

# STATISTICAL AND SOCIAL INQUIRY SOCIETY OF IRELAND.

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## MONETARY POLICY AND THE DEPRESSION.

By DR. GEORGE O'BRIEN.

*(Read on Thursday, 5th October, 1933.)*

Every period of falling prices gives rise to considerable discussion regarding monetary theory. The depression following the Napoleonic war evoked some of Ricardo's most original thought, the falling prices of the eighties were the occasion of the controversy on bimetalism, and the crisis of to-day, true to type, has aroused a widespread interest in the working of the monetary and banking machine. Discussions of this nature usually produce more heat than light, more chaff than wheat; but they nevertheless serve a useful purpose in so far as they lead to the refutation of fallacies and the exposure of error. The progress of every science depends upon the free publication of opinions of all kinds, and even the heresiarch contributes unintentionally and indirectly to the discovery of the truth.

It is not surprising that the monetary controversy should wax loudest during periods of depression, because it is at such times that everybody is seeking to discover the cause and the remedy for the prevailing discomforts. The economic mechanism is obviously out of gear, and it is an easy solution of the trouble to blame the lubricant. Before, however, arriving at a hasty conclusion, one should pause to consider whether it is not unreasonable to attack the monetary system that worked with apparent ease and success when trade was good. Did not the same monetary system, that is now the subject of such bitter complaint, amply suffice to support rising prices and advancing prosperity in earlier years? The lubricant is unchanged; why should it have ceased to work?

In spite of their differences on other matters, practically all economists would agree in answering this question. The evils of the depression, they would say, are but the reaction from an unhealthy expansion, and this expansion was caused, partly at least, by the failure of the monetary machine to act as a brake. In so far as the depression had its origin in monetary causes, they would proceed to explain, the mistakes in policy took place during the period of industrial prosperity, which was allowed to advance immoderately owing to the undue creation of credit by the banks. The inconveniences of the slump are the inevitable consequences of the boom, and it is now too late for monetary manipulation to afford any substantial degree of relief. Society is experiencing the morning after the intoxication of the night before: it is too late to urge temperance in indulgence, and the physician must fall back upon the administration of soothing and sedative drugs.

If this opinion be correct, it would appear that no mere monetary or banking policy can restore prosperity to the harassed world. It does not, therefore, follow that the controversy which the depression has aroused is useless or otiose. On the contrary, monetary science has made very rapid advances in recent years, and it is unquestion-

able that the working of the financial machine is better understood to-day than before the onset of the great depression. It is probably true that the time for the practical application of the new theoretical developments will be when prosperity begins to recover. The morning after is not entirely wasted, if it gives rise to good resolutions which are honestly observed. It may not, therefore, be an inappropriate time to call attention to some aspects of modern monetary theory, which are not without a bearing upon the contemporary situation.

It was the custom of the older generation of economists to work out a theory of value under conditions of barter and, at a later stage, to introduce the conception of money. In the early or barter part of the discussion, money was not altogether ignored. The discussion was usually conducted in terms of prices expressed in money, but the money was assumed to be "stable" and therefore unable to influence the real underlying process of barter that was being described. It was usual to explain that money was a veil, that partly concealed the movements of the body underneath. The veil, however, could be assumed and discarded at will, to suit the convenience of the theoretical exposition.

A modern economist would feel coerced to reject this procedure. Money is not a veil but a skin, not a garment that can be donned and doffed but a vital part of the body itself. The adoption of a standard in the terms of which a large number of payments are measured and expressed fundamentally alters the nature of the whole economic process. Divergences between real and nominal rates of interest and wages and between the monetary and natural rates of interest are seen to involve the most important consequences. It has been suggested that the introduction of money deprives economic life of its equilibrating mechanism, and that the divergences to which we have just referred tend to produce disequilibrium rather than to restore equilibrium and render certain price movements self-inflamatory rather than self-corrective. Credit is alleged to be inherently unstable. It is obvious that if these suggestions are valid, the old transition from a barter economy to a money economy must be entirely abandoned.

