PREFACE TO THE FRENCH EDITION

Events in the world of money move fast; but it does not follow that principles shift as quickly. In addressing this edition to the French public, I may be excused, therefore, if I seek to apply, in a few words, the principles of this book to the changes which have come over the financial situation of France during the past six months.

I have maintained for a long time that a substantial fall in the value of the franc was inevitable unless there was to be a more drastic change in the policy of the French Treasury than was likely to be politically feasible. This fall has now taken place. The effect of the fall on the mind of the public is to engender increased distrust and fear, and the atmosphere is pessimistic. Nevertheless the establishment of financial equilibrium is easier now than it was before the fall took place.

Let me first clear out of the way certain opinions and arguments, which appear in the past to have influenced opinion, yet are altogether contrary to good sense:

1. It has never been officially admitted that the value of the franc can ever be fixed at any other value, either in gold or in commodities, than its pre-war gold parity. This is absurd. A restoration of the pre-war gold parity, apart from other intolerable consequences, would increase fourfold the present burden of the French National Debt. It is easy to calculate that the holders of the debt would have a claim in that event practically equal to the entire wealth of France. No Finance Minister there ever was could balance such a budget. Unless, therefore, the franc is never to be stabilised, in terms either of gold or of commodities, this figment of an ultimate return to a pre-war parity must be discarded.

2. Whenever the franc falls in value, the Minister of Finance is convinced that this is due to anything except economic causes and attributes it to the presence of a foreigner in the neighbour-
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hood of the Bourse or to the mysterious and malignant influences of ‘speculation’. This is not far removed, intellectually, from an African witch doctor’s ascription of cattle disease to the ‘evil eye’ of a bystander or of bad weather to the unsatisfied appetites of an idol.

In the first place the volume of speculation, properly so called, is always extremely small in proportion to the volume of normal business. In the second place the successful speculator makes his profit by anticipating, not by modifying, existing economic tendencies. In the third place, most speculation, especially ‘bear’ speculation, is for very short periods of time, so that the closing of the transaction soon exerts an influence equal and opposite to its initial effect. Moreover there has probably been on balance, since the date of the Armistice, more speculation in favour of the franc than against it. At least I can testify that many Englishmen, and even more Americans, have lost large sums by purchasing francs or franc investments in the hope of profiting from an improvement in the value of the franc.

I beg the attention of French readers to the arguments of chapters 2 and 3 of this book, because superstitions about speculation can only exist in an atmosphere of ignorance concerning the veritable influences which fix the level of the exchanges. In estimating lightly the influence of speculation, I do not include, however, the effects of a general distrust of the future prospects of a currency, to which I refer later.

3. It is often argued that the franc cannot fall in value because France is a wealthy, thrifty and industrious country, or because her balance of trade is prima facie satisfactory. This again springs from confusion as to the causes which ultimately govern the value of money. A very rich country can have a very bad currency, and a very poor country a very good one. The wealth of France and her balance of trade may render it easier for her authorities to pursue a sound monetary policy. But they are not the same thing. The value of a country’s monetary unit is not a function of its wealth or even of its trade balance.

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What, then, has determined and will determine the value of the franc? First, the quantity, present and prospective, of the francs in circulation. Second, the amount of purchasing power which it suits the public to hold in that shape. (The quantity theory in the form in which I state it in the first section of chapter 3, below, may, I think, be novel to many French readers.) The first of these two elements, namely the quantity of the currency, depends mainly on the loan and budgetary policies of the French Treasury. The second of them depends mainly (in present conditions) on the trust or distrust which the public feel in the prospects of the value of the franc.

With the franc in the neighbourhood of 120 to the £ sterling, the former task does not appear to the outside observer to be unduly difficult. When the internal price level has adjusted itself to the exchanges, the yield of many of the existing taxes in terms of paper francs will naturally be increased. On the other hand, the biggest item of expenditure, namely the service of the internal debt, will remain the same as before. Thus, even apart from additional taxation, the mere movement of the exchange has in itself a tendency to restore the budget towards equilibrium; provided always that public faith is maintained in the prospects of the national currency.

It is in this second factor, therefore, that the crux of the situation lies, namely the attitude of the French public towards their own currency. I emphasise the fact that the matter lies in the hands of Frenchmen themselves, not in those of any foreign persons. For the amount of francs owned by foreigners is probably not very great, not much more than what is still left in their hands as the remnant of disappointed ‘bull’ operations; and the obstacles are insuperable to ‘bear’ sales by foreigners of francs, which they do not possess, on a really large scale. On the other hand the volume of franc-notes and franc-bills and other short-dated investments held in France itself is enormous, far beyond the minimum required for the convenient transaction of business. If Frenchmen get it into their heads (as, each
in their turn, Russians, Austrians and Germans have done) that their national legal-tender money and titles to legal-tender represent a depreciating asset, then there is no near limit to the fall in the value of the franc. For, in this event, they will diminish their holdings of such assets; they will keep fewer Bank of France notes in their pocket-books and in their safes, will liquidate their Bons de Trésor and will sell their rentes. No law or regulation will avail to restrain them. Moreover the process will be cumulative; for each successive liquidation of franc assets and their transference into ‘real values’, by provoking a further fall, will seem to justify the prescience of those who fled first from the franc and will thus prepare the way for a second outburst of distrust.

In this case the fall of the franc will not be prevented even by a reformed budget or a favourable surplus of trade. For it would be necessary for the government to absorb the redundant bank-notes and franc-bonds and -bills, which the public no longer cared to hold, a task unavoidably beyond the government’s power. We have the experience of many countries to demonstrate that unbalanced budgets are the initial cause of collapse, but that the real dégringolade only comes when the confidence of the general public is so far undermined that they begin to contract their holdings of the legal-tender money.

