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THE VALUE OF MONEY : A Historical Perspective

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ÖZET

Para ve paranın değerine ilişkin ilk görüşlerin Aristotle'a ait olduğu bilinmektedir. Bu bakımdan konu tarihsel bir perspektive içinde incelenmiş ve Ricardo, Locke, Hume, Fisher ve Keynes gibi ekonomistlerin görüşlerine yer verilmiştir. Günümüzün modern para kavramının, miktar teorisi ile birlikte M.Friedman'a ait olduğunu belirtebiliriz.

Monetary theory is very ancient, as it is simply a term for the understanding that mankind has developed about the character and the use of money, and its relationship to the economy. Classical monetary theory was developed by British economists, with some French influence, between the late 17 th and early 20 th century, that is, between Locke and Marshall. It may have been overtaken by Keynes in the way that Newtonian physics was overtaken by Einstein. Even if it has been so overtaken, that would not mean it was falsified. In the world of Einstein apples do not fall upwards; in the world of Keynes if you print more money you do not get lower prices.

The earliest traces of monetary theory are to be found in Aristotle. He lived in a period when merchants were still trading with pre-monetary economies. In his "Politics", he describes how the metallic monies, gold and silver, were originally exchanged simply by weight. In the "Ethics", he observes that it is a measure of value.(1) Thus already in Aristotle we find prefigured many of the themes of monetary theory. When we read in Aristotle that money enables men to relate the value of shoes and of houses to each other,we may think of Ricardo's discussion of the factors which determine the relative value of hats and gloves. When Aristotle calls money "a guarantee of exchange in the future", we may recollect Keynes'dictum that

> "Money in its sinnificant attributes is, above all, a subtle device for liking the present to the future".(2)

Aristotle had already formulated the first two of the classic definitions of the functions of money, which Jevons defines as a "medium of exchange" and a

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"common measure of vaule".(3) In short, all that Aristotle lacks for a comprehensive theory of the economics of money is a theory of supply and demand, but does not seem to have formulated, though he must largely have understood, a supply side to the equation.

Ricardo on the demand for money: What is the central statement of classical monetary theory? It could be put in quotations from many different economists. One could choose to quote from David Ricardo's "Principles of Political Economy", which was published in 1817.

> "The demand for money is regulated entirely by its value, and its value by its quantity".(4) That is the central definition, and Ricardo goes on to amplify it:
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> > "If gold were of double the value, half the quantity would perform the same functions in circulation, and if it were of half the value, double the quantity would be required".

It is this theory, which makes the general price level simply a reciprocal of the quantity of money, that is offered by monetary economists as the explanation of inflation. It is a theory which is still in our day a matter of immediate public controversy. We are dealing here with a contoversy that is imposed on economists by events-and by very critical events. Even Aristotle can not have been thinking of money in a purely abstract way; during his life time Alexander the Great's conquests in the East released large quantities of hoarded gold, and there followed an inflation of prices caused by the inflation of the gold supply.

Locke's quantity theory:

It is in 1691 that we have the first adequate statement of the quantity theory of money. In "The General Theory of Employment, Interest and Money" Keynes observes that

> "The gread Locke was, perhaps, the first to express in abstract terms the relationship between the rate of interest and the quantity of money. He was the parent of twin quantity theories. In the first place he held that the rate of interest depended on the proportion of the quantity of money. In the second place he held that value of money to the total valume of goods in the market..."

In 1691 he published "Some Considerations of the Consequences of the Lowering of Interest and Raising the Value of money". Locke considered that money is in one respect a unique commodity. The relative values of other commodities are set by supply and demand, and not by supply or demand only. There are some commodities, air and water are usually cited, which are in general demand, are extremely useful, but are so common that they have little or no value. Locke argues that the value of money is determined solely by the quantity. Although he believes that prices are determined by the quantity of money, he believes also that real wealth is the result of other non-monetary factors (5).

In monetary economics David Hume stands on Locke's shoulders. His essay (Of Money) was one of the "Essays, Moral, Political and Literary", Part 2, first published in 1752. Hume starts by assuming, what Locke felt he had to argue that

> "the prices of commodities are always proportioned to the plenty of money...." and he strikes out in a new direction:
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> "....the greater plenty of money is very limited in its use, and may even sometimes be a loss to a nation in its commerce with foreigners...."

Locke had seen that natural forces, the underlying cause of a nation's failure to compete, would lead to an outflow of money and to lower domestic prices; Hume saw that an increase in domestic credit would lead to rising prices of exports and therefore to a loss of competitive power. Shortly, Hume links the theory of the quantity of money determining prices to a theory which suggests that an artificial increase in the money supply, by the creation of paper credit, both raises prices to the disadvantage of the balance of trade, and finances the export of bullion, or in modern circumstances, hard currency reserves. The quantum of money which an economy is capable of retaining can be met either by domestic paper or by convertible currency.

