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THE WAY OUT OF THE DOLLAR SHORTAGE

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Among the host of diseases that have infested the community, especially since the termination of the second World War, the so-called dollar shortage has taken an important place. The dollar shortage, however, is only one form of the disease, and the shortage of other foreign currencies is often as serious.

Usually the disease is looked upon as an affliction comparable with the Black Death or the plague - an epidemic carried on the wind, nobody knows whence or why. Or could the trouble be taken to be - as some regarded the plagues of old, the judgment of God for the wickedness of mankind? And why not? From a religious point of view there is certainly much to be said for an interpretation like that.

But I speak here in my capacity as a political economist and must take an economic view of the problem. And in this light the causes of the dollar shortage are at once not so obscure. A closer examination will show that this disease must be diagnosed as entirely self-inflicted and a direct result of human actions.

Our money system, of course, is nothing but an improved and readier form of old-time barter. Our moneys are merchandise and obey exactly the same economic laws as other goods. Thus the moneys of various countries have their respective prices, although we usually complicate matters by calling these prices, rates of exchange or valuta. When the Swedes say that the dollar rate of exchange is 5.18, or the Danes that it is 6.92, they are of course simply stating the price of a dollar in Swedish or Danish kroner respectively.

When we talk nowadays about having "fixed" rates of exchange, that simply means that we have prices for foreign currencies which have been fixed by the state; in other words we have price control. The antithesis of that system is of course to have free rates of exchange.

If price control is to have any meaning at all, here or elsewhere, it means that prices are fixed so as to differ from the free market prices. But prices thus fixed must always upset the balance of supply. There will either be a shortage or a surplus of the article in question.

In a free market prices have a tendency to adjust themselves at a level where supply and demand will be fairly evenly balanced. There may of course in such a market occasionally be a shortage or an abundance of certain articles because of the tendency in prices to lag behind; but any real shortage or any actually unsaleable surplus practically speaking never obtains.

If, however, you fix the price below the market level, i.e., make an article cheaper, demand will almost always increase. At the same time it will become less profitable to produce the article, and supply will decrease. The result will inevitably be a shortage. If, on the other hand, the price is fixed above the market level, you get the converse result. Demand will be less, whereas production will be stimulated. The result will now as inevitably be a surplus.

During the crisis in the thirties the state believed that it would be able to help industry out of its distress by fixing the prices of its products at a higher level than the market price. And though a large section of the industrial machine came to a standstill on account of depression and unemployment, we had a great unsaleable surplus of wheat, cotton, coffee, pork, meat, etc., which in many cases simply had to be destroyed.

During and after the second World War the state thought, for reasons of its own, that it ought to fix prices below the market level. And although this time we have had full employment, and all wheels in industry have been humming, we have been left with a shortage of a number of necessities of life.

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The dollar shortage as well as the shortage of other foreign currencies has arisen in exactly the same way. We have not been willing to accept the market prices, but have fixed so-called official rates of exchange; in addition, the national bank has monopolised the purchase and sale of foreign currencies. As the prices - the rates of exchange - are usually fixed below the market level, demand has been too great in relation to supply, and we have got a shortage. The position has become still worse because through this price-fixing the "production" of foreign currencies - via export - has become less profitable and has therefore slowed down.

Let me illustrate this by an example. The official price of dollars in Sweden as mentioned before, is 5.18. The pronounced shortage of dollars shows us, however, that this price is too low. Many signs indicate that it ought to have been about 6.50. What is the effect on foreign trade of this low price? For the buyer of dollars - the importer of goods - it means that he will get a $100 article for 518 kroner, whereas in a free market he should have paid 650. On account of this low rate, American dollar articles become cheap; everybody wants to buy from America, and the demand of dollars consequently becomes very great.

For the seller of dollars - the exporters of goods - it means that he will get 518 Swedish kroner for a $100 article, whereas in a free market he would have got 650. He will thus be paid 20 per cent less than what a free market would have assured him. It is understandable that in these circumstances he will more often than not find the prices in the American market unacceptable and unprofitable. The consequence is that the export to the U.S.A. progressively dwindles, which is another way of saying that the "production" of dollars in Sweden is insufficient in relation to demand.