Another subject to which much attention is devoted is the effect on the economic system as a whole of injections of new purchasing power at any point. The creation by banks of credit in excess of the amount which the community is actually saving confers additional purchasing power on the recipients, who may, as producers, increase their expenditure on capital and labour, or, as consumers, on new finished commodities. In either case the new purchasing power will work its way through the whole system. The investment expenditure of producers soon finds its way into the hands of wage earners who increase their purchases of consumers' goods, while new consumption expenditure gives rise to industrial expansion with a resulting increase in the demand for capital and labour. This absorption of new purchasing power may, however, be a long and tedious process, and may produce many maladjustments during its course. In particular the demands for the different categories of goods and services will not expand at the same speed or at the same time, and divergences between different prices will tend to appear.

Divergences of price levels are of course fundamentally important in the working of the economic mechanism. The older economists

are now accused of having paid undue attention to averages in the form of index numbers, which frequently conceal the really significant movements. The well-known antithesis between relative movements in the prices of particular commodities and movements in the general price level is unduly simple to the extent of being misleading. The only important price movements are all relative, it may be between single commodities or between groups of commodities, or between commodities at different stages of their manufacture, or between commodities as a whole and other things, as for example services and securities. The point is that averages, however carefully weighted, may mislead unless used with the greatest caution, and that even the most perfectly constructed index number does not reveal many of the facts relevant to economic discussion, namely, the relative movements of the articles of which it is composed.

Thus divergences between the price levels of goods that enter into international trade and of goods and services that are the subject solely of domestic commerce have vital reactions on a country's external trade and on the external and internal values of its currency. The fact that wholesale and retail prices do not move simultaneously or equivalently is well known. Raw materials, semi-manufactured goods, and manufactured goods tend to respond to a common impulse at widely different rates, while the price level of capital goods is apparently more sensitive than that of consumption goods. Ordinary shares and fixed interest securities frequently move in opposite directions, and the price of labour is notoriously insensitive in certain conditions. Different rates of movement of selling prices and costs are of the utmost importance to every farmer, manufacturer and trader.

Any divergence between price levels is capable of producing profound maladjustments, which, if not corrected, may lead to depressions and crises. Yet, many of them may be concealed from view if reliance for purposes of observation is placed solely on averages or index numbers. The suggestion made by the older economists that a theory of value in conditions of barter could be constructed in terms of prices on the assumption of a stable value of money cannot continue to be accepted in light of the fact that a stable average price level may conceal serious forces tending towards disequilibrium. It is for this reason that modern writers have proposed substituting the assumption of "neutral" for that of "stable" money in the exposition of the general theory of value. Whether any system of money that would be completely neutral could be devised is open to question, but the conception of a neutral money is convenient for the purpose of theoretical analysis.

The failure to distinguish between stable and neutral money has been responsible for many dangerous fallacies. The matters referred to in the preceding paragraph might be dismissed as mere inelegancies of no interest except to students of pure economic science. But the notion that a stable price level should be the ideal of practical monetary policy might produce—possibly already has produced—serious consequences to the whole world. Attempts to keep prices stable during periods of increasing efficiency and productivity may amount to a concealed inflation and may encourage an unhealthy expansion followed by a collapse. During such periods, the price level should perhaps be allowed gradually to fall, with the object of preventing abnormal profits and of enabling the

possessors of fixed money incomes to share in the benefits of industrial progress. These are difficult and highly controversial questions which it is not our purpose to discuss: all that is required to be demonstrated is that stability of prices, assuming that a satisfactory index number could be found, is no longer admitted without question to be the end of monetary policy.

Possibly an insufficient degree of caution in the use of averages led the older economists to underestimate the importance of the relative price movements of particular commodities. Such movements were said to be self-corrective, and therefore of no consequence except to the particular producers concerned who had made abnormal profits or losses. But it must not be overlooked that changes in the relative prices of particular commodities may affect the distribution of the national income in such a way as to alter the relation between expenditure on capital and consumption goods or between spending and saving. Moreover, severe falls in the price of important commodities of inelastic demand may produce such a deficiency of purchasing power as to initiate the process known as the vicious spiral of deflation. It is arguable for example that changes in the demand for and the supply of wheat have been largely responsible for the existing depression. The line between particular and general prices is sometimes hard to draw; here as elsewhere in economics *natura non facit saltum*. The individual entrepreneur is consciously interested only in the price levels of the articles which he buys and sells. Each business man has his own little index numbers to the movements of which he is fully alive; he is comparatively indifferent to those major movements of larger groups of prices, the results of which so vitally affect him, and which he himself is unconsciously assisting to influence.

