PROCEEDINGS

OF THE

THIRD INTERNATIONAL CONFERENCE

OF

AGRICULTURAL ECONOMISTS

HELD AT

BAD EILSEN

GERMANY

26 AUGUST TO 2 SEPTEMBER 1934

LONDON

OXFORD UNIVERSITY PRESS

HUMPHREY MILFORD

1935

THE CURRENCY PROBLEM OF OUR TIME

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IN undertaking to discuss the present currency problem on its general basis in a short lecture, I am fully aware of the difficulties of my task—difficulties which are not decreased by the fact that this Congress calls for a discussion of the problem in specific relation to agriculture. While it is held that agriculture has a higher claim to a favourable public policy than any other branch of the economic system, yet the fact remains that the currency is an institution for the entire economy and its neutrality should be carefully guarded in the interest of agriculture itself. One might say, however, that the international character of this Conference affords some limitation to my subject, excluding, as it does, the discussion of the peculiarities of the different countries and calling for a more fundamental treatment of the general problems involved, which, I hope, will not appear unpractical or 'academic'.

I may indicate here the road I propose to travel: I shall discuss first the general aim of present-day currency policy and, second, those proposals, discussed especially in agricultural circles, which advocate the manipulation of the currency for overcoming the crisis. They are characterized on the one hand by the slogan 'controlled inflation' and on the other hand by the term 'devaluation'. In all this I cannot do more than present a short sketch which tries to carry a certain amount of conviction, less through details than through the general line of the argument.

I

The starting-point of our discussion is the historical phenomenon of the enviable tranquillity, compared with to-day, in the monetary field which mankind enjoyed from the beginning of the century until the War. Wishes and complaints and possibilities of improvement in every country were not totally lacking. Yet on the whole we had

[1] The author attempts in the following paper to make use of the entire international literature on these problems, which it is impossible to particularize, and also to take into consideration practical suggestions for reform, which have always had his particular interest. (Cf. e.g. Schumacher, 'Die deutsche Geldverfassung und ihre Reform', in *Schmollers Jahrbuch für Gesetzgebung, Verwaltung und Volkswirtschaft*, vol. 32 (1908), pp. 1257–1388; also his *Weltwirtschaftliche Studien*, Leipzig, 1911, pp. 46–169.)

achieved a certain equilibrium which is emphasized by the fact that the main endeavour was directed towards introducing the gold standard in the last 'outsider' country, namely, China.

The fact of the extraordinarily satisfactory functioning of the currency mechanism has frequently led to the conclusion—for instance in the majority report of the Gold Delegation of the League of Nations—that a return should be made to pre-War measures and institutions, i.e. to the pre-War system of the gold standard. I don't think the situation is as simple as that. A penetrating analysis is needed, which cannot wholly avoid the much discussed problem of the place of gold as currency 'basis'. However contentious the problem may be, there are a few points of comparative certainty.

It is seldom denied that gold carries special advantages for international traffic. Not only is its transportability greater than that of other goods, but for other reasons as well there has been, for centuries, a ready demand for gold in the entire world. Even to-day, though the gold standard has broken down all round, at a time when large unsaleable stocks of almost all goods have accumulated, gold retains a 'liquidity' like no other commodity in the world. For this reason gold has become a medium of settlement, one might say, for the whole world, and it is one of the most astonishing facts of to-day that England has had a greater foreign trade in gold since the 21st of September 1931 than ever before. Inasmuch as gold is used internationally for settling balances, variations in its value lose their significance, since they tend to affect all different economies equally.

The advantages that gold possesses for international traffic are to-day frequently considered decisive. Yet England had a gold currency for almost three-quarters of a century all alone—so that we have reason to expect other advantages as well. Gold is distinguished among the other commodities by its 'longevity'. No other commodity has been so carefully husbanded for ages, and of no other commodity has there been accumulated a stock, in comparison with which the fluctuations of the annual output are so trifling and of such negligible consequence to its value. It is due to this 'longevity' of gold, which subjects the supply to fewer fluctuations than that of other goods, that its cost of production has such little influence upon its price. So it is not only its international 'liquidity', but also its stability of value over long periods, which gives gold special advantages. These cannot be denied as facts. It is about their significance that there exist differences of opinion, which, however, cannot be discussed here.