In such a situation, the dollar supply in the national bank will melt away like snow in the spring sun, and unless the price - the dollar exchange rate - is quickly altered, the supply will simply run out. With the demand continuing grester than the supply, and the purchasers' need for dollars exceeding what the exporters can deliver to the national bank, there is in this situation no alternative but to increase rationing of the article in short supply. Anybody wanting to buy dollars for one reason another will have to apply for them, and only those applications will be granted which the national bank or the responsible government department, from its special view of the case, considers to be important.

Why does a regulated price regime as a rule tend to keep the prices - the rates of exchange - for foreign currencies, below the market level? Several reasons can be given, but they are all based on false assumptions and the results of pure wishful thinking. First of all, it is believed that by this system imports could be cheapened; a $100 article will now cost the importer only 518 kroner, whereas at a proper rate of exchange it should have cost 650 kroner. This observation is correct if you look at the immediate result, but in the long run it is completely false. For the system also means that the exporter will get only 518 kroner for a $100 article, whereas at the proper rate he should have had 650. In reality the same effect is produced as if exports under free rates of exchange were burdened with a 20 per cent export duty. As it is, there are the complaints about the dwindling Swedish export to the U.S.A. and Swedish producers are reproached for their inability to compete successfully in the American market!

The argument that imports are cheapened is a false one. In the long run the only means of paying for our imports is by our exports. What benefit can we have of cheap imports if our exports fade out? We shall have nothing to pay with. Moreover - if the problem is merely to get cheap imports, why don't we fix the dollar rate at 2.50? Or why not at a half-krone? A rate like that would surely make imports really cheap!

Rates of exchange that are too low act as a noose round the neck of export. The tighter the noose, i.e., the lower the rate, the greater will be the part of export that is strangled. But as there must be exports in order to have imports, the latter will be strangled to the same extent.

Rates of exchange that are too high are by no means better. Suppose that in Sweden we fixed the dollar rate of exchange at 10 kroner instead of the 6.50 that the market level warrants. The exporters would then get 1,000 kroner for a $100 article instead of 650 kroner. That would amount to the same thing as an export subsidy of more than 50 per cent. Under these conditions the export to the United States would be highly profitable for the exporters, and we would get a tremendous export rush across the Atlantic. But at the same time the American imports would become so expensive in Sweden that nobody could buy them, and the import from the U.S.A. would fall away completely. The system would in fact have more or less the same effect as a prohibition against the import of American goods. But export is not an aim in itself; if we got no imports in exchange for exports, it would be senseless to export at all. The system would simply be an exquisite illustration of currency-fed dumping. Swedish exporters would be able to oust all American producers in the American market, but very soon this would give occasion for American counter-meaures in the form of increased customs duties or other restrictions on import. And in such circumstances those counter-measures would, in my opinion, be fully justified.

In Sweden we have an example of such a system in our trade with Argentina. The official rate of exchange for pesos has been absurdly high, and as a result the export to Argentina has become particularly profitable, and tempting from a Swedish point of view. At the same time the price of Argentine imports has so risen that practically all import has become impossible. If consequence we now find ourselves with large frozen assets in Argentina without possibility of converting them into goods on reasonable terms. And at length the Swedish state was forced to adopt various expedients, including export duties, in the effort to stem this exportation so senseless from the Swedish point of view.

Too low rates of exchange will cause exports to shrink and imports to swell. Too high rates of exchange will have the opposite effect. In both cases a disequilibrium is produced followed soon by a decline in the volume of foreign trade. It is easy to show mathematically that the volume of foreign trade is greatest when the rate of exchange is at a level where the supply of and the demand for foreign currency balance one another. And that, as is well known, is the rate of exchange which is reached in the free market.

There is no sense in managing the rates of exchange unless to make them differ from the rates that a free market would determine. But whether they are fixed below or above the market level, the result will inevitably be a decline in foreign trade, and the greater the decline, the greater this difference is. And with that decline so also is lost the gain otherwise derivable from the international division of labour. The benefits of the division of labour redound upon our standard of living to a degree considerably greater than people generally recognise. The system of managed rates of exchange cannot but result in a reduced standard of living.

Let us further examine some of the arguments adduced in favour of rates of exchange that have been fixed too low (we paying too little of our currency for foreign currency). It is said that if the exchange-rate were adjusted to the market level (that is, by devaluation so that now we should pay more for foreign currency) then inflation would be aggravated. Imports would be made dearer, and by the change exporters would enjoy greater profits - hence the possibilities of raising wages and increasing investments. The reasoning is no less fallacious by being seductive. First of all there will be no change in the total purchasing power of the country. The higher incomes of the exporters will be counterbalanced by the reduced purchasing power of would-be importers. False rates of exchange will cause decrease in foreign trade and with that the supply of goods in general and thus they are factors that make for inflation.