With the blurring of the clearcut distinction between changes in particular prices and changes in the general price level, it becomes more difficult to distinguish between monetary and non-monetary factors affecting prices. At one time, it would have been safe to assert, subject to certain well-understood qualifications, that relations between particular prices were caused by non-monetary, and changes in the general price level by monetary influences. Furthermore, by monetary influences was generally understood changes in the amount of money. Of course the importance of changes in velocity of circulation and in the structure of the banking system were not ignored, but the main emphasis was laid upon changes in the amount of money. The price level was stated to depend principally on the relative rates of growth of money and trade, and falling prices in particular were ascribed to a shortage of the medium of exchange. These views are widely held at the present time by public opinion, which looks to an increase in the supply of money as the certain remedy for the prevailing depression.

In regard to long period or secular changes in the general price level, it is unquestionable that the supply of money is a factor of the first importance. The well-known swings in the price level which occurred during the nineteenth century are explicable by the changes that took place in the output of and the demand for gold. Moreover, assuming that the gold standard is again restored, the future supply of gold may be a matter for anxiety, although economies in the use of the metal by means of lower reserve ratios and the adoption of exchange standards may neutralize any tendency towards a falling

price level caused by the slowing down of the output of the mines. It is generally agreed that no such shortage threatens in the immediate future, and that the breakdown of the gold standard in recent years is the result of the maldistribution of gold caused by the disequilibrium in the world balance of international payments. It cannot be seriously contended that the colossal fall of wholesale prices of the last four years was in any way caused by a deficiency in the supply of the monetary metal.

Nor can it be suggested that credit has been in any way restricted. In Great Britain and Ireland for example, the volume of bank deposits has increased since 1929, while wholesale prices have continued to fall. Apparently the price level and the amount of money have moved in opposite directions. This would appear to conflict with all the conclusions of *a priori* reasoning, and some explanation is obviously required. The explanation is that the mere figures of bank deposits tell us nothing in themselves; they are mere aggregates and, unless their internal composition is revealed, obscure rather than clarify the monetary situation. Aggregates are as fallacious as averages when incautiously or uncritically used, and many of the fallacies that have arisen in monetary science have been due to their indiscriminate employment.

The important statistics necessary for understanding the operations of the banks are the ratios between time and demand deposits and between investments and advances. The former ratio determines the distribution of the banks' liabilities and the latter that of their assets. Changes in the ratio between time and demand deposits indicate the action of the public in regard to saving and spending, and are the best available index of the velocity of circulation in the community corroborated and possibly corrected by reference to the clearing statistics. Changes in the ratio between investments and advances indicate the extent to which the banks' assets are employed in providing working capital for industry and trade. The last four years have witnessed a decline in the ratios of demand deposits and advances, movements which are normal during a period of falling prices and bad business. The manner in which the resources of the banks are utilized is far more significant than the mere volume of the resources in relation to industrial activity and the price level. But it is only the latter, namely the quantity of resources available, that the banks can themselves completely determine; the manner in which the resources are utilized depends mainly upon the decisions of their customers. The banks can provide abundant water, but they cannot make the unwilling horses drink.

The total resources of the banks depend upon the amount of cash at their disposal and their ratio between cash and deposits. The amount of cash is determined almost altogether by the policy of the central bank, while the ratio is fixed either by legislative regulation or by the banks' own prudent discretion. The distribution of deposits between time and demand liabilities depends entirely on the decision of the banks' customers, while the distribution of assets between investments and advances also depends, though not to the same extent, on the dispositions of the public regarded as borrowers. The banks can influence these decisions within certain limits by their policy regarding rates of interest, but the amount of influence that can be exerted by this means tends to be exaggerated in popular discussion.

The extent to which high interest rates can succeed in discouraging borrowers when prices are rising and trade is good is the subject of a good deal of disagreement. It is obvious that when a boom has developed, very high rates will not prevent borrowing on the part of speculators who anticipate large capital gains. Even in the earlier stages of an upward movement, the mere rate of interest on loans may fail to damp the optimism of business men. It is, therefore, generally agreed that the raising of rates should be accompanied by quantitative rationing of loans and possibly by a certain amount of qualitative selection. Of course, the rate allowed on time deposits practically always moves in the same direction as the rate charged on loans, and a higher rate therefore enhances the attractiveness of leaving money idle. It is possible to conclude that the banks possess the power, by means of these rates and other weapons at their disposal, to restrict credit within reasonable bounds and to prevent an unhealthy expansion of business activity.

