ABNORMAL DEVIATIONS IN INTERNATIONAL EXCHANGES.

ACCORDING to the theory of international exchanges which I have tried to develop during the course of the war, the rate of exchange between two countries is primarily determined by the quotient between the internal purchasing power against goods of the money of each country. The general inflation which has taken place during the war has lowered this purchasing power in all countries, though in a very different degree, and the rates of exchanges should accordingly be expected to deviate from their old parity in proportion to the inflation of each country.

At every moment the real parity between two countries is represented by this quotient between the purchasing power of the money in the one country and the other. I propose to call this parity "*the purchasing power parity.*" As long as anything like free movement of merchandise and a somewhat comprehensive trade between the two countries takes place, the actual rate of exchange cannot deviate very much from this purchasing power parity. Even restrictions of trade will not cause the rate of exchange to move from this purchasing power parity as long as they strike the trade in both directions equally. However, as I have tried to show in my book, "Dyrtid och sedelöverflöd" (Stockholm, 1917), if the trade between the two countries is hampered more severely in one direction than in the other the rate of exchange will deviate from its purchasing power parity. If the imports of a country are more severely restricted than its exports the consequence will be that foreign money will sink in value, as claims on such money will be comparatively easy to procure, but difficult to make use of. A country whose imports are impeded from all sides, but whose exports are relatively free might in this way see its money go up in value in foreign places considerably above the rates which would correspond to the internal value of this money as it is expressed by its purchasing power within the country.

This I think is, under the present circumstances, the case with respect to several neutral countries, and especially with Sweden. In February, 1916, the Swedish Mint was closed to the minting

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of gold and at the same time the Riksbank was released from its duty to buy gold at the mint par.[1] From that time the Swedish currency was freed from its connection with the metal gold, and its value in comparison with foreign money could be expected to be governed only by its relative purchasing power.

This seems indeed to have been the case during the first year subsequent to the above date. But during the course of 1917 it became clear that the internal value of Swedish currency no longer corresponded to the high value of the Swedish exchange in foreign countries. And in 1918 the deterioration of Swedish money has advanced so far that its purchasing power is now, probably, even more reduced than that of sterling. Nevertheless the sterling rate of exchange was lately quoted at about 14 crowns as against 18.16 as the old mint parity. So far as can be judged the purchasing power parity must at present lie considerably above even this old mint parity. At the same time the general level of prices in England stands, according to the *Economist's* index, at about 250 in comparison with 100 before the war. And even if this index does not, for reasons which are well known, represent the full real rise of prices, the error is hardly so great that the English inflation could be estimated at anything like as much as 330, which is the approximate figure for the Swedish inflation in the autumn of 1918.

That in spite of this Swedish currency is valued in England very much above its old mint parity is, from a scientific point of view, a very interesting fact, the true interpretation of which is also, under the present circumstances, of the highest practical importance. The explanation must, according to what has been said above, be the exceedingly severe hindrances which are put in the way of Sweden's imports and which surpass, considerably, those in the way of her exports. The result of these artificial conditions of Sweden's international trade has been an unprecedented accumulation of assets in foreign countries together with a great import of Swedish securities from abroad. This involves an export of capital on a scale which, indeed, far surpasses the economic power of Sweden. The foreign and internal claims on the capital of the country have together exceeded her accumulating capacity, with the consequence that fresh credits in Swedish crowns could only be obtained by measures involving creation of new money and further inflation of the monetary standard of the country.

[1] *Cf.* my article, "The Depreciation of Gold" [ECONOMIC JOURNAL, September, 1917].

When foreign countries complain of the high price which they must pay for the Swedish crown they in reality complain over a state of things which is not Sweden's fault but is the inevitable result of the hindrances which these countries themselves lay on imports to Sweden. If the same foreign countries would only send Sweden more goods they would have it in their power to bring down the international value of the Swedish crown as much as they liked, right down to its purchasing power parity, which would mean a sterling exchange of at least 18.16 crowns to the pound, perhaps even more. And when they, in order to escape from the present high costs of procuring means of payment on Sweden, claim fresh credits in Swedish money, they choose a way which is more injurious for the Swedish monetary standard and therefore for the whole economic life of the country, and which, moreover, is not at all so advantageous to the interests of the credit-claimers as it seems to be. Furthermore, the policy of this excessive credit-claiming must clearly prove a failure in so far as the object is to improve the rate of exchange and thereby to get Swedish goods at a lower price. The rate can no doubt be improved in this way, but only at the cost of a further inflation of Swedish money and, consequently, of a corresponding rise of the general level of prices of Swedish goods.

If the goods which are demanded from Sweden were paid in the normal way by goods, there would be no need of Swedish credits. It is an economic paradox that the whole world should ask credits from a country which, owing to her being cut off from imports in payment for her exports, stands in reality at the margin of starvation.

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