To these qualitative advantages of gold we can add a quantitative one, and it is, as usual, the conjunction of the qualitative and the quantitative element that makes up the specific character of our problem. If a commodity is to be used as currency basis, it should not be 'increasable at will', like wheat, or cotton, or even iron. Not only must its production be subject to effective limitation, but there must at the same time exist a certain minimum quantity, which is lacking, for instance, in the case of platinum. These difficult requirements, to avoid abundance as well as scarcity, are fulfilled by gold to such a degree that man is normally able to adjust his demand for gold to its stock. The question of the minimum gold stock may thus be considered the central problem for the organization of the gold standard. Here lies the justification for the saying that gold policy is an art—an art, however, which can be successfully employed only if supported by a thorough knowledge of theory.

So this is our first result: up to now proof has not been advanced that a substitute can be found for those three main advantages mentioned, which have in combination helped gold to gain its special place. If it could be found, there would be no reason to stick to gold as currency basis; as long as a substitute does not exist—and this can be proven—experience and reason make it advisable to maintain gold, even though it is not ideal and does not fulfil all wishes.

II

So far we have said nothing about the organization of the gold standard. The singular success of the gold standard during the hundred years before the War was due decidedly to the fact that it had not been arbitrarily constructed, but had grown organically. Its first form, arrived at after a long time of trial and waiting, was the result of the peculiar conditions of England. It grew in such a way that it is hard to tell how far conditions have simply brought it about and how far it has been the result of the conscious actions of men. Also in other countries there has been a constant adjustment to existing conditions. Those economic conditions out of which the organization of the gold standard originally developed have to-day disappeared in almost all parts of the world. Never before has there been such a thoroughgoing change within a short period of time as was caused by the Great War. The organization of the currency system has to take these changes into account. The more this is done, the more successful the gold standard will be in meeting the tasks of the future, the difficulty of which has not diminished. Again it will be a matter of finding out the latent 'ratio' of existing conditions by practical experiment, without historical or dogmatic prejudice.

The most fundamental change, which the pressure of war has brought about everywhere, will have to be accepted as a definite fact: gold has so generally disappeared from circulation that all attempts to return to previous conditions must be given up. What formerly had been regarded merely as a substitute or as a temporary arrangement, the GOLD EXCHANGE STANDARD (*Goldkernwährung*), has to-day come to be normal—a fact of greater consequence than is commonly supposed. While previously bank-notes used to be convertible into gold for internal purposes as well as for foreign trade, to-day one of the two links connecting gold with money has disappeared. Previously 'internal' and 'external' value of the currency were closely and artificially connected. Now this linking device has been abandoned. Thus, no doubt, greater divergences between the development of the internal and the external value of money have become possible. In cases, however, where foreign trade shows a certain substantial development, we may assume that the one-sided convertibility of banknotes, namely for purposes of foreign trade only, is sufficient for maintaining an effective connexion between the commodity of gold and money in the internal economy as well. The fact remains, however, that what used to be a certainty has to-day become a problem and thus, frequently, a task of banking policy.

Yet this task of banking policy goes much farther. It may remain undiscussed whether the much-disputed and much-misunderstood 'automatism' of the gold standard has ever fully functioned. It is certain that there was no large country in Europe before the War whose gold standard was not regulated by banking policy. In Germany, for example, we have had since last century a discount policy as well as a foreign exchange and open-market policy. The much-discussed 'management' of the gold standard is nothing new, though the problem of counteracting the shortcomings of 'automatism' has since the War become at once more difficult and more urgent. Monetary policy has become something more than an auxiliary to the gold standard; it has assumed fundamental importance. It cannot be shown here what it means in individual cases, as it is different in every country.