It by no means follows that a contrary policy of low rates and plentiful accommodation will succeed in retarding a slump and stimulating activity during a period of business contraction. Borrowers will not be tempted by any terms however generous if they have no reason to anticipate anything but losses, and savers will not be driven out of the comfortable security of their time deposits by any lowering of the rates of interest they receive. It is of course arguable that negative rates would drive even the most timid depositor to utilise his resources in investment. Negative rates, while conceivable in theory, would not be possible in practice, because they would simply lead to the hoarding of currency. It is to counter this danger that proposals have been advanced for the introduction of a currency that would itself carry negative interest by its having to be stamped at short intervals to keep it alive. The adoption of such a currency would simply lead to the hoarding of something else, probably gold or other precious metals. No device has yet been invented to make the hoarder dishoard.

That cheap money is by itself unable to reanimate business activity must be admitted in the light of both reason and experience. The leading advocates of a policy of cheap money are apparently in agreement with this opinion, because they have recently added to their programme a vast expenditure on public works to be financed by borrowing in order to stimulate investment. This new proposal is something quite different from the well-known suggestion that public expenditure should be increased in times of bad trade and reduced when trade is good with the object of reducing the fluctuation in production as a whole. The new proposal is based on the assumption that the investment by public authorities will increase the demand for capital and labour to such an extent as to stimulate private investment in its train, and thus break the vicious circle of the depression. It is to act in the expression of its German advocates as an *initialzündung*, an initial ignition that will relight and revive economic activity.

The advocates of public expenditure on a large scale have many followers and many critics. The answers which they have furnished to various objections directed against their proposals have not been very convincing. The nature of the public works to be undertaken has not been clearly defined, and the narrow range of purposes for which public borrowing may be properly incurred has scarcely

received adequate recognition. It is conceded that the planning and initiation of a suitable programme of public investment would occupy a considerable time, and that the beneficial effects on employment and trade would be felt but gradually and tardily. Moreover, it has not been made clear how long such outlay should be continued. If it is to be continued indefinitely, the borrowing will assume immense proportions; if it is to be of short duration, its discontinuance will give rise to a fresh problem of unemployment.

The financial consequences of these proposals are to some extent obscure, and, in so far as they are not obscure, they are disquieting. It is probably not correct to object, as has been objected by certain critics, that the effect of public expenditure would be to raise costs against the private investor. This objection is scarcely valid to-day when society is suffering from agglomerations of idle resources for which the private investor is not prepared to pay any price whatever. It is possible, however, that extensive borrowing by public authorities would tend to raise the rate of interest, with the result that the date of the revival by means of renewed private investment would be delayed. While it is true that cheap money by itself will not stimulate recovery from the slump, it is no less true that cheap money is an indispensable condition of recovery as soon as the other factors in the situation are favourable, and that any increase of interest rates by the creation of an artificial demand for loans would retard the natural convalescence of the industrial system.

A further important objection to an extended programme of public works is the budgetary difficulties to which it would undoubtedly give rise. Nobody suggests that more than a small part of the new expenditure would be productive of a direct financial return. The greater part of the outlay would be in no sense self-liquidating and would involve national or local taxation for the additional debt service which it would involve. Nobody would be so foolish as to suggest that no public expenditure that is not directly remunerative should be undertaken. Such a proposition would amount to a denial of the principal functions of the State. But at a time like the present, when the world is reeling under the burden of existing debt, further deadweight debt should not be incurred except with the most extreme caution and deliberation. Casting out Satan by Beelzebub is proverbially an illogical proceeding.

The advocates of public works are alive to these difficulties. The increased expenditure, they argue, will automatically increase the public revenue, because it will increase the incomes out of which all taxation is paid. To the objection that such results will take time to emerge, the answer is made that the old practice of annual budgets must be abandoned, and that a longer period must be adopted as the unit for public finance. This amounts to a proposal that budgets in the immediate future should be unbalanced in the hope of a surplus emerging in future years. The effect of such a change in financial procedure might, however, be unfavourable if it weakened the confidence of investors in the security of the public debt. Such an attitude of distrust would raise the price that would have to be paid for loans, and by increasing the prevailing rate of interest, would still further retard the process of normal recovery.

