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Preface to the 1922 German Edition of Volume Two (Money and Credit) of the *Lectures**

Knut Wicksell

The present translation of the second volume of my *Lectures* in Swedish had been almost completely type-set seven years ago, when publication had to be suspended on account of the War. I must ask the reader to have the goodness to bear this in mind, because, if the book is read under the otherwise quite natural assumption that it has recently been written or at least revised, it will make an unusual, not to say bizarre, impression. My repeated praise of the relatively settled state of the "present monetary system", which I would like to see replaced only by one that is superior from a theoretical point of view, as well as my assurance (page 188) that the calamitous state of confusion in the finances of the Reich and in the monetary system "is now a thing of the past" etc., are, I confess, likely to stir mixed feelings, especially in the German reader.

Yet all this is, in the final analysis, a secondary consideration; the main issue naturally is whether or not the experiences of the War have confirmed my basic conceptions, expressed here and in my earlier writings, regarding money. I venture in all modesty to believe they have. Certainly, in the monetary field, many puzzling phenomena have appeared, both during and since the War, for a correct explanation of which the necessary data are, in my opinion, still not to hand. By and large, however, one can affirm that the classical theory of money, the so-called Quantity Theory, of which my own theory or hypothesis forms only a modification or variant, substantially holds and indeed has gained support from some who were previously more or less sceptical about it.

Above all, the old blind faith in the intrinsic invariability of the value

* *Vorlesungen über Nationalökonomie auf Grundlage des Marginalprinzipes*, Theoretischer Teil, Zweiter Band, *Geld und Kredit*, Jena, Verlag von Gustav Fisher, 1922.

The Preface has been translated from the German by Derrick Plant.

of *gold* has now finally taken a beating, from which it is not likely to recover very easily. Indeed, both during and since the War the value of gold has submitted unresisting as yielding wax to the developments in the means of credit, so that one has every justification in saying that the present-day value of gold is quite simply the value of the dollar, neither more nor less, or, in other words, that it is entirely governed by the credit policy of the United States.

So, if the metal gold is once more to become a common standard of value, then it will be absolutely necessary — and in this I am in full agreement with my fellow-countryman, Professor Cassel — to establish rules capable of regulating the value of this standard itself and to confer upon it a stability which, if it is left to its own devices, it patently does not possess. Still, in whatever ways these rules are formulated, they can only achieve their purpose if they can impose a rate of interest policy on the banks which is itself capable of maintaining the stability of the value of money, that is the stability of the average price level for commodities. And then it also seems that it will be simpler and also more effective if the maintenance of the value of money is entrusted directly to the central banks after exemption from the present (pre-War) obligation to convert notes. In other words, gold had best be or remain demonetized, as silver was demonetized nearly fifty years ago, or at most it should be retained, with *variable* value, as a means of payment in trade, and banknotes, or the banks' unit of account, should definitely be taken as the monetary unit. That such a development is quite possible cannot really be doubted any longer. The only point in dispute is whether, in order to re-establish the practical invariability of the exchange-rate, we should aim at some *average* value of money, i.e. some average level of prices of commodities for the world as a whole, while the price levels of the different countries would of necessity remain more or less fluctuating; or whether it would not be better for each country to keep its price level as stable as possible, which would naturally at the same time keep the variations in the exchange rates within fairly narrow limits, however without the possibility of producing that almost total stability that there was before the War. The first thing to do, to my mind, is to attempt to reach the *latter* goal: the experience may then show to what extent the *former* goal is the more desirable.