Against that, it is quite ridiculous to maintain that free rates of exchange could aggravate inflation. These free rates of exchange simply register the value-relationship between the domestic and the foreign currency, exactly in the same way as a clinical thermometer registers the temperature of the body. The patient will not recover any quicker by tampering with the thermometer, as is occasionally done. If our own currency depreciates in value in terms of other currencies, it is nearly always and to an extreme degree the result of our own internal policy, by which people usually try to live above their means.

In these times of inflation when so many people try to put the blame for their own inflation upon conditions abroad, it is well perhaps to remind them that nothing so effectively excludes foreign inflation as free rates of exchange. Let us illustrate this by an example. Suppose that a country A has a currency - call it sequins - of the same value as the Swedish currency so that 100 sequins equals 100 kroner. Suppose that out of various circumstances - chiefly an irrational economic policy -there should be a prodigious inflation in country A. The price level in that country is doubled, the sequins consequently losing half their value. Let us further suppose that the internal value of the Swedish krone has remained unchanged during the same period. Under a system with officially fixed exchange rates 100 sequins will still cost 100 kroner. But as the price level in country A has been doubled, this means that prices of Swedish imports from A are also doubled, just because it now takes twice as many kroner to purchase the sequins in order to pay for the goods. At the same time, our exports to A will become exceedingly profitable. The exporters will be paid twice as much as before. Our trade with A will be thrown completely out of balance and eventually and inevitably dried up.

What would have been the course of events if we had had free rates of exchange instead? The rate of exchange would then all the time have registered the changing relative value of sequins and kroner. When sequins had fallen to half their original value, we in Sweden would have been able to buy 100 sequins for 50 kroner. This would mean that the article which at the outset cost 100 sequins in country A and today costs 200 sequins, could all the time have been had for 100 kroner in Sweden. Exactly the same would have applied to our export. The exchange of goods with country A would have proceeded all along in both directions completely unaffected by inflation. No inflation from abroad can penetrate the frontier of a country which has free rates of exchange. There is only one disadvantage attaching to free rates of exchange that should be pointed out: it is that if inflation does occur, the country in question will have no excuse for putting the blame on other countries!

Another argument against the adjustment of foreign currencies to the market level is that devaluation would mean a recession in the exchange of goods with other countries. It is maintained that we would get fewer goods from abroad in exhcnage for our own. This view is fundamentally mistaken. No manipulation whatsoever of our rates of exchange will change the prices in the world market. A $100 article will still cost $100, whether we buy or sell it. Thus the real value-relationship of goods for goods can never be affected by alteration in monetary rates of exchange.

Don't interfere with the rates of exchange! Our money ought to be a stable standard of value, and its value in relation to other currencies should not be changed from time to time. This argument also may be thrown at you if you venture forth to propose an alteration in the rate of exchange. It is based entirely on an error of judgment. Free rates of exchange are nothing but a pair of scales where the value of our own currency is weighed against the value of others. Our Swedish krone will be neither heavier nor lighter if we tamper with the scales. Its real weight is not affected by it. As a rule we wish to see our krone weight as much as possible and when we fix lower values for foreign currencies, it is due to that wish. But the real weight and value of the krone is of course completely independent of all manipulations with the scales. If we have continued to tamper with the scales so as to make them show a higher value than the kronereally has, then the krone will not get any lighter by our adjusting the scales so that they show the correct weight.

If our own money for some reason or other depreciates in value, this is a deplorable fact and you may not wish to admit it. In a case like this there will always be a temptation to begin tampering with the scales; that is, fixing the value of the foreign currencies at too low a level. The consequences of this manipulation will inevitably be shrinking of exports and swollen imports. If you will not adjust the rates of exchange according to the scales, there is no other way of establishing an equilibrium in foreign trade than to slash the excess of imports over exports. The more you tamper with the rates of exchange, the more will export shrink, and the more you must cut down your import. If you travel sufficiently far along this road you will at last strangle your import as well. Faced with this policy, the ultimate and only radical remedy for this lack of balance will be the complete prohibition of all foreign trade. Thus you will cure the malady as certainly and as effectively as you would cure a headache by decapitation! And with much the same result to the patient!

