The Fiction of the Dollar

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Forty years ago money meant gold, or paper which could be exchanged for a definite amount of gold. The leading commercial countries in effect bought or sold gold on demand in unlimited quantities with no questions asked and no conditions attached. An individual was free to buy gold, to hoard gold or to sell gold. He could keep it in his strong box or lend it to a banker. If he lent it he was entitled to get back the same amount of gold, or the money which would buy it. Under these conditions the economists[1] were able to list among the functions of money that of being a "store of value" and that of being a "standard of deferred payments". These are very important functions in a civilized society.

There was no suggestion that either of these functions was perfectly or, except by chance, adequately performed. The world's supply of gold increased so slowly and the demand for it, had it not been for the almost incredible progress of banking, would have increased so fast that there seemed to be a constant danger that the monetary unit, defined in terms of weight and fineness, would continually increase in value. In this case prices in general, expressed in terms of the monetary unit, would have fallen continuously. New discoveries of gold, new techniques for extracting it, might postpone the evil day but ultimately it seemed as if we were doomed for progressive deflation — for a fall in price levels which only a change in the character of our money could arrest.

There was always the possibility of a lucky coincidence. A great improvement in methods of production might increase the

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[1] Stanley Jevons, or Francis Walker, for instance.

volume of goods which society could produce and the consequent fall in prices might ensure that the benefits of increased production were equitably shared by all — by the wage-earner, whose wages would buy more, by the rentier whose investment income would buy more, by the pensioner and by endowed institutions. This lucky coincidence was extremely unlikely and it was always possible that prices might fall too fast and that the state might be compelled to intervene by reducing the weight of gold in the dollar. The possibility of such action being taken in an orderly way was seriously discussed, on the assumption that it would be taken only if conditions justified it — that is to say, if the smaller dollar would buy as much of everything except, of course, of gold itself, as the larger dollar had been able to buy. Very ingenious plans were propounded.[2] It is important that their aim was both beneficent, directed to the maintenance of prosperity, and honest, directed to ensuring that no class of income suffered undeserved hardship or secured undeserved gains. The plans contemplated legislative action as a matter of high policy. It was not, for instance, suggested that the courts should, of their own accord, give special relief to mortgagors because prices fell while money debts did not. The state, in countries with English law, has uniformly succeeded in keeping its money system out of the clutches of Equity. This may have been because of the prestige of the Crown or because prices did not fall either very fast or very far.

The same inaction followed when prices rose in the later stages of the first world war, and in the years immediately following, as a result of the way in which the war was financed. In the countries with which we are most familiar the increase was not immense — was not of the order of more than two or three to one — and, what is even more important, the suspension of gold payments was described as temporary, so that a fall in prices could be quite confidently predicted when these payments were resumed. The return of the United Kingdom to the gold standard in 1925, with the old gold content for the pound, seemed to mark the climax of this process. The promise to pay gold, which had been in abeyance for a decade, was not dishonoured.

In many countries, however, it appeared out of the question that the currency obligations should ever be honoured by selling gold freely at the 1914 price. A fall of the order of five to one is different in kind from anything we have experienced; a fall of fifty to one is something different still.

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[2] *E.g.*, by Irving Fisher.

A fall of a hundred or a thousand or a million to one is utterly different. All rules of prudent behaviour are reversed when currency behaves in this way. Money should be spent the moment it is received, before it has time to depreciate. A bank account is senseless unless it can be kept in overdraft. Life insurance is madness. Those who do not observe these new, and perhaps to them shocking, principles are ruined. They may be innocent and honest people who trust their government; they may be people like pensioners who have no choice in the matter; they may be unfortunate speculators who believed that the moment had come when action would be taken to arrest the decline in the value of the currency or even to restore it. Such a moment is likely to come some day, but even before it does much hardship and injustice will occur and it is almost certain that legislative relief of some sort will be forthcoming in the meantime for the more politically influential among the sufferers. For instance, rents may be controlled or pensions increased.

It is obvious that when a substantial change occurs in the purchasing power of money some legal recognition will have to be taken of it either by legislation, or by the direct action of the courts, or in both these ways. What is true when money falls in purchasing power, that is to say when prices rise, is true when money rises in value, that is to say when prices fall. Indeed, the classes affected are likely to be even more influential in the second case and legislation is likely to follow on a much smaller percentage change, as it did in Canada during the 1930's.