It is apparent that the case for an extensive public expenditure requires further proof before being adopted. The benefits of the proposal are conjectural, and injurious reactions might be produced.

The raising of the rate of interest would deprive industry of an indispensable condition for healthy natural revival. Mere cheap money, however, will not in itself stimulate recovery until the situation is favourable for its employment. At the present time money is suffering from unemployment; large sums are idle and cannot find employers at any price however low. The reason is obviously that no hope of profit is possible for borrowers until equilibrium has been restored in the price system. The severe fall in the wholesale price of foodstuffs and raw materials has reduced almost to vanishing point the purchasing power of primary producers all over the world; while retail prices and the price of labour and other services have failed to fall in proportion. The manufacturer is between the devil of reduced demand and the deep sea of rigid and inelastic costs. The essence of the existing depression is this disequilibrium between different groups of prices. The crisis is the result not only of the fall that has taken place in some prices, but also of the failure of other prices to fall sufficiently. In order that this maladjustment may be resolved, either the prices that have fallen must be raised or those that have failed to fall must be reduced. Which alternative promises the more hopeful results?

Many influential economists strongly advocate that attempts should be made by means of appropriate monetary policy to raise the price level of primary commodities. Such a proposal is full of unsolved and insoluble difficulties. The prices of all primary products have fallen by different amounts and for different reasons. Here again the incautious use of averages conceals the realities of the situation. Some commodities have fallen moderately, others disastrously, not two by the same amount. In some cases the fall was due to over-production, in others to unsuccessful attempts at valorization, in others to technical improvements. How could the path traversed by these innumerable single prices be retraced? What conceivable monetary policy could distinguish between desirable and undesirable increases? At what point of the system would the new purchasing power be injected? Is the problem of monetary unemployment to be solved by swelling the ranks of the unemployed? These and many other similar questions have been frequently asked but never satisfactorily answered.

Assuming that some action in the monetary field were capable of raising the price of primary commodities as a whole, to what level should they be raised? The answer usually given is that the price structure was in equilibrium in 1929, and that the aim should be to restore the price level of that year. What appears to be overlooked by the advocates of this proposal is that it is quite impossible to undo the millions of events that have happened in the economic life of the world in the last four years, and that a price level of raw materials that was appropriate in 1929 would be quite inappropriate in the utterly changed conditions of to-day. For one thing, costs of production in many branches of agriculture and mining have fallen considerably, and the normal price that would enable many commodities to be produced at a profit to-day is much lower than the actual or the normal price in 1929. To raise the price of such commodities by monetary policy—assuming that such a thing were possible—would be grossly inflationary, and would give an irresistible impetus to their over-production, while depriving the consumer of the benefits of technical progress. The fact probably is that in the



case of many primary commodities, quite a small rise from the present price level would enable production to be profitably undertaken, and that an appropriate rise would appear in the early stages of a natural industrial recovery.

Such a revival depends very largely on the restoration of profitable conditions of production in manufacturing industry which would stimulate the demand for all kinds of primary products. The failure to realize profits in manufacturing industry to-day is to a great extent the result of the slowing down of output. Overhead expenses in large scale production become very onerous when the machine is not working to full capacity. The good effects of any revival of trade will therefore tend to be cumulative. With every expansion in output overhead costs will become relatively lighter, and every increase in the scale of operations brings the opportunity of further economies in its train. Assuming, therefore, that trade once begins to recover, profits will grow rapidly, and the whole system will benefit, so to speak, at compound interest. The beginning of such a revival depends upon the reawakening of the hope of profit among investors, which in its turn depends on the reduction of the level of existing costs.

The cost of capital has already engaged our attention. The world is encumbered with an unprecedented load of unproductive debt, both public and private; and a drastic process of liquidation is obviously necessary. The problem of international debts is being solved by settlements, moratoria and repudiations, and industrial and agricultural indebtedness is being largely written down or written off in the books of the creditors. The liquidation of hopelessly insolvent enterprises is an unpleasant necessity, the delay of which, through the mercy or the optimism of creditors, impedes the recovery of their more healthy competitors, and retards the process of rationalization which should aim at concentrating production in the most efficient units. The fall in interest rates in recent years has enabled a large amount of debt to be converted, and many industries have already improved their position substantially by the reduction of their debenture liabilities. The price of new capital is very low. Governments could probably lower it still more by improving the international situation by reasonable measures of political and economic disarmament, while, on the other hand, they might raise it against investors by further unproductive borrowing.