What finally concerns the question of the level at which the value of money and the price level of goods in the different countries should be fixed, and especially the question of the restoration of the monetary system in countries, such as Germany, with greatly depreciated currencies, I must permit myself the observation that this in reality is not a technical, but entirely a *legal* problem. The technical side of this problem is purely formal and can be resolved in a trice. The calling-in and cancellation of notes — just as was done in Czechoslovakia during the War and as is at present planned in Russia on a far vaster scale — can without any doubt

bring about as low a general price level as is required, so that the value of the monetary unit is as high as required — on the condition that the cancelled (or newly created) banknotes are not once more issued in ever-increasing quantities. As soon as the 'domestic' and 'foreign' values of the national currency have been brought into tolerable accord with one another, it would even be possible — though, after what has been said above, I would not myself like to advocate it — to make the note convertible with gold, possibly at the old parity — something which, according to *pre-War* experience can indeed be undertaken however small are the reserves of the precious metal (the gold exchange standard!).

The only considerable question — which, significantly, hardly anyone cares to discuss — is rather that of what should be done about *liabilities* and *assets*. Suppose a person has contracted a debt in paper marks during the crisis and that subsequently the *gold* mark once more becomes the monetary unit in Germany, as a result of the above-mentioned or some similar procedure, what happens to the debt? Will the person be obliged to pay the original amount of the debt in the same number of gold marks — that is to say, possibly forty or fifty times as much? Or conversely, must the person who before the war accepted a bill in gold marks now have to content himself with one-fortieth or one-fiftieth of his due? Neither of these possibilities can, in my opinion, be seriously entertained. The former would in most cases actually be physically impossible, while the latter alternative seems equally unacceptable. Why should *real* assets remain unaffected when financial claims have been practically abolished? The consequence seems then far more to demand that *all* property should devolve on the state. If one wishes to stick to the principle of private property, then it is surely imperative — as at the time of the abolition of the French *assignats* — to have a regulation of liabilities and assets, and consequently even a revision, where this is still feasible, of all business transactions over the past seven years, in accordance with the principles of justice.

More or less all the countries of the world are in the same situation as that of Germany. Even if, as for example in Sweden, paper money has a value only a small percentage below the country's parity with gold, there has still in reality been a great depreciation, as *gold*, despite its recent rise in price, is still worth very little in comparison with its *pre-War* value. If the present average cost of living in Sweden is calculated in terms of gold, it would still be twice as high as before the War, though considerably lower than a year and a half ago. If Sweden were now to return to gold to the old parity — and this in my opinion would present no difficulties — and if the value of gold thereafter were to remain unchanged, then all the creditors from *pre-War* times (or from the early part of the War) would have irretrievably lost half their wealth. At the same time all those who had contracted debts during the far more costly years, 1918-1920, or had

bought in stocks of goods, etc., on credit, would be obliged to make repayments, which would often bring them to bankruptcy (as in fact this has already been the case). Conversely, if gold were in the near future to regain its old purchasing power, the pre-War creditors would then in fact automatically regain their old rights, but those debtors from the time of the crisis would suffer still more atrocious losses. Retaining our present 'free' monetary standard, the only sensible way out therefore seems to me to consist in preserving the current price level with the help of a discount rate policy, or, what from many points of view would be better, in returning *in one step* to the price level of before the War by calling in and cancelling notes — and in preserving this level in the future —. However, this would have to be accompanied in any case by a thorough-going revision of all debt relations, indeed, where possible, of all business transactions entered into during the period of crisis.

The claims of justice should at any rate, in this case as so often, correspond to the claims of sound economics. With the present variability and uncertainty of all values, in other words with the present *legal* uncertainty, as everyone must recognize, the whole of business life has been transformed into a pure game of chance. Hard work and honest efforts no longer serve; instead, luck and unscrupulousness alone serve to avail oneself of the vicissitudes of the economic situation. Though they occasionally provide a stimulation, these circumstances have nevertheless a debilitating effect on the business world; they are certainly among the most important causes of the present economic depression. It has to be made clear from the start, both to debtors and creditors, that the debtor will not be compelled to pay more or the creditor to accept less than the value of the sum agreed upon when the contract was effectuated. Only then will trust be restored and will it be possible to speak once more of healthy, and therefore successful business activity.

