

obtained, it is necessary to enter on another and more difficult calculation—namely, how these prices have been affected by changes in the quantity of money—as difficult an operation as the attempt to measure changes in temperature with a thermometer whose scale contracts as the mercury expands and expands as the mercury contracts.

The unit of value should be the measure of exchange values. It should not alter those values, and yet with every increase in the total available supply of things in general relative to the supply of money the purchasing-power of each unit of value appreciates or increases in terms of things in general, and as the total available supply of things in general will be increased by developments that bring the forces of nature more effectively under man's control, such as an increase in the efficiency of the people individually or an increase in their collective efficiency, either through mechanical inventions or through improvements in business organization, the classes referred to in the foregoing sections will find their relative positions altered, some for the better, some for the worse, by every increase in the money supply and by every improvement in science, invention, education, or even by the bounty of nature.

The purchasing-power of money, or increase or decrease in the cost of living, or increase or decrease in the value of the sovereign depends exclusively on five factors:—

- (1.) The quantity of money in circulation.
- (2.) The velocity of its circulation.
- (3.) The quantity of bank deposits subject to cheque.
- (4.) The velocity of deposit circulation.
- (5.) The volume of trade.

In other words, the general level of prices is determined by the relation between the volume of the circulating media (the first four factors) and the quantity of commodities (the fifth factor) or the volume of trade. These five factors are the proximate cause of changes in the purchasing-power of the unit of value, and therefore in the general price-levels. An increase in either of the first four factors—the fifth remaining constant—lessens the purchasing-power of the unit of value and raises the general price-level, and a decrease raises the purchasing-power of the unit of value and lowers the general price-level; while an increase in the fifth factor—the other factors remaining constant—will raise the purchasing-power of the unit of value and depress or lower the general price-level, and an increase will have the reverse effect. Each factor depends on numerous antecedent causes, but they do not depend on each other, except that deposits subject to cheque depend on money in circulation, the two normally varying in unison; the velocity of circulation both of money and of deposits tends to increase with an increase in the volume of trade; and any two or more of the five factors may be influenced by a common cause or causes. For example, the growing density of population has tended to increase all the five factors. The purchasing-power of the sovereign and the price-level are the result of these five causes normally varying directly with the quantity of money, provided that the velocity of circulation and the volume of trade remain unchanged. It follows, therefore, from this, that a rise in the price of any particular commodity must be accompanied by a fall in the price of some other commodity or commodities, unless there is an increase in one of the first four factors or a decrease in the fifth. Rises in wages since 1896, as a means of meeting increases in the cost of living, have proved illusory, not because of any vicious circle, but because since that date the currency or circulating medium has expanded faster than the volume of trade, which has resulted in the general level of prices constantly rising and the purchasing-power of the sovereign constantly falling. But for this circumstance the rise in wages would have inevitably resulted in a redistribution of the national dividend, giving a greater share to labour and a smaller share to other classes in the community. The proposal that wages should be regulated by the cost of living needs careful examination with reference to (a) normal circumstances, (b) such exceptional circumstances as we have experienced during the war period, and will continue to experience in the reconstruction period after the resumption of peace.

In normal circumstances the proposal would only secure a part of what is wanted, and that part could better be obtained by making wages vary with the prosperity of an industry, for a rise in the cost of living always means, in normal circumstances, a rise in prices generally; and a rise in the price of the output of a particular industry would mean an increase in that industry's general prosperity. Consequently a sliding scale of wages, based on the prosperity of an industry, secures ordinarily a rise of wages concurrent with the rise in the cost of living; and it may secure more than this—namely, a rise in wages when there may be no increase in the cost of living, though there may be an increase in the prosperity of a particular industry. Thus prices might fall all round in consequence of greater productivity, and wages, if based on a sliding scale with the cost of living, would then mean a fall, whereas as a matter of fact an industry might be more profitable because of enlarged output due to greater productivity, and might more than make up for the fall in prices.

In the exceptional circumstances of reconstruction it may be necessary to provide for some direct variation of wages with the rise in the cost of living. It is difficult, if not impossible, to forecast what will be the course of prices during the next few years. Will the general price-level decline, or will it advance, or will there be fluctuations more or less violent? Some competent authorities hold that prices will undoubtedly decline. This they say will be due not so much to the removal of the war demand for goods and services—since the gap created by the removal of this war demand will probably be filled to a substantial extent by demands arising from the desire to make up for the limited consumption during the war, by making up the leeway in repairs and renewals, by replacements necessitated by the damage of the war, and by the reaccumulation of the world's stocks—as by the return to more normal conditions in the matter of the currency and the financing of businesses. This is dealt with in a later section.

It is impossible to say now to what level prices will subside, or how long it will take to reach that level; much depends upon the financial policies of the various Governments of the world, and