The peculiar difficulties of agriculturists all over the world in regard to the growing burden of their debts caused by the fall of agricultural prices give rise to a special problem calling for special treatment. Sympathy with the hardships of this afflicted class is undoubtedly responsible for much of the widely felt desire that prices should be raised by any possible means, and the distinction is not sufficiently drawn, even in well-informed discussions, between price-raising with the object of relieving debtors and with the object of reviving trade. If a determined effort were made to relieve the burden of agricultural indebtedness by public assistance, the campaign in favour of raising prices would lose one of its attractions and many of its adherents.

Wages in recent years have been notoriously rigid, and the index number of wages has not fallen as rapidly as either the wholesale or cost of living index numbers. Here again averages are misleading, and, if the internal composition of the wage index number is

examined, it will be seen that in some trades wages have fallen considerably more than in others. The distinction between the sheltered and the unsheltered wage earners is well known, and it must be admitted that the rigidity of the sheltered wage level has helped to prevent costs from falling in the sheltered trades, and in other trades as well to the extent that they have to make use of the products of sheltered labour. It is well known, for example, that the high costs of railway transport, houses, and retail distribution are to some extent caused by the high wages paid on the railways and in the building industry and the distributive trades. It is, therefore, arguable that a greater plasticity in certain wages rates would ease the industrial situation.

Any suggestion that wages, even in certain narrow categories, might be advantageously reduced is usually met by the argument that a reduction of wages amounts to a reduction of purchasing power in the community and would, therefore, deepen rather than relieve a depression. This view is so widely held and is so superficially attractive that it must be refuted, as it is responsible for many misapprehensions in discussions on monetary policy to-day.

Regarded from the point of view of the recipient, wages undoubtedly constitute income, and they do in fact constitute the most important part of the national income and spending power of every industrial country. Regarded, however, from the point of view of the employer wages are no less certainly costs. Nobody will argue to-day that badly paid labour is cheap or that well paid labour is dear; the economy of high wages is fully recognised, and a rising wage level is accepted as a sign of economic progress. Nevertheless, it must equally be admitted that in periods of severe disequilibrium, when all prices are moving downwards and the price of certain grades of labour is practically immobile, high wages can continue to be paid only at the expense of other incomes—for example, the incomes of those workers who are unemployed as the result of the high wages demanded and the incomes of the other factors of production, profits in particular. Other incomes, therefore, are either reduced or prevented from coming into existence because wages in certain trades are unduly high.

These other incomes also constitute purchasing power and give rise to demand for goods and services. The assumption seems sometimes to be implicitly made in the contemporary discussion of these questions that the wage earner is the only member of society who spends his income. Nothing could of course be further from the truth. The income of the receivers of interest and profit constitutes the demand for innumerable types of goods and services which are never consumed by wage earners, and the reduction of these categories of income brings depression and distress in numerous directions. But, what is even more important, the incomes of the interest and profit receiving classes are the source of practically all new investment, and if these incomes are reduced the demand for capital goods and for labour employed in the production of capital goods is correspondingly diminished. Certain economists never tire arguing that an unequal distribution of the national income leads to continuing over-investment on the part of the rich. This may be true, but it involves the corollary that an unduly rapid equalization of distribution might have the effect of over-consumption of finished goods and under-investment in new capital.

A reduction in wage rates in the trades in which they are unduly high would probably tend to increase the incomes of the wage earners as a whole. The amount of the labour income depends upon the average wages paid multiplied by the numbers employed, and it is obvious that an increase in employment in the unsheltered and capital goods trades might easily more than offset the effect of a reduction of rates in the sheltered trades. In so far as the cost of living is prevented from falling by the rigidity of sheltered wages, it would tend to fall as the result of their reduction, and the decrease in real wages would not be so great as that of nominal wages. The industrial activity which, it is suggested, would result would automatically reduce the amount spent on unemployment relief and other social services, while the re-emergence of profit incomes would give buoyancy to the revenue which depends so greatly to-day on the proceeds of direct taxation. Thus the public finances would be eased, and reductions in taxation might be possible, which would, in their turn, relieve the industrialist in another direction and release further funds for new investment.

