

**I**N RECENT MONTHS there has been an increasing amount of discussion concerning international liquidity, balance of payments, dollar glut, gold outflow, and monetary stability. Economists, even when they agree on the nature of the problems involved, seldom are unanimous on the solutions. The debates that are going on among economists, bankers and politicians are frequently phrased in highly technical and abstruse language, but the basic issue is simply this: how can nations continue to inflate their domestic currency and credit systems, and at the same time preserve mutual trust in each other's solvency?

The ideal economic world, in the view of many of our leading economists, is one in which we would have "freedom for each country to pursue its own independent economic policy unhampered by balance-of-payments considerations; and stability of [monetary] exchange rates to encourage international relations"\* Unfortunately, as the author hastens to add, "the two are incompatible . . ." The goal of today's international finance experts, therefore, is to discover the best compromise possible, the most workable balance between the two alternatives.

In the context of contemporary economic theory and practice, the phrase "freedom to pursue domestic economic policy" invariably means the freedom of the monetary authorities to inflate a nation's circulating media (currency, coins and credit). The motivations behind domestic inflation are varied; an important one is that the state can raise its level of expenditure without imposing a corresponding increase in the visible tax rate. Inflation, in short, is a form of invisible taxation, and those on relatively fixed incomes are the ones who pay the tax; they must decrease their purchases of consumer products and services when the level of prices rises.

#### **Inflation for Full Employment**

But the primary economic argument which is used today to defend an expansion of the domestic money supply is that inflation keeps effective demand at high levels, that people with the newly created money will buy more goods, and that businesses as a direct result will be stimulated to increase production. Consequently, more people will be employed by these firms.

Fundamental to this argument is the idea that the operation of the free market is insufficient to ensure employment for all those who desire to work. Somehow, the market fails to dispose of all goods offered for sale (through the unhampered action of the pricing mechanism) and therefore the demand registered by purchases is unable to encourage greater production. This perspective has been common to most socialist parties, but it became a basic pre-supposition of modern non-socialist thought through the teachings of John Maynard Keynes in his *General Theory of Employment, Interest and Money* (1936).

\*Tibor Scitovsky, "Requirements of an International Reserve System," in *Essays in International Finance*, No. 49, November, 1965.

# Domestic Inflation International

GARY

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Keynes realised that a downward revision of the level of wages would be opposed vigorously by labor unions, and the governments of most western democracies would find such a downward revision politically inexpedient. Money wages must not be permitted to fall. However, if inflation were allowed to raise costs and prices, real wages would fall without the organised opposition of labor. It was clear that if real wages did not fall, the result would be unemployment; the least productive workers would have to be dismissed.

Keynes wrote during the depression, but an analogous situation exists today. The structure of minimum wage laws creates a similar problem: the low production worker would lose his job were it not for the fact that governments are permitting real wages to fall (at least in comparison to what the wages would be in the absence of inflation.) Minimum wages laws have, in effect, made inflation a political necessity. Eventually the misallocation of scarce resources promoted by the inflation will harm both the laborers and the manufacturers as prices soar beyond the means of all but the most influential companies (politically) and the members of the strongest labor unions.

According to the "new economics," in order to keep businesses going at full production, thus keeping labor fully employed, ever-increasing doses of inflation are required. As Wilhelm Roepke has pointed out, it was precisely this philosophy of inflationary full employment that motivated the peacetime economic planning of Nazi Germany, with the resulting system of "repressed inflation"—rationing, shortages, and mis-allocation of resources.

The nation that indulges itself with an inflationary boom inevitably faces the economic consequences: either runaway inflation or serious recession. If the inflation should cease, unemployment will increase, and the earlier forecasts of the nation's entrepreneurs (which were based on the assumption of continuing inflation) will be destroyed. Since no political party is anxious to face the consequences at the polls of a depression, there is a tendency for inflations, once begun, to become permanent phenomena. Tax increases are postponed as long as possible, tight money (i.e., higher interest rates) is unpopular, and cuts in government expenditure are not welcomed by those special interest groups that have been profiting by the state's purchases. The inflation contin-

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ues. As Jacques Rueff has put it: "I know that these [monetary] authorities are not able, they have not the power—the human possibility, at least in our régime—to follow the policy which they ought to."

