THE VALUE OF MONEY

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The subject I am going to talk about to-day is the value of money. It can be a very complicated subject if one dots all the "i's" and crosses the "t's", but at the outset of my remarks I think I should warn you - particularly any economists who happen to be in the audience - that my approach will necessarily be that of a layman.

This subject has, I think, attracted more attention in the United States and Canada during the last year or so than ever before, in time of peace. The attention has in the main been concentrated on the fall in the value of money which has taken place within the last eighteen months and on the risk or probability of further declines in years to come.

Inflation is the word commonly used to describe the phenomenon, and without pausing to give an exact economic definition of the word, I will use it frequently in the course of my remarks.

We can all recall that inflation was a cause of great concern during and immediately after the two great wars, as well as during the rapid build-up of defences at the time of Korea. The concern was by no means academic, because a major decline in the value of money in fact took place between 1914 and 1920 as well as in the 1939/49 period. Korea dealt a smaller but not insignificant blow to stability.

It seems to me that there is a great difference between these happenings and the current expectations or fears of inflation. On the earlier occasions, there was a widespread feeling - at least in countries such as the United States and Canada - that the reductions in the value of money which took place - painful as they were for many people - were a result of the overpowering financial strains of war and not to be regarded as a continuing hazard in times of peace. There was good reason for Canadians and Americans to hold this view, because then indices of cost of living and wholesale prices in 1939 were lower than they had been almost twenty years earlier. After the upward movement of prices following on the last war, and the further flurry caused by Korea, we had stability in the indices for nearly five years - rather an uneasy stability for reasons which I won't touch upon, but nevertheless one which gave encouragement to the belief that continuing inflation was not in prospect. Nowadays, when so many people seem to have the impression that the value of money has been going down in war and in peace for many generations, and that there is something inevitable about the process, I think it is worth while to remember that this has not in fact been the case in countries which have any claim to fiscal and monetary responsibility, except as an adjustment to the financial consequences of war.

The better informed people who hold the view that a more or less steady erosion of the value of money will take place, even without war, base their case not on the past - at least not on the history of the last 150 years - but on major changes, social, political and economic which they believe to have taken place in fairly recent times. They point first to the responsibility publicly assumed by governments for maintaining full employment - a commitment unthought of fifty years ago. The second factor to which they attach importance is the great increase in the strength of organized labour. The argument is then made that under conditions of full employment, trade unions will demand, and will receive, increases in wages and so-called fringe benefits greater than increases in the productivity of labour; and employers will recover any net increase in costs by charging higher prices to the consumer. It is assumed that credit will be expanded by an amount sufficient to finance business at the higher price levels; and that if ever business should falter and unemployment increase, governments will take decisive steps to restore the situation. Such steps would presumably include the acceptance of sizable deficits in public accounts, and further expansion of credit. Thus it is argued that even if there are intervals during which prices remain stable or decline slightly, government policy will turn to inflationary measures to encourage a return to full employment and, as a by-product, a resumption of the rising price trend.

It should be noted that those who think continuing inflation is inevitable or even necessary do not regard it as a good thing, but rather as less evil than possible alternatives. One alternative which they have in mind is a situation in which demand is not pressing on supply, employment is less than full ~~and~~ and credit policy not inflationary. Wage increases would of necessity have to be restrained, because increased costs could not be passed on to the consumer. It is assumed that in these circumstances, there would be a political swing to the left, particularly on the part of trade unions, and governments would be found willing to countenance and support inflation or perhaps turn to direct controls in an effort to combine full employment with some degree of stability in prices. So it is argued that it would be better to accept inflation - preferably creeping inflation - in the first place, rather than make an abortive attempt to avoid it.

In the course of this argument, we leave the field of economics and get in to the field of human behaviour, because it is necessary to prophesy what the reaction of the majority will be to a given set of circumstances; and that is a very risky game, unless one goes to extremes in setting up the circumstances. For example, I think it would be quite safe to assume that massive and continuing unemployment on anything like the scale of the thirties, would produce formidable political reactions and adoption of policies of the kind I mentioned a moment ago. But can one assume that the same thing would occur if unemployment at times rose moderately above the average level of the post-war years? Government figures have put this at about 3.8% of the working force in the United States and 3.1% in Canada. The Canadian figure of course includes seasonal unemployment, which is much more of a factor in this country than it is in the United States. These unemployment figures have generally reflected a situation in which some unemployables are listed, plus others who are in the course of changing jobs and are out of work for only a brief period of time. Can unemployment go no higher than this without forcing the adoption of policies which impose on everyone the penalties of continuing inflation? No one can give a categorical answer to that question, but there would appear to be something farcical about a system which penalized one hundred per cent of the people in the hope of gaining some benefits for a changing group of say two or three per cent of the working force. To me, however, that is not the weakest point of the argument. The proponents of inflation as a lesser evil have to specify that it should be creeping inflation-sometimes defined as an increase in prices averaging two or three per cent per annum over the years, at least sufficient to halve the value of money within a generation. They are bound to reject a more rapid inflationary movement, because they recognize that this would produce a boom and bust situation - and hence at times a heavy degree of unemployment. To support the notion that creeping inflation is practicable, they contend that business competition, and a suitably restrictive monetary policy when booms are under way, would keep price increases within bounds.