The other change which monetary policy has to recognize has already been mentioned. I refer to the limitation of the gold stock. I don't believe that there has been a notable change for the worse in gold production; the ever-increasing process of industrialization in gold mining has made production possible in places where it had formerly been unprofitable; it has brought a continuity of output formerly unattainable; and it has given the cost-factor in production a greater influence upon the volume of output than used to exist. While, therefore, there is no just reason for apprehension in this respect, it will nevertheless be necessary in future to pay more attention than hitherto to this basic defect of the gold standard. Now we have to take into consideration possibilities still remote. Besides the old questions of credit currency without the use of cash, the problem of the quantitative and qualitative cover of banknotes has gained increased importance. To use silver in addition to gold in this connexion seems to me not only devoid of risk but useful.[2]

While, therefore, thoroughgoing changes in the organization of the gold standard are necessary, this does not necessitate a change in the goal of monetary policy. Here the question arises, whether money fulfils its functions best by remaining 'neutral' towards relative prices—as used to be the case before the War—that is to say, if 'changes from the side of money' are eliminated, while 'changes from the side of goods' are allowed to work themselves out upon the price structure; or whether the nature of money calls for a policy of positive action concerning the price system and the stabilization of all prices.

The movement for raising prices 'from the side of money' has spread to a degree unknown hitherto. This is no surprise. Economic life is an everlasting process of adjustment which goes on day after day, hour after hour, in innumerable forms. Each single adjustment is small, but they all combine in one grand total, which is hardly ever perfect, yet normally sufficient. This living organism has been crippled by the War as never before. Maladjustments have accumulated for years without finding a solution, to such a degree that the small natural forces of adjustment are now powerless in face of them. And powerless are, frequently, the arts of men. What is easily achieved in small quantity goes beyond normal powers once it has grown large. The neglect of the prophylactic now necessitates a tremendously difficult cure.

The result is that to-day infringements upon economic life may become necessary, which in times of constant natural adjustment would have been out of the question. The more unusual those infringements, the more painstaking should be the preceding investigation. We must bear in mind that, while most maladjustments are prominently exposed in the price structure, a mere price policy in

[2] This is the case, because a careful utilization of silver makes it possible to avoid shipments of gold for the absurd adjustment of the balances of payment with Asiatic silver countries, and because a stabilization of the price of silver, which is not impossible to achieve, would put an end to gold-hoarding in Asia, or at least reduce it to unobjectionable proportions.

the bulk of cases—there are exceptions—is but a cure of symptoms. The task is normally much greater. It is the task of creating artificially an equilibrium—primarily between costs and prices—which in the normal course of events would have grown organically. Exorbitant profits, no less than insufficient ones, have to be prevented; the new artificial equilibrium must not be rigid; it must be flexible, so that the natural forces of adjustment may resume their wholesome activity. Otherwise a new crisis is bound to develop immediately.

All this goes to emphasize that only careful investigation in every individual case can decide if and to what degree a rise of prices is required. We have no panacea. A rise of prices all round would be ineffective, even if it could be achieved smoothly and without the differences in speed and scope out of which unjustified advantages for one group and unjustified disadvantages for another grow. Such an all-round rise of prices, unless occasioned by increased demand, tends to diminish demand and, thereby, further to widen the dangerous gulf between production and productive capacity. Indeed, every rigid fixation of prices works against progress in the long run. It prevents the lowering of prices through the use of machines and the enhanced demand, and thereby removes the stimulus for the use of machinery.

If the aim of an increased price level is doubtful, the same is true of the means by which it is to be achieved. All of them are sometimes called 'inflation', because they raise prices artificially. Yet they are so different that it is advisable to differentiate between them. It makes all the difference whether the increase of prices is to be caused by an increase in the volume of money circulating or by a devaluation of the currency unit. The former we call inflation in its proper sense; the latter we call devaluation—a phenomenon which in itself has nothing in common with inflation.

III

An increase in the volume of money circulating, unless brought about simply by the issue of paper money, is based upon an artificial expansion of credit. Such credit expansion is two-sided, like every market phenomenon: if it is to be at all effective, an increase in supply has to be met by increased demand. Under normal conditions this is an automatic process, but if the enlargement of supply is artificial a corresponding demand has to be created. Otherwise it may happen that the business community has no use for additional credits. Even if the state uses the new money for the payment of debts or for the financing of public works, it is doubtful—as the United States have demonstrated on the greatest possible scale—whether tendencies are not set to work in other places which bring about a compensatory reduction. The raising of prices through credit expansion is by no means a simple matter.