The usual objection against free rates of exchange is that they will mean continuous fluctation and thus render difficult all calculations in foreign trade. As a rule business people emphasise their desire for stable rates of exchange thus to be on firm ground with their calculations. Unfortunately the reply must be that this is just one of those pious and ethereal wishes that can never come true in this imperfect world of ours. We live in a dynamic and changing world where all values are constantly changing. The currencies of various countries are by no means exceptions to this rule. Certain countries succeed in keeping the value of their currency comparatively stable; others are liable to quick inflation.

Even countries with managed currencies must sooner or later allow variations to find expression in altered rates of exchange, even if they usually wait as long as possible. Their only choice in the world of realities is on the one hand between the continuous and responsive adjustment of the rates of exchange which in a free market reflects the actual changes in relative values, and on the other hand the sporadically recurring landslides in the rates of exchange which we find in the managed exchange-market. The dollar value of the Swedish krone was changed in July 1946 from 24 to 28 cents, an increase of about 17 per cent. In September 1949the rate of exchange was lowered from 28 to 19 cents, a decrease of more than 30 per cent. Which alternative is to be preferred from a business or calculation point of view?It must be remembered that the business man who does not want to take the risk himself of alterations in the rates of exchange will always be able to safeguard himself by advance purchase of currency.

But a system with free rates of exchange has other qualities that are not looked upon as merits in certain circles. Since we have learned by means of subventions to manipulate the prices of various necessities, we can no longer, with any exactness, estimate the extent of inflation by means of a cost-of-living index. Free rates of exchange would here act as an extremely sensitive barometer that would register most accurately the course of the inflation, and thus at the same time give a continuous indication of the character of the economic policy of the country. No doubt this is one of the most dreaded qualities of the free system.

We should understand what these manipulated rates of exchange mean to our traders competing in foreign markets. When competing on equal terms it is usually sufficient for a firm to rationalise its production to such a degree that it can undercut the prices of its competitors by a few per cent. But what is the use of rationalising if - as is the case with dollars in Sweden - you have a rate of exchange which in reality has the same effect as an export duty of 20 per cent? Is it surprising that the Swedish export to the U.S.A. in these circumstances must be going from bad to worse? It certainly does not improve matters that most firms do not seem to realise the true state of affairs.

With no reason at all they are at present feeling ashamed because of this failure to compete in the American market!

It is, I think, most unfortunate that the economic pattern of our society very often has become so complicated that it is beyond ordinary people to understand or comprehend it. Particularly from a liberal point of view must this be deplored as it prevents people from comprehending the true causes of most of the afflictions and sufferings that disturb our managed economy. But undoubtedly it suits and satisfies the economic planners!

If you fix the price of an article too low - whether it be houses, electric energy, paper, or foreign currencies - there will be a shortage of those necessities. We have fixed the price - the rate of exchange - of dollars and other currencies too low, and we have got our shortage. The malady that has been labelled 'dollar shortage' is entirely self-inflicted, a result of the official currency policy. The way by which we can be freed from this plague, is to have a free market in currency. This would have widely beneficial effects without any corresponding drawbacks, for all the advantages we imagine we gain by tampering with the currencies are but castles in Spain.

The dollar shortage is wholly and entirely self-inflicted, but openly to admit this is of course out of the question. In our desperation we look about for scapegoats on whom to put the blame. A common attitude is to throw the blame on the Americans and more particularly on their tariff policy. But whatever one may say the denounced tariff is in this instance completely innocent, since no tariff in the world can create a dollar shortage for us if we have a free currency market. The tariff is a barrier to world trade, and the higher it is the greater is the barrier, and the less foreign trade there will be.

In fairness to the Americans I should like to remind you that their tariffs on imports have been reduced from about 26 per cent ad valorem to 13 per cent in the period from the middle thirties to the present day. Of course this 13 per cent is too high, and of course we all hope that the Americans will find strength and courage to continue along the road they have taken until the remaining tariff barriers have been demolished. America will thereby become a leading example of almost inestimable importance to the rest of the world.

When we in Europe and elsewhere blame the United States for the dollar shortage we reason in the same way as the wolf who accused the lamb, drinking further down the stream, of muddying his water.

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