Some of the people who think inflation is inevitable are a bit dubious about its creeping quality, and are led to suggest that the injustices of a constantly rising price level would be less unfairly distributed if wages and salaries were tied to some cost-of-living index - with a certain lag. The same arrangement would apply to social service payments and state pensions. Bonds would have payments of both interest and principal linked to the cost-of-living index. It is admitted that such measures would cause prices to rise faster than they would otherwise have done; but the objective would be to ensure that all parties were more or less equally cheated by the fall in the value of money. I assure you that I am not inventing these suggestions. They have been seriously made by people who are not wild-eyed cranks.

I have presented in simplified form what I believe to be a fair sample of the views of those who think that continuing inflation will take place and who regard this process as less objectionable than any practicable alternative. Perhaps I have done so at unnecessary length but I make no apology, because I think this is a matter which deserves to be taken very seriously. There is no denying that the political and social ideas on which the structure of our modern society is based have implicit in them a bias towards inflation.

I need hardly say that a formidable body of opinion is against the view that continuing inflation is either inevitable or is the least of any number of evils. I hope the opponents are right; and I believe they are. For one thing it seems to me that if inflation even so called creeping inflation not caused by war were to continue for a certain time, and more important if people felt that Governments and central banks were displaying tolerance rather than active opposition, a run from money would develop. It is all very well to suggest - as one prominent economist has suggested - that if people lose faith in bank deposits and fixed interest investments as vehicles for their savings, they will or should be content to put their money into real estate or the shares of mutual funds - or even increase their purchases of insurance to offset the lower value of the currency in which their death claims or annuities will be paid. Surely this underestimates the intelligence of the public, and the lengths to which they would go in an effort to protect themselves against inflation. Only a small minority would succeed in coming out ahead in a financial sense, but the majority would try hard and with considerable ingenuity - at least that has been my repeated experience of public behaviour in situations of this kind at other times and in other countries.

I believe that the lessons learned in the thirties, and the many changes which have taken place since that time in the financial and economic structure of countries such as Canada and the United States, will enable governments and central banks to prevent a repetition of the great depression, or anything remotely resembling it, provided, but only provided, that serious inflationary booms are avoided. If governments had to contend with the aftermath of such a boom, they would have a hard time getting things going again; and that is when the political consequences of failure to avert inflation would become apparent.

It should be remembered that no one contends that it is impossible to prevent inflation.

As the London Economist said in an article published six years ago "the proposition that inflation is inevitable is not an acknowledgement of economic determinism but a political judgment that the will to control it has disappeared". They went on to suggest that while the political will is obviously and lamentably weak, the right course for those who see realistically the strength of inflation is not to accept its inevitability but to do all that can be done to strengthen the will to stop inflation before it is too late.

At this point, I would like to depart from what I might call the hard core of the argument on inflation and take a look at one or two of the by-products. One of them is the advice so freely given in the last year or so to buy common stocks as a hedge against inflation. I am sure that those of you who are in the insurance business have quite frequently heard the view expressed that fixed interest securities and savings or endowment policies have lost some of their virtues as a repository for savings - equities are the thing. We have recently been reminded by the behaviour of markets that indiscriminate purchase of common stocks is not always a sure-fire method of building up capital. Indeed, I am very dubious about the efficacy of equities as a hedge against inflation in a country whose currency is steadily losing value. For one thing, this produces a situation in which a crash can take place. For another, the political tax gatherer might conceivably sharpen his weapons to try to prevent the owner of equities from profiting from inflation, at a time when the general public was acutely conscious of the ever rising cost of living. Common stocks of good enterprises are likely to produce the best results for shareholders, not in a country which is constantly inflating, but in one which maintains the value of its currency and so encourages sound development. This may be rather a platitudinous observation, but I confess to taking a dark view of those who brush aside the problems of the small saver if inflation is continuous, and cheerfully advise him to concentrate on real estate and common stocks.

