DO NOT TALK INFLATION

WARNING TO AUSTRALIA

Advice of Professor Gregory

The suggestion that a little inflation might not be a bad thing for Australia is dealt with in this, the fourth section of Professor Gregory's lecture. The three earlier sections have already been published.

For the remainder of this lecture I want to discuss possible remedies, not for the short period fluctuations, but for the long period fluctuations. I hope I may say one thing perfectly frankly to an Australian audience. Since I have been in this country, which is not so very long, I have noticed a distinct tendency to argue that a little amount of local inflation would not do Australia very much harm. I hope I may be permitted to say at least this about Australian problems, that local inflation in Australia will not help Australia in the very least, for two simple reasons. In the first place, you remember the attitude of the man Dickens described rather frequently, who used to take off his coat and announce in a very loud voice to all and sundry that when he had taken off his coat he was prepared to fight, but who never did fight. Why did he not do so? It was because the other fellow knew, of course, that he had not the faintest intention of doing it. If you take off your coat, and announce to all and sundry that when you get into office, or when your friends get into office, you propose to double the Australian note issue, you will not secure the slightest success when you do get into office, because unfortunately you have told everybody of your good (or bad) intention. If you are going to announce beforehand to every man, woman, and child in Australia that, when you get into office, you propose to cut the value of money in half, everyone with sense is going to take jolly good care that his own particular property will be exempt from the consequences of cutting the value of money in half.

The Modern Financier

You see, in the modern world, it is not very much use to talk about the bondholder and the international financier as if those persons were high and mighty individuals living in elaborate palaces in Park-lane, Fifth-avenue, or anywhere else. It is quite ridiculous to talk in that way about Fifth-avenue, anyhow, as all the palaces there, except picture palaces, disappeared long ago. If you announce that you are going to inflate, what is the consequence? It is that everybody who has any sense—and a large number of people who have no sense like to follow their neighbors—will escape from the consequences of inflation by converting their holdings of money, which will fall in value if inflation takes place, into something which will rise in value in the event of inflation occurring. Now, of course, the simplest way by which you did that in the good old days of European inflation was that you went to an innocent banker and bought dollars, and you paid for them two or three months afterwards when the value of your local currency had gone down. Those were the people who used to be called "Valutaschweine," or speculators, in the German press, the people who speculated in exchange. Of course, you may say to me, "Well, Australian bankers are not going to sell exchange to weak-kneed persons of that sort, who try to convey money out of the country; Australian bankers are going to pursue a policy of rectitude." That will not save you in the least, because no one has yet been elected to Parliament, even in Australia, by saying that if I have £100 I may not use that £100 either to buy wool, wheat, lollypops, or a bit of garden, or what not.

Results of threatening Inflation

On the first day you announce beforehand you are going to inflate, people will escape by withdrawing deposits from the banks, and using the proceeds of those withdrawals to buy goods in Australia. In other words, the price level will rise before you have inflated, and, if that is so, you have either to inflate a great deal more than you intended to do, or, if not, you cannot inflate at all. In other words, if the people know you propose to lower the value of money, you cannot lower the value of money. As far as I can observe, the inflationists in Australia have been so busy explaining what they propose to do, when they have the chance, that everyone has been forewarned from the beginning. It seems to me that inflation in Australia would be a very risky and a very dangerous expedient. You are, of course, a great many miles away from the nearest land. I do not know how far you are from New Zealand, but everybody in this country appears to forget New Zealand. You are, at any rate, a great deal farther away from the other great centres of population than any other part of the world, but that does not save you from being a part of the world. If you are going to depend in the future, as in the past, on the great international money markets to supply you with part of the capital you require for the further equipment of this country, you cannot possibly inflate; and, if you ask me why, the answer is simply that the psychology of European and American investors is such at present that if you announce your intention to inflate on the one hand and borrow on the other, they will, in fact, have nothing to do with you. Therefore, although I say that the little dose of inflation which some people recommend in this country has a very attractive air, I believe that its ultimate consequences would be fatal, not only to the banking stability of Australian institutions, but to the ordinary progress of this country in every direction. That is all I want to permit myself to say on the subject of your own local problems.

Uses of Gold

Let me get back to the wider problems. What can the world do as a whole to prevent this instability in the purchasing power of money? The problem of prices is primarily a problem of how to manage the gold standard. In its essence, looking at it as an economic problem, it is simple enough. The gold problem rests upon the three following foundations:—In the first place you have a certain visible volume of gold production. Every year the gold mines of the world turn out so much gold. If the price level falls, as it is falling now, the quantity of gold which can be turned out goes on increasing. If it rises, the quantity of gold goes on falling, but ultimately gold production is governed, as various critics of the gold standard state, by the chances and fortunes of nature over which no man has any control. On the other hand, there are two other elements in the situation, over which human beings have some control. One is the industrial consumption of gold in such things as dental fillings, earrings, and other impedimenta of that kind; the other is the consumption of gold in Eastern countries for the purpose of hoarding. If I buy earrings, and give them to my wife, who sometimes wears them, that has no direct effect on the price level, though a powerful indirect effect. If people were to give up wearing gold as earrings, or using it as dental fillings, and if the Eastern potentates ceased to keep the cellars beneath their palaces stocked with gold, there would be so much more gold for the third use, which is monetary. Before the war, gold was actually in circulation as an everyday part of the supplies of the world, but in the modern world the only monetary use which gold possesses is to be stacked in the cellars and vaults of the various central banks of the world.

Gold in Central Banks

The quantity of gold which the central banks need keep against their liabilities is a matter over which the central banks, taking them altogether at any one particular moment of time, have complete control. In the modern world, in which gold is no longer in circulation, all central banks would recognise that the whole of the gold which they possess is required only for one reason, namely, to settle those temporary deficits in the international balances of payments which sometimes arise. If you have a panic in Australia, in England, or the United States of America, you do not meet that panic by the banker unlocking all his vaults and throwing sovereigns over the counter. You meet the panic in the modern way by paying out notes of the central bank, and you cannot do it in any other way. You want the gold for one purpose, and one purpose only: if French creditors of the Bank of England, for instance, demand payment of their indebtedness, they can be paid in gold at a moment's notice; or, if the London money market is on balance a debtor to New York, the only real function of the gold reserve of the Bank of England is to enable the bank to ship gold to New York at a moment's notice. In other words, the gold stocks of the central bank have one purpose, and one purpose only. There are certain people who think that unless the bank holds a certain amount of gold its notes will not circulate. That is absolute nonsense, because during the war they circulated perfectly freely. The only function that gold reserve serves in the modern world is as a medium by which you can settle temporary deficits in the balance of payments.