Excerpts from *The Economic Consequences of the Peace* by John Maynard Keynes, 1919, pp. 235-248.

Keynes is often viewed as an economist who tolerated and supported mild inflation as an unfortunate byproduct of sustained, managed, economic prosperity. Yet this excerpt from The Economic Consequences of the Peace, *written just at the end of World War I, makes clear how fully he understood inflation's potential to destroy the fabric of society. It is also prophetic regarding the fate of all government attempts to control the price of goods by force of law. Its later passages also illuminate (by analogy) the negative effects of trade of any international currency during crisis (such as the devaluation of Thailand's baht that triggered the Asian economic contagion in 1997). The predicament of the responsible German trader facing rapid fluctuation in international currency values has been reproduced innumerable times across the world in the modern era of floating currency markets.*

Lenin is said to have declared that the best way to destroy the capitalist system was to debauch the currency. By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. By this method they not only confiscate, but they confiscate arbitrarily; and, while the process impoverishes many, it actually enriches some. The sight of this arbitrary rearrangement of riches strikes not only at security but [also] at confidence in the equity of the existing distribution of wealth.

Those to whom the system brings windfalls, beyond their deserts and even beyond their expectations or desires, become "profiteers," who are the object of the hatred of the bourgeoisie, whom the inflationism has impoverished, not less than of the proletariat. As the inflation proceeds and the real value of the currency fluctuates wildly from month to month, all permanent relations between debtors and creditors, which form the ultimate foundation of capitalism, become so utterly disordered as to be almost meaningless; and the process of wealth-getting degenerates into a gamble and a lottery.

Lenin was certainly right. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose.

In the latter stages of the war all the belligerent governments practiced, from necessity or incompetence, what a Bolshevist might have done from design. Even now, when the war is over, most of them continue out of weakness the same malpractices. But further, the governments of Europe, being many of them at this moment reckless in their methods as well as weak, seek to direct on to a class known as "profiteers" the popular indignation against the more obvious consequences of their vicious methods.

These "profiteers" are, broadly speaking, the entrepreneur class of capitalists, that is to say, the active and constructive element in the whole capitalist society, who in a period of rapidly rising prices cannot but get rich quick whether they wish it or desire it or not. If prices are continually rising, every trader who has purchased for stock or owns property and plant inevitably makes profits. By directing hatred against this class, therefore, the European governments are carrying a step further the fatal process which the subtle mind of Lenin had consciously conceived. The profiteers are a consequence and not a cause of rising prices. By combining a popular hatred of the class of entrepreneurs with the blow already given to social security by the violent and arbitrary disturbance of contract and of the established equilibrium of wealth which is the inevitable result of inflation, these governments are fast rendering impossible a continuance of the social and economic order of the 19th century. But they have no plan for replacing it....

The inflationism of the currency systems of Europe has proceeded to extraordinary lengths. The various belligerent governments, unable or too timid or too short-sighted to secure from loans or taxes the resources they required, have printed notes for the balance. In Russia and Austria-Hungary this process has reached a point where for the purposes of foreign trade the currency is practically valueless. The Polish mark can be bought for about [three cents] and the Austrian crown for less than [two cents], but they cannot be sold at all. The German mark is worth less than [four cents] on the exchanges....

But while these currencies enjoy a precarious value abroad, they have never entirely lost, not even in Russia, their purchasing power at home. A sentiment of trust in the legal money of the state is so deeply implanted in the citizens of all countries that they cannot but believe that some day this money must recover a part at least of its former value.... They do not apprehend that the real wealth, which this money might have stood for has been dissipated once and for all. This sentiment is supported by the various legal regulations with which the governments endeavor to control internal prices, and so to preserve some purchasing power for their legal tender....

The preservation of a spurious value for the currency, by the force of law expressed in the regulation of prices, contains in itself, however, the seeds of final economic decay, and soon dries up the sources of ultimate supply. If a man is compelled to exchange the fruits of his labors for paper which, as experience soon teaches him, he cannot use to purchase what he requires at a price comparable to that which he has received for his own products, he will keep his produce for himself, dispose of it to his friends and neighbors as a favor, or relax his efforts in producing it.

A system of compelling the exchange of commodities at what is not their real relative value not only relaxes production, but [also] leads finally to the waste and inefficiency of barter. If, however, a government refrains from regulation and allows matters to take their course, essential commodities soon attain a level of price out of the reach of all but the rich, the worthlessness of the money becomes apparent, and the fraud upon the public can be concealed no longer.

The effect on foreign trade of price-regulation and profiteer-hunting as cures for inflation is even worse. Whatever may be the case at home, the currency must soon reach its real level abroad, with the result that prices inside and outside the country lose their normal adjustment. The price of imported commodities, when converted at the current rate of exchange, is far in excess of the local price, so that many essential goods will not be imported at all by private agency, and must be provided by the government, which, in re-selling the goods below cost price, plunges thereby a little further into insolvency....

The note circulation of Germany is about 10 times what it was before the war. The value of the mark in terms of gold is about one-eighth of its former value....

It is a hazardous enterprise for a merchant or a manufacturer to purchase with a foreign credit material for which, when he has imported it or manufactured it, he will receive mark currency of a quite uncertain and possibly unrealizable value....

It may be the case, therefore, that a German merchant, careful of his future credit and reputation, who is actually offered a short-period credit in terms of sterling or dollars, may be reluctant and doubtful whether to accept it. He will owe sterling or dollars, but he will sell his product for marks, and his power, when the time comes, to turn these marks into the currency in which he has to repay his debt is entirely problematic. Business loses its genuine character and becomes no better than a speculation in the exchanges, the fluctuations in which entirely obliterate the normal profits of commerce....

Thus the menace of inflationism described above is not merely a product of the war, of which peace begins the cure. It is a continuing phenomenon of which the end is not yet in sight....