Emergencies have been dealt with in Canada as and when they arise, in an *ad hoc* way, doing "justice" so rough that the word itself is derisory. We actually find one department of our government, concerned with selling annuities, representing that they will provide security, while official spokesmen speak of the dangers of inflation. Both propositions, one promising security, the other suggesting danger cannot be true, unless we adopt the fiction that dollars are more important than what they buy and that security, therefore, means a given dollar income regardless of the purchasing power of the dollar. This is precisely what our law — current legislation and the practice of the courts — seems to do. But is this "operation Ostrich" really desirable?

The question which has been raised does not admit of an obvious answer. It can be answered only if we consider whether there are practicable alternatives. A theoretical alternative would consist in establishing what is sometimes derisively called the "rubber dollar", a dollar which would have the same purchasing power this year, next year, an hundred or a thousand years hence, because it would be controlled by an index representing the weighted average of significant prices. For some statistical comparisons we do use such a concept, respectfully designated the "constant dollar". As a concept it is open to fatal objections: the same prices are not significant to all people (what does the price of meat matter to a vegetarian, or the price of sugar to a diabetic?); as between one period and another the same commodities are not equally significant (slaves, horses, gasoline, uranium might find their place in the index of one century but not in that of another). But an index which does substantial justice within short time intervals and which itself can be adjusted to do rough justice as between more remote periods is not beyond the range of possibility. It could, for instance, make an annuity a reasonably safe investment for a man of fifty. It could prevent the grotesque situation in which an annuity bought in 1913 on the French side of Lac Leman is worth today only a very small percentage of an apparently equal annuity bought on the Swiss side in the same year.

But, if the index is practicable, does it follow that it is practicable to base a currency unit upon it? It is probably possible to devise suitable techniques, for example, redemption of the currency in gold, or some other suitable commodity, varying the amount according to the variations in the purchasing power of gold. But it would take a bold man to suggest that a government should maintain the purchasing power of its currency under all conditions at all costs. The economist, Francis Walker, came near to doing this when he described the use of inconvertible paper in war time as analogous to the use of the brandy-bottle by an athlete.[3] But he made no estimate of the intensity of the political pressures to which a government is constantly subjected by those whose interest lies in allowing prices to rise. Preservation of the will to victory usually requires that concessions should be made to these pressures.

The plain fact is that the purchasing power of the currency

[3] Francis A. Walker, Political Economy (3rd ed., London, 1892) p. 160n: "It is my firm belief that the issue of inconvertible paper money is never a sound measure of finance, no matter what the stress of the national emergency may be. I believe it to be as surely a mistaken policy as the resort of an athlete to the brandy bottle. It means mischief always. If there ever was a time when a nation needs its full collected vigor, with a steady pulse, a calm outlook, a firm hand, a brain undisturbed by the fumes of this alcohol of commerce — paper money — it is when called to do battle for its life with superior force."

unit is subject, even when it is deliberately and competently controlled, to many influences of which the desire for its stability or for justice is only one. The others include such things as the maintenance of full employment; the maintenance of the balance of trade without resort to politically inexpedient reductions in money wages; the acquisition by the government in an emergency of purchasing power without relying solely on taxation or on borrowing funds which would otherwise be used for consumption. Politically we are probably all inflationists at times, in the sense that we make demands that are inconsistent with constant prices; for example, we seek higher incomes for the same work as before. We are, of course, all deflationist, too, in the sense that we make demands inconsistent with higher prices. There is a constant tug-of-war which assumes a political aspect comparable to the need for a political party to promise a high price for wheat and a low price for bread. In short, the constant dollar remains a plaything for statisticians.

There is perhaps another possible alternative to the injustices involved in abrupt changes in the purchasing power of the dollar. It might be quite frankly recognized that the modern dollar is not suitable either as a store of value or as a standard of deferred payments — is not suitable for hoarding and is not suitable for defining annuities. The attempt to use it for these purposes by those who are speculatively inclined need not be forbidden by law but a modern government might take steps to provide reasonable substitutes for those who are not.