Even apart from that, credit expansion is more difficult than is generally supposed. We distinguish between a normal and an abnormal expansion of credit. The former is discussed too little, the latter too much, which may be explained by the fact that normal expansion to-day is frequently cramped and needs an artificial support. We talk of a normal expansion when the existing credit facilities are merely used more thoroughly and more fully. Doubt as to the economic soundness may arise if the existing volume of credit is to be not merely more fully utilized, but artificially expanded.

The line of demarcation between normal and abnormal expansion is clearly given under the gold standard. Just as the credit expansion of private banks is limited by the cash reserve, so in the same way the Central Bank is bound by its gold stock. One may even consider it the main object of the gold cover to effect such limitation. It is therefore of the greatest importance that the gold stock should correspond to the economic requirements of the different countries, as used to be the case to a far-reaching degree before the War in all important countries. A gold stock had grown up in close relation to the development of economic life, and monetary policy had no more important function than to maintain its efficiency in this respect. If an expansion of credit seemed economically necessary, this meant that the gold fund had to be enlarged correspondingly.

The limits to a sound credit expansion also exist under a paper currency, but they are not recognizable—and that means almost as much as if they did not exist at all. The choice is between a system where the limitations have a certain rigidity and one where the limitation, not being apparent, is inoperative; and our choice cannot be in doubt since in the one case the rigidity can be mitigated in a number of ways, as experience has shown, whereas in the other case it is not possible in practice to make the limitation more apparent. The drawbacks of a gold standard currency, which lie in its comparative rigidity, disappear in face of the boundlessness which is inherent in a paper currency and which has always led to disaster, unless it had merely a transitory character.

This difference between a gold and a paper currency, however, has during recent years lost much of its previous importance. This is due less to the fact that the paper currency has to accept much of the stern self-discipline of the gold standard if it wants to lead back to it, than to the problems that are created by the fact that too much as well as too little gold cover prevents the formation of a solid basis of credit expansion. This has frequently become a source of danger of inflation or deflation respectively. But I must emphasize again, this is not a characteristic of a sound gold standard, and it is a factor that could be avoided, if the gold standard is to be re-established.

The failure of normal credit expansion after the War is ultimately explained by the international distribution of gold. Before the War gold was distributed according to the monetary requirements of the countries; for the last two decades, however, it has stood under the one-sided influence of the War and its consequences. It is non-economic factors that have brought about increases of national gold stocks to the point of senselessness in some countries, and have equally depleted the stocks of others. At the same time there has arisen an amount of 'vagabonding' capital, which has caused gold to move about in the world as never before, not directed by monetary policies of Central Banks, but exclusively driven by private interests. This movement must be stopped. It seems that the time has come for large-scale international co-operation in this connexion, particularly for the liberal use of international credits which alone will bring the urgently needed results. The fact that a normal expansion of credit was frequently impossible has naturally directed attention to the abnormal, which is justly called inflation. Again we have to differentiate between its different forms in order to see quite clearly.

The non-monetary aims of abnormal expansion can be of a financial character. If a budget deficit cannot be covered either by taxation or by long-term loans, an inflationary expansion of credit may appear as the only way out. Out of this has grown the worst type of inflation, war inflation. As long as the deficit existed, inflation was bound to grow violently. It cannot be corrected or stopped by monetary means; relief can only come from the side of public finance.

There is another milder form of inflation, which is not related to the past, but looks to the future. It attempts to anticipate a more fortunate future for the purpose of mitigating the needs of the present. In such cases everything depends upon the question, whether the expectation of an early recovery is justified or not. The hope, however, so frequently held, that in this manner capital can be created out of nothing, is a superstition like that of the alchemists. If the anticipation of the future proves correct, it is possible through inflation to establish a bridge between the present shortage of capital and future abundance. If it proves incorrect, the resulting over-indebtedness of the state does not lead to a breakdown, as in the case of a private enterprise, but it may well lead to emergency inflation with all its disastrous consequences.