Another interesting field to examine is

that of international trade and financial relationships in an era of continuing inflation. It could hardly be expected that each country would keep in step with the others. Devaluations would become even more common than they have been in post-war periods; and they would of course be preceded by substantial transfers of capital to countries which seemed at the moment to be putting up the best battle against a fall in the value of money. Even the United States would not be immune to a run, if it were thought that their government had succumbed to the notion that creeping inflation was acceptable. I well remember the run they experienced twenty-five years ago, at a time when foreign short term claims on the United States were infinitely smaller than they are to-day.

If upsets of this kind plagued the major countries, I should think they would work against the maintenance of a high level of employment; and they would certainly make nonsense of collaboration in strength between the leading countries of the free world.

Being an optimist, and having in mind what I believe to be the disastrous consequences of losing the battle for standards of value which will command public confidence over a considerable area of the free world, I look for arguments to refute the pessimists. I derive encouragement from the fact that not all the social and economic changes which have taken place in the last generation have inflationary implications. One of the changes which should contribute to a desire for stability is the great increase in, and much wider dissemination of, personal savings. I refer not only to savings in the form of bank deposits and life insurance, but perhaps most important of all in the form of prospective pensions. Those who have no savings find it hard to attach great importance to a decline in the value of money. But there is a large and growing number of people - certainly in Canada and the United States - who have a real stake in the future of their currencies, and who are far from incapable of understanding how a major decline in the value of money would affect their interests. They may not yet be an effective fighting force, but at least the saver or prospective pensioner no longer belongs to a small minority which can easily be forgotten, or which would remain content if an annual two per cent rise in prices reduced the value of their saving by a third every twenty years.

Current discussions of inflation often refer to it as the "cost-push" type; and as labour is a very important factor in costs, price increases more often than not are attributed to the successful efforts of labour unions to secure wage increases greater than increases in output per man hour. Labour, quite properly I think, resents being saddled with a large share of the blame for the lower value of money. They are certainly not responsible to any greater degree than all the rest of the population for what occurred during and immediately after the two world wars. It is not worth while to argue about the extent to which increases in wages in excess of increases in the productivity of labour have contributed to the rise in the cost of living during the last year and a half. It is the future which counts; and the fear undoubtedly exists that labour is the only group in the population with sufficient economic power and political influence to persuade governments that acceptance of inflation is preferable to anything less than full or overfull employment. In recent times, leaders of government in the United States and the United Kingdom - to mention only two examples - have had occasion to appeal for restraint on the part of labour and business - labour in formulating its wage claims and business in raising prices. While such exhortations are no doubt useful in focussing public attention on the problem, I doubt whether they have any immediate practical effect. How could they? In any specific negotiation, labour leaders must get the most they can for their supporters; and a business, if it is going to survive, must strive for a satisfactory return on capital. It is only when the consumer cannot readily be saddled with increased costs, that restraint must be observed - not as a result of exhortation but as a matter of necessity. But here is the Achilles' heel of governments. If they and their central banks are unwilling to promote and finance a continuing boom with rising prices and rising costs of living, they are likely to be accused of deliberately creating unemployment. And it is a bold government which will say that if so called full employment (which in effect is often overfull employment) inevitably spells inflation, then employment will have to be something less than full in the interests of the nation as a whole. These considerations are by no means academic. They are a matter of immediate practical concern in the United Kingdom, and they may come to the forefront of the scene in Canada and the United States if a tapering off of the boom causes trouble during the next year or so, and inspires demands for a return to the conditions which prevailed in 1956.

I do not pretend to know what solutions to the problem will be worked out over the years. As I mentioned earlier in my remarks, questions of human reactions and behaviour are involved and on these subjects no one can afford to be dogmatic. Public opinion, not only in our own country, but in other countries with which we are closely associated, will dictate the course of events. In a matter as tricky as the economics of inflation, there is a risk that some of the people can be fooled some of the time, and that acrimonious and harmful debate can take place about the apparent interests of different classes. One must hope for the best possible leadership, not only from governments, but from representatives of all important sections of the community. In a situation of this kind, each one of us can make a modest contribution. Indeed I am sure that those who are in the business of selling insurance to great numbers of our people can make more than a modest contribution to the formation of public opinion on the subject of the value of money.