## International Complications

From an international standpoint, the situation is reversed. The primary need for international trade is a common means of payment that is not subject to violent upward surges, a money free from most inflationary tendencies. Foreign governments and central banks want to be able to trust their neighbour's currencies.

The best means of ensuring international responsibility in monetary affairs is the gold standard. This has always been true. Since gold cannot be mined rapidly enough to create mass inflation it retains its value over long periods of time. For example, the stability of British wholesale prices between 1821 and 1914 was remarkable. Central banks can demand payment of debts in gold or in currencies that are (supposedly) 100 per cent redeemable in gold. The banks can then use these foreign securities as a base on which to expand their own credit systems, on the assumption that the debtors' promises are as good as gold. At present, central banks hold American dollars and British pounds in lieu of gold—or, more accurately, they hold interest-bearing bonds and securities that are supposedly convertible into gold at any time.

## The Dilemma

Here is the basis of the conflict between domestic and international economic policies. Gold is presently necessary to support international trade and to maintain international trust in the two key currencies, the dollar and the pound, but both Britain and the United States have printed more paper and credit IOUs to gold than they have to redeem all outstanding claims. The domestic inflations have kept their post-war booms going, but now the trust abroad in both currencies is weakened. It is becoming clear that either domestic inflations must stop or else the key currencies are going to experience an international run on their gold reserves. Domestic inflation, in short, is the sole cause of the gold outflow in both the United States and Britain. Since 1960 the U.S. Treasury's stock of gold has been cut in half and at the present time there are foreign claims outstanding for over twice the amount of gold that the United States has in reserve (including that gold which is supposed to support our domestic credit and currency.)

Jacques Rueff, a French economist, certainly cannot be criticized for these words: "How can you expect a creditor to remain passive when he sees every day an increase in monetary liabilities and a decrease of the gold available to repay them? That is where you get a 'scissors phenomenon.' The U.S. is caught between the blades of the scissors." Yet Rueff is sneered at as France's "palace economist," as if the truth of a principle were the monopoly of the French. De Gaulle is castigated as economically insane for his attempt to claim what is legally his, the gold to which his country holds claims. The United States has contracted debts; it now is faced with the prospect of not being able to meet its debts. The issue is really very simple.

If higher interest rates are not offered in the United States and in Britain, foreign investors and central banks will cash their investments and demand payment in gold. But if interest rates *are* permitted to climb higher, the domestic rate of growth will be drastically affected. Money will be too tight, too expensive for the prospective borrowers. Hence, the "scissors" effect. There is no simple solution to the problem.

In 1964 the United States lost some \$385 million in gold; in 1965 the loss tripled, amounting to over \$1.1 billion. In the first six months of 1966 the outflow was almost \$300 million. The costs of the war in Viet Nam are increasing the deficit in the budget. In Britain, Prime Minister Wilson has been forced to declare a price and wage freeze in order to halt the inflationary rise in prices; this, of course, is repressed inflation—the hampering of the market by government controls—and not a cure. But at least political leaders in the two nations have come to the realisation that continued deficits and continued increases in the money supply (apart from increase in gold and silver) cannot go on much longer without serious repercussions in the world money market, and hence in the world's trading community.

## The Search for Substitutes

Thus we can understand the frantic search for a non-gold international medium of payment. The economic isolationism that always results from domestic inflation cannot be permitted to disrupt the fabric of international integration and trade. Devaluation (charging more dollars or pounds for a given quantity of gold) could easily destroy the confidence in both currencies and thus result in international economic chaos. Mutual distrust would then be the order of the day in all international transactions.

The problem is that no substitute for gold has yet been discovered (or created) by mankind, and gold, because of its resistance to full employment inflationary policies, is taboo. What is needed, we are told is something as good as gold, yet which permits domestic inflation. There are numerous suggestions for such an international money, probably under the control of the International Monetary Fund, but no single plan has reached even partial acceptance by the economists and officials of the nations involved. A fun-

damental obstacle to be overcome is the basic division between the central banks and the governments: certain policies that are favourable for one group are harmful for the other. Paul H. Douglas, in his recent study of world trade, attempts to find a synthesis of these various schemes, but even his powers of exposition fail him.<sup>1</sup> The solution to the dilemma has not been found, and time (and gold) is running out.