An industrial expansion, once afoot, would quickly lead to a rise in the prices of primary products. The increase in the labour income would give rise to a growing demand for foodstuffs and raw materials of many kinds, while the increased investment would call for new supplies of metals, fuels and other primary commodities. A rise in prices generated in this way would be far healthier than one produced by monetary manipulation, assuming the latter to be possible, as it would contain no inflationary danger and would tend to bring up each article to its normal price in the new conditions of present day production and no further. The upward movement would restore the purchasing power of the primary producers, and thus the demand for industrial products would revive. No corresponding increase in the cost of living in industrial countries need be feared, as the wholesale price level could rise substantially without producing any equivalent movement in retail prices. The rise in prices would thus constitute an unmixed blessing both to the primary producers whose incomes would be augmented, and to secondary producers whose idle resources would be employed.

It would be a blessing provided it is not allowed to advance too fast or too far. The expansion of trade will be the testing time for the administrators of the monetary and banking machine. It will be then that the opportunity will arise of applying in practice the lessons learnt in the terrible years of the depression. When profits begin to reappear, the irrepressible optimism of the investor will tempt him forward at an imprudent pace, and it will be then that the banks can perform a vitally useful service to society by pursuing a policy of caution. All recent monetary theory indicates that it is in the boom that the money machine fails to function properly, although it is in the slump that the evil consequences of the failure are experienced. It is when the patient is stretching out his hand to seize the intoxicating draught that the wise physician must restrain him. If prudence is thrown to the winds the night before, the morning after will bring its inevitable revenge.

In conclusion, attention may be redirected to the fact that the prevailing depression assumes different forms in different departments of economic life. In the primary industries it is shown in falling prices and apparent over-production, while in the secondary

industries it takes the form of unemployed labour and capital and apparent over-capacity. In the former industries a rise of prices is the condition of revival; in the latter a fall in costs. What is wanted is not an all-round increase of prices, but an increase of one group of prices accompanied by a reduction or at least stability in other groups. The difficulty of restoring prosperity by monetary management is that of isolating the effect of the injection of new purchasing power in those parts of the economic system where a rise of prices is considered desirable. If such isolation proves impossible nothing will have been done to correct the disequilibrium between prices in different groups which is the outstanding cause of our present distress, and all that will have been accomplished will be the creation of a new disequilibrium at a higher level. But the acrobat who is in danger of losing his balance is not saved from falling by raising the trapeze, the sole effect of which may be simply to make his fall more dangerous.

## DISCUSSION ON DR. O'BRIEN'S PAPER.

*Following are résumés of the observations of some of the speakers to the paper:—*

**Mr. G. A. Duncan:** It gives me great pleasure to be the first to convey to Dr. O'Brien the Society's congratulations on a paper not only able and interesting, but also wholesomely discouraging to a number of beliefs presently much in vogue. Hitherto the advocates of "easy money" as a panacea for economic ills have had all the publicity: their doctrine is obvious, appears simple, and accords well with many vocal inclinations and influential interests: the opinions of the more orthodox economists—that the liquidation of the disequilibrium must be allowed to proceed, that hardship to many persons is not only an inevitable but a necessary part of that process, and that the utmost collective action can achieve is the removal of obstacles to that liquidation—have been complex, revolting to a false sentimentality, and anathema to all kinds of legal, class and nationalistic vested interests—and therefore buried in professional journals. I agree with the two principal contentions of the paper: (a) that, while monetary authorities acting independently can effectively check expansion or induce contraction, the contrary course of inducing expansion requires the co-operation of solvent borrowers with sound projects; (b) that it could not be expected that the indiscriminate raising of prices by effective inflation would restore the system of relative prices shaken up by the slump. Still less could it be expected to be of any assistance whatever in determining the new equilibrium schedule of relative prices, rendered necessary by the permanent changes in the conditions of production and consumption of many goods and services, which have been taking place during the last four years or more of readjustment. Misunderstanding by the vulgar would be prevented if a specific distinction were drawn between stability of world prices (whose desirability as an aim of monetary policy Dr. O'Brien is criticising on p. 3) and local price stability, an aim whose achievement, given the conditions of an effective international standard and instability elsewhere, is definitely harmful.