Finally we may have inflation for non-financial and at the same time for non-monetary purposes, mainly directed towards a raising of prices, which is now frequently called 'reflation'. While it is the obvious aim of such policy to achieve an all-round rise of prices, it is in reality a fact of great importance that this cannot regularly be attained simultaneously in all branches of economic life. The price rise normally occurs earlier and more easily in consumption goods than in producers' goods; wages especially tend to follow hesitantly. It is just this difference in the effect which makes such a policy attractive to all those entrepreneurs who find a lowering of real costs, particularly of wages and interest, unduly difficult. It brings about a redistribution of incomes which is bound to carry new disturbances into economic life. The latter could be taken care of, if the situation were such that the profitableness of industry could be restored by this and by no other means. But this seems to be highly doubtful. The stimulus of 'controlled inflation' is active only as long as inflation goes on; the moment 'control' sets in, it is removed. Unless, by the time that point is reached, a considerable strengthening of the economic system has been attained, the removal of the stimulus causes a breakdown, which thus turns out merely to have been postponed. To avoid this evil consequence there will be shouts for more inflation. The outcome is not as inescapable as in the case of a budgetary inflation, for there remains economically the possibility of supervision. But the danger cannot be denied that the same political forces which had successfully pressed for the inauguration of the process will now successfully press for its prolongation.

The conclusion from all this seems to be that the kind of credit expansion which is called 'controlled inflation' is a potent means of 'priming the pump', only under some very definite conditions, namely, when the natural forces of recovery are already very definitely at work. Even then it is only justified if it is of great importance to gain time; otherwise in such cases a 'priming of the pump' will not really be necessary.

There can, however, be no doubt that the normal expansion of credit is far more important than the abnormal, and the main task should always be to make the normal expansion of credit effective, if possible more effective than before.

IV

The phenomenon of inflation which is occasioned by an increase in the volume of circulating media should be carefully distinguished from everything that is concerned with devaluation, i.e. a deterioration of the currency unit. The two have no common logical structure or tendencies.

The deterioration of the currency unit may assume a number of different forms. The metal content of the unit may be reduced, as in the case of the United States, where the dollar has been devalued to 59·06 per cent. of its former value. The greatest deterioration, of course, occurs when the unit is entirely deprived of its metal basis; such suspension of the redemption of notes for gold took place in England on the 21st of September 1931 and marks the step from a gold currency to a paper currency.

Such total or partial 'going off gold' is always followed by a certain depreciation of the currency and, therewith, a rise of prices. Yet the value of money is supported by a number of factors, notably the faculty of 'legal tender' or the general acceptability of money for payments to the state, so that even the removal of one of its bases, the redeemability in gold, will not necessarily cause a proportional loss of value. As long as inflation is avoided, paper money will always maintain a considerable proportion of its former gold value. The amount depends on circumstances. It is also of greatest importance whether the transition to a paper currency is generally considered to be a temporary arrangement, a mere suspension; for then the redeemability, though renounced for the present, remains a possibility of the future, which keeps the price level more or less stable; and it is primarily the varying expectations of the level of future redemption which are reflected in the movements of the exchange rates. In the fact that the gold standard was merely 'suspended' in England lies an explanation of the relatively insignificant rise in prices by which this measure was followed. It quickly appeared as a certainty that the change would relate only to the quantity of the gold content of the pound.

As another alleviating factor in the English situation must be reckoned the fact that not only the different countries of the British Empire, but also a number of other countries, as for instance Scandinavia, have followed the British example. Thus the external depreciation of the currency was prevented from having full influence upon the prices of imported goods since England draws her most essential foodstuffs from the countries of the sterling bloc. The small increase in the average prices of imports has, of course, strengthened the internal general price level.