Hume's basic doctrine was that an expansion of paper was dangerous, but an expansion of gold was desirable, even though it would have a tendency to cause prices to rise. He was also the firs to draw attention to the time-lag between an increase in money supply and an increase in prices. This time-lag, which was first verified statisticall, and shown to be normally between, one and two years, by Jevons in 1863, plays a leading part in the theory of Milton Friedman. Hume believed that an increase in the quantity of money caused prices to rise, but with a delay, and that during the interval it caused an increase in industrial activity; Keynes believed-with some reservations-that an increase in the quantity of money caused some increase in prices and a substantial increase in industrial activity until full employment was reached, and then caused a fully proportionate increase in prices.

Early in 19 th-century, Henry Thornton, Director of the Bank of England, offered the first satisfactory description of the working of inconvertible paper and warned of the consequences of over-issuing paper which follows Hume. (6) Thornton's search for an effectual principle of restriction on the issue of paper money becomes one of the main themes of 19 th-century economic debate. If Thornton posed the question, it was David Ricardo, in his monumental "Principles of Political Economy" (1817), who answered it. The principle he asserted was that of convertibility; there is no such thing as a sound but non-convertible paper currency. It is the great Ricardian doctrine that convertibility at a fixed rate is the only valid control on issue, and moreover convertibility not into other paper currencies but into some form of metallic commodity money. Here Keynes and Friedman are on the same side: They are both opposed to it!

Irving Fisher, Keynes and Friedman;

Fisher and the velocity of circulation- I.Fisher discovered the equation that the money supply times the velocity equalled the volume of transactions times the level of prices, or MV = TP. This velocity concept and Keynes' liquidity preference concept are different ways of looking at the same relationship. According to Keynes (7):

> "Instead of starting with the amount of cash held by the public, Professor Fisher begins with the volume of business transacted bu means of money and the frequency with which each unit of money changes hand."

The monetarist school in the US has strengthened the evidence for monetary theory by detailed statistical work. Milton Friedman's most influential contribution to proving the validity of this theory was a work he wrote in collaboration with A.J.Schwartz (8). He states the conclusions he comes to as follows: "Throughout the near-century examined in detail we have found that:

1) Changes in the behaviour of the money stock have been closely associated with changes in economic activity, money income, and prices.

2) The interralation between monetary and economic change has been highly stable.

3) Monetary changes have often had an independent origin; they have not been simply a reflection of changes in economic activity."

Friedman's work has been particularly important in confirming Hume's theory of the time-lag, already supported by Jevon's observations on the relationship between issue of money and price movements in mid-19 th-century England. The time-lag, though it has an average period of about two years, is shown to vary in duration.

Keynes proposes that changes in liquidity preference, that is, the desire for cash, should be offset by the aut horities creating or reducing credit, with a view to keeping the total of active money constant. This should be done, not with a view to stabilising the exchange rate, as Ricardian orthodoxy would have required, but with a view to stabilizing domestic prices. If we use the Irwing Fisher equation, Keynes wants to keep the quantity in order to offset changes in the velocity. This sounds theoretically very attractive; it dos, however, fail to take into account the crucial discovery of Hume, verified statistically by Jevons, that there is a time-lag between changes in the money supply and the effect on the price level.

Another objection to Keynes is that liquidity preference is itself influenced by changes in the quantity of money and by the "expectations" about such changes in the future. If one wants to avoid the danger of violent fluctuations in liquidity preference, one should probably follow Thornton's and Friedman's prescription for bank policy on issue, if not Ricordo's. Stable expectation depends on stable policy. Keynesian monetary theory can be stated as follows:

"... if there is perfectly elastic supply so long as there is unemployment, and perfectly inelastic supply so soon as full employment is reached, and if effective demand changes in the same proportion as the quantity of money, the quantity theory of money can be enunciated as follows - So long as there is unemployment, employment will change in the same proportion as the quantity of money; and when there is full employment, prices will change in the same proportion as the quantity of money-" (9)

It is Milton Friedman who has restored monetary theory to a central position in economic theory and it is to his work that one should look for the policy implications. His central recommendation is that the rate of increase of the money supply should be low and regular. If money supply is increased sharply then an inflation of prices follows. If there is a sharp reduction in money supply then a depression will follow.

A policy of money supply discipline is likely to be pursued only by an independent central bank. Governments tend to be inflationary because it suits their short-term needs. It is clear that independent central banks handle the money supply more responsibly and are in fact more successful in limiting inflation. It is important that policies should be pursued openly. The end of inflation is always followed by a period of economic distress. It is a characteristic of inflation that it borrows from the future in order to create boom in the present, and the boom is always followed by a trough. The length and depth of the depression in a post-inflationary period is determined partly by favourable expectation is one of improved price statibility.

The stabilizations associated with Schacht and Poincaré in Germany and France in the 1920 s, the post-war German stabilizations under Erhard and the 1958-59 under de Gaulle were all based on sound money. They all succeeded, though they occured in different circumstances; they were all followed, once the initial impact was absorbed, by economic recovery and rising employment. Stable control of money supply and an independent central bank are the essentials of what we need, especially in Turkey.

SUMMARY

Developments in Monetary theory and the stages of the value & money has been analysed in a historical perspective. Following Aristotle's opinionsi Ricordo, Locke, Hume, fisherd home all coatributed on the monefay theory. Coacluding remarks and modern theories are all belong to M.Friedman.

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