### Why Gold?

A full gold standard would unquestionably solve the problem of international acceptance and solvency. Gold has always functioned as the means of international payment, and there is no reason to suppose that it will not do so in the future (assuming that prices and wages are permitted to adjust on an international free market). The opposition to gold in international trade is based upon ideological assumptions that are hostile to the idea of the free market economy. Gold would ensure monetary stability, if that were what the economists and legislators really wanted. It would ensure too much stability to suit them, and this is the point of contention. As the late Professor Charles Rist once wrote: "In reality, those theoreticians dislike monetary stability because they dislike the fact that by means of money the individual may escape the arbitrariness of the government. Stable money is one of the last arms at the disposal of the individual to direct his own affairs, whether it be an enterprise or a household. It is certain that nothing so facilitates the seizure of all activities by the government as its liberty of action in monetary matters. If the partisans of [unbacked] paper money really desire monetary stability, they would not oppose so vehemently the re-introduction of the only system that has ever insured it, which is the system of the gold standard..."<sup>2</sup>

## THE BULLDOZING COUNCIL

"AN ENGLISHMAN'S HOME is his castle," as well as being an incredibly trite remark, seems to be in danger of becoming a complete lie.

Like so many who are led to believe that to buy a house is a good investment, Mr. Roy Fielding bought a £1,200 house with a £1,000 loan from a building society in 1960. At that time there was no mention of any likely redevelopment. In fact, the Newport Corporation claim that it was only in 1962 that they started to make plans for that area, and until Mr. Fielding read in the local paper in 1964 of their plans he had no idea he had made a bad investment.

Now the council are offering him £200 compensation for his house, which they are bulldozing into the ground. Mr. Fielding still owes £800 to a building society, so for the next ten years he will be paying for a house that does not exist.

<sup>1</sup>Paul H. Douglas, *America in the Market Place* (Holt, 1960), p. 139.  
<sup>2</sup>Charles Rist, *The Triumph of Gold* (Philosophical Library, 1960), p. 139.

## BURDEN OF LANDLORDISM THROUGHOUT ASIA

IN *PACIFIC* (March-April, 1967) organ of the A.I.C.D., New South Wales, Jean Richards, Convenor of the Australian Quaker Peace Committee, reported on a Young Asian Leaders' Conference in the Philippines. She devoted some attention to land tenure, the main features being the following:

The feudal system of land tenure until recently operated all over Asia and still operates in many parts. It keeps the land tiller in abject poverty; division of the crop is at best 50/50 between owner and tenant. Sometimes it is as high as 75/25 in the landlord's favour. From his share the tenant must usually supply seed, fertilizer, plough, water and labour. Out of the balance he must maintain himself and his family. There is little incentive to increase output, as any increase brings only a marginal increase in his own return.

In the last twenty years some sort of land reform has been attempted in some Asian countries. In a few cases the landlord has been dispossessed and the land redistributed. In others, various compensation methods have been adopted. Yet again, in some places, landlords have been able to block almost all reform (South Vietnam, incidentally, being in case in point). There has been a successful land reform scheme in Taiwan, but it must be remembered that this was undertaken by an alien government which took over from those who had no say in the government.

Mrs. Richards correctly remarks that land reform, to be successful, must be instituted because it is beneficial for the people, and not just as a reaction to a crisis, e.g., an upsurge of communist influence. She also observes that the land tenure system has perhaps contributed more than anything else to the growing communist influence in Asia. She cites the example of the Philippines, where failure to implement promised land reforms was followed by the upsurge of the communist-led Hukbalahap movement, and she reminds us that for starving and semi-starving people, ideologies matter little; any system that results in better living standards is welcomed.

To all this must be added a consideration of the *method* of land reform. This is to be not by liquidating landlords, nor by compensation schemes (under which heading nationalisation often appears). Compensation for improvements made by landholders is unobjectionable, indeed, quite fair; but why should landlords be compensated for the fact that they are no longer able to exploit others? The essential point to recognise is that different sites of land have different degrees of potential earning power. This is a reflection of the community amenities to which particular sites are accessible. The logical and ethical step is to draw upon site rents as the primary source of government revenue, while simultaneously reducing taxes on goods, earnings and consumer services.

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