The English suspension of September 1931, which is but a preparation for devaluation, is very different from the devaluations which have been put through as a consequence of war in such countries as Germany, France, Belgium and Italy. These earlier devaluations merely put a legislative stop to inflation after the financial cause of the latter had finally been removed; they fixed legally what had been achieved practically. The two devaluations, which form to-day the centre of discussion, could almost be called stragglers of war development, originating, as they do, from those two participants in the War who had not decided upon devaluation before. Yet the delay means at the same time a change in purpose. It is not a question of fixing a condition previously attained, but of bringing about a new condition, and it is realized that for that purpose mere devaluation is not sufficient. It is for that reason that England made a virtue of necessity and introduced an intermediate period of paper currency. The elasticity of this arrangement makes it possible to arrive at a new equilibrium between the value of money, prices, and costs carefully adapted to the internal economy by ever-renewed small tentative adjustments, and to provide therewith a solid basis for the legislative act of devaluation. Not before this much-misconstrued task of internal reorganization of the currency system has been fulfilled by every individual country can the further task of achieving international equilibrium be successfully attacked. Only then can we rebuild what had grown up organically during long years before the War and fix the international rates of exchange without any one country attempting to keep the external value of the currency lower than the internal.

The devaluation of a currency produces a number of important effects. It results in an increase in the price of foreign commodities. The internal general price level is raised in proportion to the part played in the internal economy by imports from gold standard countries. At the same time exports are increased—at least temporarily—though this advantage can, as England's policy has shown, be converted into a permanent one. It also reduces the burden of indebtedness, although it depends on the strength of creditors and debtors, as well as on the kind of indebtedness, whether such reductions turn out to the benefit of the national economy as a whole. And since a devaluation of the currency increases at the same time the value of the gold stock, it causes the state to make a 'profit'—of doubtful value, to be sure—which is the larger the greater the size of the gold stock. In the United States it amounted to nearly three milliard dollars.

In a country that does not own a large gold fund this possibility of profit is non-existent. Where a far-reaching alleviation of the burden of indebtedness has already been attained once, the repetition of the process may be dangerous. If exports are already stimulated by other means, this factor, too, loses its attractiveness. Finally, in a country which has other methods of raising prices at its disposal (if indeed this increase is in the interest of the whole nation), no further steps are required. In a country like Germany, therefore, the advantages of devaluation lose much of their weight, at least for the present, where they are heavily overweighted by the disadvantages. If measures of this kind are to be taken into consideration, it can only be because other reasons compensate for the unavoidable losses. Such reasons could only lie in the field of general currency policy.

There are three groups of countries which are of special importance for the future solution of the international currency problem: the gold-standard countries, led by France, the so-called sterling bloc, and the United States, which in many respects are close to the sterling bloc. There can be no doubt that the sterling bloc is by far the most prominent (even without participation of the United States) in its unity, strength and economic importance.

Yet there is no lack of efforts to increase the strength and importance of the gold bloc as well. It would be a regrettable international development if the difference, which has grown up historically, should develop into a lasting and fundamental cleavage. A strong common interest works for agreement, which is not impossible; but this is not an occasion for its discussion.

In retrospect one is naturally reminded of the development of the currency problem in the beginning of the nineteenth century. At that time the old gold-standard system developed after a long period of trial and experiment—a system that was destined to become decisive in the end for the currency organization of all civilized countries. To-day England lives again in the middle of such a period of conscious transition, where voluntary and unvoluntary decisions, creative action and mere 'muddling through' are combined in one indefinable whole. It is not a matter of realizing dogmatic notions but of crystallizing the inherent logic out of the facts and conditions of our day. The final result already becomes noticeable in its rough outline. It will not be a copy of the old. It will be, as once before, the fruit of an entirely new set of conditions.

It is to be hoped that the result is not too far off. The recovery of international trade depends on the international recovery of the currency system; it is an essential for the strengthening and prosperity of agricultural import countries no less than for agricultural export countries. The first necessity, however, is to clear the international debt and credit system of the dangers that have arisen out of the War. Other prerequisites for the solution of the international currency problem are not necessary provided there exists a good will for co-operation. The reorganization of international trade and of international currencies can only proceed simultaneously. Both issues cannot be solved at once. If the new is to be durable, it will grow out of small and careful beginnings. It is to be hoped that men may not be lacking who combine such far-sightedness, efficiency, and patience as are indispensable for the achievement of the great goal.