**Lt.-Col. K. E. Edgeworth:** In introducing his main theme on p. 1, Dr. O'Brien seems to employ some rather mixed metaphors, for he refers to money first as a lubricant and then as a brake. It does not appear to me that either metaphor is very happy. In regard to the doctrine which is actually the subject of discussion, Dr. O'Brien's questions and answers may be paraphrased as follows:—The two main questions are: (i) To what extent is the monetary system to be regarded as responsible for the present crisis? (ii) To what extent can monetary policies be utilised to assist recovery? The answers suggested are: (i) That money is not the only cause of the crisis. (ii) That monetary policies are necessarily important, but they do not provide short-cuts to prosperity, and in fact no such short-cuts exist. If I have correctly interpreted Dr. O'Brien's meaning, then I can say that I am in complete agreement with the doctrine which he has set forth. On p. 2 Dr. O'Brien refers to the view that the monetary system is responsible for the instability of the economic structure. I suggest that the exact position of the monetary system can be elucidated by means of a mechanical analogy; that the monetary system, and particularly the use of credit, can be compared to the springs of a motor-car. If all transactions were settled at once and in cash the economic system would resemble a country cart which is completely devoid of springs. On the other hand, a vehicle in which the springs are too flexible is subject to violent oscillations which may reach such amplitude that they may endanger its stability. It is the duty of economists and business men to devise methods which will render the economic structure less flexible. It is now generally agreed amongst economists that

the price level and other important economic factors are subject to periodic or quasi-periodic fluctuations. Now such fluctuations have been subjected to intensive study by physicists and engineers for generations and there exists a large amount of valuable theory in relation to such problems. I suggest that economists would do well to acquaint themselves with the more elementary aspects of these theories, for in so doing they would avoid many pitfalls.

**Mr. E. G. Peake** agreed with all that Dr. O'Brien said, and only disagreed as far as the emphasis placed on different points was concerned. He thought that economists were not clear as to the difference between banks' current and deposit accounts, and as to the effect of the size of these, separately, and as a whole, on the price levels. He would like to see them produce something from these figures that would be useful to business men. He thought that more emphasis should have been placed on the importance of reductions in wages as a factor in bringing the depression to an end. He was against unproductive Government expenditure, because it prevented these reductions in wages and in rates of interest that were important in producing recovery, and because it saddled the future with a millstone of debt.

**Senator Thomas Johnson**: Perhaps the most definite assertion in the paper is that a reduction in the rates of wages in certain sheltered industries would help to restore prosperity, and the economists who had spoken generally endorsed that opinion. Wages on railways were cited. The official returns for the year ended March, 1932, showed that the average weekly earnings for the majority of railway workers in the Free State ranged from 45/- to 50/-, the weekly rates of wages being somewhat lower. Do the economists believe that prosperity depends upon a reduction of such wages? If so, to what level? What constitutes the normal wage if these rates are unduly high? Is it the rate which would prevail in unsheltered industries, where there were no tariffs but free competition and where trade unions did not exist? Japan had its sheltered industries and low wages; yet Japan had not escaped economic depression. The social and economic system which depends for recovery on reductions of wages to the levels which were general when times were normal—whenever that was—ought to be superseded; in so-called normal times the producing masses were in greater distress than they are to-day.

**Mr. G. S. Phillpotts** pointed out, in reply to the previous speaker, that Mr. Peake's demand for a fall in wages in sheltered industries need not necessarily mean a fall in money payments but an increase in the work done by them and in efficiency; and taking two typical sheltered industries, building and railways, this could quite easily be accomplished. It was notorious that bricklayers could greatly increase their output per hour, and many railway men nominally working an eight-hours day were actually doing two or three hours' work for over 40/- a week, as against the agricultural labourer working hard often ten or even twelve hours a day, and considering himself lucky if he got 30/- a week, and his wages suffer from high wages in sheltered industries. As regards the suggestion that the whole of our system of civilisation should be scrapped if wages of 47/- have to be reduced, it must be remembered that, thanks to this present system the working man has got better and better conditions as years go by, and the rise in their true wages last century was very great indeed; whilst there are not the least signs of that for the wretched Russian peasant, who works under what the speaker supposed is the alternative system, and who is far worse off than even the lowest paid worker in these countries and there are no signs of improvement in his conditions.