From the Foreword to the first Swedish edition (1906), I carry over the following quotations which I have supplemented by some recent reflections.

"While these lectures (originally delivered to an audience of quite young students) were being prepared for publication, I made it my rule, to deal with only in passing and for the sake of coherence with that information which the reader can obtain just as well if not better from other, easily accessible sources than from me, and I have limited detailed treatment to the points where I either believed myself able to give traditional teaching a more easily understandable and more systematic presentation, or where I could demonstrate the rational coherence of certain data which one might otherwise be inclined to treat only empirically, or where I felt the dominant views in teaching needed completion or were actually erroneous. The last point is especially true of the still far from clear question of the cause

of the value of money and the variations in the general price level of commodities. Without the correct answer to this problem all discussion of money matters will continue to hang in the air. The solution of this problem, with its extremely important practical consequences, forms the main purpose of this book and occupies its fourth (or, discounting the introduction, its third) section, where the main argument of the discussion will be found.

The principle from which I have started — the relationship between the actual money rate of interest and what at the same moment in time is the going real or natural rate of interest — is substantially the one I have developed in my book, *Geldzins und Güterpreise*¹. However, in my treatment of this principle, I have made several changes and, I believe, improvements"... "Among other things I have attempted, through a careful analysis of the controversy between Ricardo and Tooke, to defend my own view of the connection between money interest and commodity prices against the objection, which is at first sight so plausible and is still occasionally heard today, that lower money interest will not cause a rise, but rather a fall in the price of commodities, because it reduces their *costs of production*. Seemingly, this latter opinion is in addition based on the fact that one normally finds lower prices alongside lower money rates of interest and conversely higher prices with higher rates".

With respect to the last-mentioned part of this objection, I refer to what is said in the book itself. With regard to the view in general, the following is to be observed: unless I am mistaken, it is an example of the very common and fatal error of confusing the point of view of the individual actor with that of the national economy as a whole. If a single producer (or a small group of producers) is able to borrow money at lower rates than those usually asked, then there is no doubt that this puts him in a position to reduce the price of his products, thus enabling him to beat his competitors. This would be even more the case if he were able to get loans without paying any interest at all and it would of course be even more advantageous to him, if he, in his capacity as producer, were freed, entirely or in part, from the obligation to repay the money capital. How preposterous it would be to believe that, if all producers, in that sole capacity, could obtain money free of interest and without any obligation to repay the loan, this would bring about a reduction in the price of goods! It is as clear as daylight that they would rack up prices beyond measure in the shortest possible time on account of their reciprocal competition for labour services and other productive services, raw materials and so on. In order to maintain the view under discussion, it will be necessary at least to imagine a *minimum level* to which a falling interest rate would be accompanied by falling prices, while beyond that level it would have the opposite

¹ G. FISCHER, Jena 1898.

effect of causing prices to *rise*. Already the logic of this should suffice to indicate the arbitrary nature and the untenability of the entire approach.

The view that I advocate against this rests entirely on a fact that can be obscured by the multifarious interdependencies of economic magnitudes, but not made to disappear. This fact is that, ultimately, the borrowing and lending of money — though intermediated by the credit system — is in reality always a borrowing and lending of *real* capital, i.e. of commodities and/or services. In order to bring supply and demand with respect to this real capital into equilibrium, *either*, the loan interest rate must be sufficiently high or low (i.e. the normal rate) *or* there must be a rise or fall in the prices of the commodities and services in question, which clearly has the same effect as long as the *future* prices are still considered to be unchanged. But the moment that the future prices are judged according to the level already reached by current prices — as will sooner or later be the case — then the rise or fall in prices that has already occurred will no longer suffice, instead it must make way for another change of the same kind. The *direction* in which too high or too low an interest rate influences the prices of commodities should therefore not be in doubt; it is far harder to say anything precise as to the extent and rapidity of the influence, as, in the end, everything comes down to the purely psychological impetus of the *opinion* at any given time about future prices, because it is this opinion which actually underlies everyone's greater or lesser propensity to borrow or lend money at interest. In any case, however, this effect is of a *cumulative* nature and must therefore eventually go beyond all other influences on prices².

