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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. 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. A closer examination will show it must be diagnosed as 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.

Price control 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.

If 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.

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 monopolized 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.

This relief, by Staehr Nielsen, appears over the door of the Folk School in Odense, Denmark. It was inspired by the parable from "Protection or Free Trade" by Henry George, who compared this helpless bull to the masses.

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 greater 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 introduce rationing of the article in short supply.

Why does a regulated 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 argument. 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-kroner? 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. 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.

This 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 import 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

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producers in the American market, but very soon this would give occasion for American countermeasures in the form of increased custom duties or other restrictions on import. And in such circumstances those countermeasures would in my opinion be fully justified.

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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 kroner 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 will inevitably dry 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 attached 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 exchange for our own. This view is fundamentally mistaken. No manipulation whatsoever of our rates of exchange will change the prices in the world market.

Don't interfere with the rates of exchange! 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. The usual objection against free rates of exchange is that they will mean continuous fluctuation and thus render difficult all calculations in foreign trade. As a rule business people emphasize 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.

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 rationalize 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 rationalizing if—as is the case with dollars in Sweden—you have a rate of exchange that 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 realize 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!

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 thirities 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.

(Address at International Conference for Land Value Taxation and Free Trade, 1952, Odense, Denmark.)