The central task of the French government at this moment is, therefore, to preserve confidence in the franc in the minds of the widest circles of the French public. For it is the failure of this internal confidence, not speculation by foreigners (though foreigners and Frenchmen too may take advantage of a collapsing currency to win great gains), which would prove their undoing.

Now, if they go the right way about it, there is nothing impossible in the task of restoring and maintaining confidence. The examples of Russia, Austria and Germany are not a just parallel. Those who foresee the future of the franc in the light of such previous experiences may make a big mistake. For in those countries the problem of balancing the budget was, during
the earlier phases, a virtual impossibility. The initial impulse
towards collapse was, therefore, also a continuing impulse. This
is not so in France. There is no impossibility in achieving a
fiscal equilibrium, provided that reconstruction expenditure is
reasonably postponed. I applaud the efforts of M. Poincaré and
the French Treasury in this direction. But this is not enough by
itself. It is also necessary to restore public confidence; and in this
sphere of action every step taken by M. de Lasteyrie has been
away from wisdom.

For upon what foundations does the credit of a currency rest?
They are much the same as with a bank. A bank can only attract
and retain the deposits of its clients, so long as these clients
possess a complete confidence in their freedom to withdraw
these deposits for exchange into other assets, if they have a mind
to do so. As long as this liberty is beyond doubt, it will not be
exercised; the deposits will rest and grow. But if it is once called
in question, they will shrink and disappear. So is it with a
currency. Men hold a part of their resources in money, because
they believe it to be more readily and freely interchangeable
than any alternative hoard, into whatsoever object of value they
may select hereafter. If this belief proves wrong, they will not
hold money and nothing can make them do so.

Now the prime object of most of M. de Lasteyrie's regulations
is to restrict the liberty of holders of francs to exchange them at
their discretion into other forms of value. So far, therefore, from
protecting the franc and restoring its credit, they are directly
calculated to shatter confidence and to destroy its credit. A suf-
ficient number of regulations would destroy the value, precisely
because they would destroy the utility, of any currency in the
world. As soon as there is a doubt as to whether francs (or Bons
de Trésor) are a truly liquid asset, these instruments cease to
serve the purpose for which they are held, and holders hasten
to dispose of them before the doubt is resolved into a certainty
and yet further obstacles can have been placed in the way.

An instructive example of the way in which regulations pro-
The opposite effect to that which they intend is given by those of which the object is to hinder speculative operations. Those who have opened, in one way or another, a ‘bear’ position against the currency in question are in no way perturbed; for they can reckon with confidence that it will always be possible for them to buy the currency which in due course they will require to cover their open position. Those, on the other hand, who have taken up a ‘bull’ position and will, therefore, require to sell the currency at some later date, are thrown into confusion and seek in haste to sell their interest while still they may. It is for this reason that the threat of interference with the freedom of exchange dealings invariably operates to depress the value of the currency which it is sought to regulate. Just as a man draws out his deposits at the bank, whether he needs the money or not, as soon as he has reason to believe that he may not be free to do so later on, so the general public and the financial world alike withdraw their resources from a currency, if they fear a limitation on their subsequent freedom of withdrawal.

What course then should the French Treasury now take in face of the dangers surrounding them? It is soon said. First the government must so strengthen its fiscal position that its power to control the volume of the currency is beyond doubt, the necessity of which is at least accepted. Secondly—and especially during the interval which must needs elapse before the first category of measures can be brought into full operation—the government must restore such complete confidence in the liberty of the franc that no one will think it worth while to enter by way of precaution into sales of francs not immediately urgent—the equal necessity of which seems to be overlooked.

To achieve this latter object nothing more is required than a reversal of the recent policy of restrictions on dealing, of the useless hoarding of gold, of a relatively low bank rate, and of secrecy about the actual position of the Treasury and the Bank of France. The chief measures which are necessary can be summarised under three heads:
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1. All limitations on the use of francs to purchase foreign currencies, foreign bonds, or goods, whether for immediate or for deferred delivery, should be wholly repealed.

2. The discount rate of the Bank of France should be raised to a high figure, probably not less than 10 per cent in present circumstances (though it might not be necessary to maintain such a high rate for any length of time), so as to counteract anticipations, well- or ill-founded, as to the possible depreciation of the franc. In view of the high rate of interest now obtainable on French government securities (let alone the rates on forward exchange) the present rate of discount does not correspond to the facts of the situation and is calculated to stimulate over-borrowing. Possibly some increase of the Bank of France’s rate may have been effected by the time these lines are in print.

3. A considerable sum, drawn from the still ample gold reserve of the Bank of France, should be made the basis of a foreign credit, either by outright sale or by borrowing against it, to be available for use without stint in supporting the exchange near the present level and restoring confidence during the interval before fiscal reforms can produce their full effect.

I warrant that these simple well-tried measures, in combination with political moderation and with the drastic economies and taxes, without which no other measures can finally avail, would have a marvellous efficacy. After a few weeks of this medicine and with a benevolent reception by M. Poincaré (or his successor) of the forthcoming Experts’ Reports, the franc would be as steady as a rock. But if, on the other hand, distrust in the franc is countered by the methods of the Holy Inquisition, if Frenchmen prefer the concealed capital levy of inflation to other forms of taxation, if France remains the trouble-peace of Europe, then the franc may follow the course of other once-noble tokens.

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