"Meanwhile, I have found myself induced, in explaining the actual price formation, to restrict the range of the validity of that principle, namely with reference to the influence of the *quantity of gold* itself on prices. I had previously imagined, in entire agreement with the viewpoint of the classical school, that this effect also worked chiefly through the intermediation of the money rate of interest, in so far as gold production that exceeded demand would in the first place bring about an increase in the gold reserves held by the *banks* and thereby a reduction in their

² To put it into a nutshell, as long as price changes which have come into effect in the way mentioned above are seen as temporary, they will in fact remain permanent; as soon as people see them as permanent, they will become progressive and if they are eventually seen as progressive, then they will become an avalanche.

As it turns out, I was not the first to put forward the reasoning followed in the text. In the Swedish *Ekonomisk Tidskrift* (1916, p. 391) Prof. Davidson showed that the same train of thought had been developed in a clear and fairly complete way by the English economist, H. THORNTON, in his study, "The paper credit of Great Britain", which came out as early as 1802. It seems, however, as Davidson points out, that Thornton's work was almost entirely neglected by later economists. In Palgrave's *Dictionary*, the book and its author are mentioned only very briefly and in the *Handwörterbuch der Staatswissenschaften* not at all.

interest rates, which would in its turn lead to a price increase, such that the fresh reserves of gold would just suffice for current needs of trade. On further reflection, I came to the conclusion that the main responsibility for this should be placed rather on excess *demand for commodities* on the part of the gold-producing countries, a demand which, if it did not correspond to an equal excess supply of commodities, that is, an equal demand for new gold on the part of the other countries, must necessarily be followed *immediately* by an increase in prices, so that the money rate of interest might perhaps not change at all or might even be caused to move in the opposite direction³. For the practical conclusions regarding the possibility of a rational control of the value of money, this modification of my earlier opinion has, however, no significance, because such control, in my opinion, presupposes the total detachment of the value of money from the fluctuation in the value of the metal gold”.

In connection with this question, I have, if only briefly, put forward a view with regard to the phenomenon of capital formation in so-called good and bad times, which departs considerably from the usual way of thinking and which in any case might offer some viewpoints for the explanation of these still obscure problems.

I concluded the previous foreword with a statement of the reasons why, in my opinion, the final confirmation of the proposed theory could unfortunately still not be provided statistically. In this regard, however, it seems to me that the situation has greatly changed. The mighty upheavals brought about by the War have provided material in abundance for a critical judgment of this question. Through the elaboration of this material a theory of money will probably emerge which will enjoy much wider general acceptance by political economists and business men than has been the case so far. I feel sure that it will then be seen that the theory put forward by me will in any case have to be recognized as a necessary element in the overall theory of the value of money so that my efforts in elaborating it will not have been wasted.

Stocksund (Sweden), January 1922

³ What is said here about the production of gold is valid, *mutatis mutandis*, also for the issue of paper money by the State, etc. Yet this case could be brought under the general formula in so far as such an issue could be conceived as money loaned at *very* favourable conditions against opportunities for very high, if uncertain profits (for example, a victorious War!).

For the rest, it must not be forgotten — as a young Swedish political economist has rightly pointed out — that both large gold imports and, even more, an issue of paper money by the State, tend to reduce the real capital of the country concerned and thus cause a rise in the real interest rate; hence there will also from this side emerge a discrepancy between the agreed rate and the expected real rate of interest. However, whether this circumstance suffices to explain the actual price increase in such cases seems to me doubtful. The tangible fact of the increased demand from that side, which simply *generates* means of payment, either through the production of money or the issue of paper money, should here be given priority.