of Austria's balance of payments, and which would be most likely to remain stable. The first two considerations inclined him to a ratio of 2.10 francs to the *Gulden*, but in view of the probable rise in the price of gold, he urged that if a ratio had to be adopted at once, it should be a higher one. Menger believed, however, that the effects of Austria's reform on the price of gold could not be correctly assessed in advance and that no ratio should be adopted until the completion of the gold purchases was well in sight.

Unfortunately, his view was not adopted. Already, in June, 1893, Menger was able to show the harm which had been done by the hasty fixing of the parity and to point out that, in spite of an initial success, the reform had got into difficulties. It was true that the currency stabilisation loan had found a good public, but the parity of 2.10 francs, fixed in August, 1892, was rapidly being stultified by a rising premium on gold which, in May, 1893, reached over 3 per cent.

Menger finds the causes of this movement in a sudden worsening of Austria's balance of trade, in an untimely conversion of Government loans which caused an outflow of foreign funds from Vienna and in the large purchases of gold abroad. He believes that a rise in the premium could have been avoided. As soon as a premium occurred, the purchases of gold and foreign exchange should have been stopped; indeed, the authorities should have proceeded to sell in order to support the exchange. He regarded the removal of the premium on gold as the first condition for a resumption of the currency reform, although he was fully sensible of the sacrifices which it would entail. Menger's advice had not been heeded before 1892, nor was it followed afterwards. The result was that Austria never had a full gold standard, that the premium on gold remained and even increased, and that the resumption of cash payments, originally envisaged for 1896 or 1897, was beginning to be seriously discussed when the War once more threw the currency into the melting-pot.

The present volume is also the last in the first series of reprints of the London School of Economics. The great debt of gratitude under which the editors have put all social scientists, is already being increased by the issue of a new series. May it be as successful as the old!

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