The difficulties in the way are not theoretical. A government could issue bonds, in time of war or in time of peace, which would entitle the lender to receive the payments of interest and the repayments of principal in terms of a suitable price index. Such bonds would resemble bonds expressed in a non-Canadian currency. If this had been done in the recent war a bondholder who parted with $100 would be entitled to receive some such sum as $170 if his bond matured today. If the rate of interest were three per cent, he would have received annual interest payments ranging, according to the changing prices, from $3 to $5.21. There would be nothing inequitable in this. The ultimate debtor is the taxpayer. He would be repaying what he got, in terms of commodities, and would not (as is the case in practice) be making a gain at the expense of the bondholder. It may well be that, if the bond had been expressed in these terms, the interest rate need not have been so high, and the interest payments *might* have had a lower range, for example, $2 to $3.40, might have been zero or might have been negative.

In the same way an annuity could be sold in terms of a price index. The purchaser would get back the same purchasing power as he gave, whether by a single payment or by instalments. He would get what he is told he is getting, namely security. The taxpayer would have to foot the bill, but he would suffer no real hardship. If prices rose, he would merely be precluded from making an inequitable profit. If prices fell, he would be protected from an inequitable loss.

These techniques could be adapted for use by insurance companies, if they were compelled, or allowed, to make some of their contracts in terms of constant dollars and were enabled to cover their risk, if they thought it necessary to do so, by the purchase of government bonds expressed in constant dollars.

So much for theory. In practice it might be expedient to limit the use of these devices to those who are quite unable to protect themselves against the risk of inflation in any other way. The small scale annuitant is a case in point. So, too, is the small scale insurer who seeks to make provision for the minimum needs of his dependents. So, too, is the pensioner. So, too, is a charitable endowment. For such cases the use of constant dollar calculations might well be made obligatory. And the index used could be designed to meet their needs. A perfect index is, as has been shown, impossible, but almost any index would be preferable to the present Canadian dollar.

The use of constant dollar contracts might be facilitated in other cases in which their use might be found convenient by the parties if a suitable mechanism were readily available and if people were accustomed to the idea. Mortgages would be a good illustration. The use of constant dollars would have prevented many such obligations from becoming oppressive in the 1930's. Government budgets at all levels would have been afforded welcome relief during that period if interest payments, maturities, pensions and welfare payments had fallen automatically as prices fell. Indeed, it must not be forgotten that the device works both ways and that, if the creditor is protected, so too is the debtor.

The innovations which have been suggested would do little more than make available to those who need it most a type of protection already used by those who are in a position to do so. There are, obviously, various devices which can be employed as a hedge against inflation. These comprise hoarding precious stones, pictures or stamp collections; investment in real property; investment in equities; purchase of foreign currency securities; wages fixed in whole or in part on a sliding scale.

What is not so widely recognized is that these devices have inconvenient characteristics. They are not available to the pensioner at all since he is not free to sell his pension and invest in equities. They are not suitable for the small scale annuitant whose position is roughly the same as that of the pensioner. They involve peculiar risks, and we find our banks still advising clients not to sell government bonds because these are "the best investment they will ever have", that is, the banker is conscious of the demerits of these devices and considers the risk of a depreciating dollar inferior in magnitude to the risk of a fall in the return on a composite investment in equities. It might be amusing to work out the mathematical implications of this opinion as from (say) 1945 as a base year. But the result should not be used to suggest that it was not, or is not today, a well-considered, honest opinion, for which a strong case could and can still be made.

Another inconvenient feature of these protective devices is that, in order to make the best use of them, it is necessary to have a fairly precise idea of the magnitude of the inflation which is apprehended, the rate at which it is expected to occur, and the period of time that is in contemplation. Estimates involve a good deal of guess work. For instance, it is one thing to anticipate an increase in significant prices of the order of one per cent a month for a period of twelve months; another to dread an increase of the order of 100 per cent within a two year period; and something else again to fear a sharp rise in prices from day to day. The safeguard must be skilfully fitted to the danger and, as the danger changes, the safeguard too must be changed. In such circumstances it is almost inevitable to pass from cautious insurance to calculated speculation and it is extremely easy to make a miscalculation. What may be a profitable amusement for an alert business man is not a road to safety for dependent classes in search of security.

It should be made extremely clear that there is nothing in the measures which have been advocated, nothing, that is, in the use of constant dollar pensions and constant dollar contracts, which will repair any damage that has already been done. The contrary is the case. These measures lock the stable door after a horse has been stolen in order to protect the remaining horses. The recovery of the stolen horse is a separate operation.

Any calculations must accept the price level of some selected period either as itself suitable for perpetuation or as an indication of what it would be desirable to perpetuate. If, as seems the simplest course, a very recent period is selected, for instance today's price level, then the parties to contracts expressed in constant dollars are protected against both a rise and a fall in these prices. Such losses as they have already sustained, and such gains as they may have already made, are frozen. That is all that the devices described can be expected to achieve. It is a great deal but it may not be enough.

Concern with the problem of stability should not, therefore, be allowed to distract our attention from the different but important problem of redressing wrongs already done in so far as this may be practicable. Pensions, for instance, determined at a lower price level might well be raised to conform to the price level at which they will be stabilized. This paper is not concerned with discussing this problem but with distinguishing it. The problem exists, whether or not steps are taken to prevent any analogous problem from ever arising in the future. It does not lend itself to planning. It must be dealt with on the old *ad hoc* lines with very rough and ready ideas of fair play as the criterion. Stabilizing future payments would, indeed, aggravate this problem if those who have suffered from rising prices appeared to be deprived of their chance of benefiting by falling prices. It would be highly irritating to a pensioner to find that after a pension of $100 a month had lost a third of its buying power by the rise in prices, it was pegged in terms of constant dollars so that even though prices might fall it would not regain any part of the purchasing power it had lost. A practical remedy is easy enough to devise. The taxpayer, who has benefitted by the shrinkage in terms of constant dollars of the pensions which he is taxed to pay, should be prepared to honour these pensions for some years to come in terms of Canadian dollars *or* constant dollars at the option of the recipient. If prices rise further, this option would never be exercised. If they remain where they are it is indifferent whether it is exercised or not. If they fall, the pensioner benefits but he is not at all likely to benefit excessively. If necessary, his option might expire if prices fall to the point at which he first acquired his pension. There is nothing novel in a device of this sort for we are well accustomed to bonds expressed in two, three or four currencies at the option of the holder.

In this paper an evil has been discussed which has given rise to much hardship and much discontent. An attempt has been made to show that its recurrence could be prevented in so far as the groups most seriously affected by it are concerned. It follows that something ought to be done. It does not follow that the remedies which have been discussed ought to be applied. There may be much better ones. I hope there are. The moment they are proposed those which have been discussed need not be considered again. The latter have been advanced as examples to show that something is practicable. At most, there is a prima facie case for adopting them if nothing better can be found. Almost certainly something better can be devised, for the methods themselves are capable of much more intricate development. But delay in doing something is as indefensible as delay in providing the defensive techniques of today because those of tomorrow may be superior to them. A *spatium deliberandi* has its merits if it is used in good faith. It has none if it a mere pretext for doing nothing at all.

The Sovereign State

The instrument of totalitarian rule has invariably been the state — the state, captured by a single party and making absolute claims first on its own citizens and then, where power allowed, on its neighbors. It is therefore not surprising that deeper reflection on the state and on its responsibilities is another thread in the web of this century's new thinking. The change in mental climate is naturally more noticeable on the Left, where acceptance of state action has long been almost automatic. There are many symptoms of this new approach — the interest in decentralization, the turning away from direct physical controls and planning to the more flexible methods of financial control, the decline in nationalization as a dogma. It implies no retreat from the belief that the power of government must be used purposefully for the welfare of the community. It does imply far more caution about the manner in which the power can best be exercised.

But in the matter of the sovereign state's external relations, it must be admitted that both Right and Left, conservatives and radicals, have all had in them a strong strain of absolutism. It is not only the totalitarians who accept no claims beyond those of their own nation-state. They may have pushed the notion of sovereignty to hideous lengths. But the exclusive rights of the sovereign nation has also been and still is a thoroughly democratic fallacy. May one not discern here too, however, the beginnings of a new trend of thought? One strand is the renunciation of imperialism in which Britain has been the pace-setter for the old colonial empires of Europe. Another is the urge towards federation, which is already producing its first concrete achievement in the pooling of Europe's iron and steel under the Schuman Plan — a movement which had undoubtedly owed much to American enthusiasm for the federal principle. . . . (Barbara Ward, The Illusion of Power. The Atlantic, December 1952)