Economic Fallacies of Monetary Control

This is the fourth of a series of articles condensed from the book *The Free Convertibility of Sterling* by GEORGE WINDER, published by the Institute of Economic Affairs.

INTERNATIONAL MONETARY CONTROL

I HAVE shown, I hope, that national monetary control can be exceedingly dangerous. In times of peace it is seldom exercised for the general good, but for the benefit of sectional interests and for the ends of party politicians. It creates a huge monopoly in the sale of essential commodities that should receive the benefits inseparable from competition.

But if national controls of overseas exchange are dangerous what must we think of international controls? I have shown that the British Exchange Equalisation Account was formed with the purpose of holding a great pool of foreign currencies. The International Monetary Fund launched at Bretton Woods has the same purpose but it claims immensely greater powers.

The money for this great experiment in international control was supplied, by the member nations, upon a quota system based upon the extent of their international trade, part of this quota being paid in gold. Each country was required to agree with the Fund's authorities on a gold par value for their respective currencies. But to agree to a gold value for a currency that need not be convertible into gold is unrealistic, and this caused the Fund's first troubles. Some countries have not yet agreed to a par value for their currencies, while others, having agreed to a value, have allowed it to lapse. There has also been quarrelling among the nations as to the true par value of a currency. France and Italy have both claimed that they have been harmed by the original par value of the British sterling that produced a rate of £1=4.03 dollars.

Among the objects with which the Fund was formed was that of facilitating the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income. Also, 'to provide exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.'

These objects sound well enough, but the Fund was formed on the assumption that all foreign exchange was in future to be controlled by national governments. This in itself makes the Fund a hindrance rather than a help in attaining its professed aims. Competitive exchange depreciation is only possible when nations monopolise the sale of foreign currencies, yet the Fund did not propose to get at the seat of these evils and cure them by restoring freedom; it proposed merely to apply superficial remedies that would assuage the wounds. In doing so it tended to establish national controls of exchange rates more firmly than ever. In the words of Professor Wilhelm Röpke, it ended by throwing 'the whole weight of the International Monetary Fund behind the policy of keeping "wrong" exchange rates stable.'

It is probable that John Maynard Keynes, the British representative at Bretton Woods, saw in the International Monetary Fund merely an instrument for ironing out exchange fluctuations, but the real author of the Fund was the American representative, Harry Dexter White, and he may have had another object in view. He has a strange history. Was he one of those who thought that the economy of the post-war world could be planned by an all-powerful authority with its inspiration and ideals centred upon Communist Russia? Did he work with such an authority in view? Was he at Bretton Woods serving America or Communism? When we consider this, we must remember that Harry Dexter White was one of the most successful undercover workers for the Communist cause that the free world has yet exposed. The exchange control regulations are typical of the type of legislation demanded by Karl Marx in his Communist Manifesto.

The European Payments Union is another experiment in pooling nationally controlled currencies. Instead of receiving a national currency for the supply of goods, the supplying nation receives a credit in the central fund. As such a credit would not satisfy the individual businessman who sold the goods, again we have an organisation built upon the assumption of nationally controlled exchanges. The rules provide that a country that runs into debt must pay in gold, but not to the full extent of the debt.

The Union is now divided into a number of nations heavily in debt to its funds and a smaller number heavily in credit. It has only existed as long as it has because it has been bolstered up by large supplies of American dollars.

Both the International Monetary Fund and the European Payments Union were formed to check the evils arising from the national control of foreign exchanges. They are the consequences of, and not the cure for the disease, and they are creating further evils and making it more difficult than it otherwise would be to return to exchange freedom.

However, these difficulties can be overcome. Whether or not Great Britain permits a free market is a decision for our Government alone. It is quite wrong to think that international action is necessary before we allow our own people to purchase foreign currency wherever they can get it, and at whatever price they can arrange.

All international funds to control exchange transactions are based on the totalitarian ideas that the once free nations have absorbed into their blood stream from Communist Russia and Nazi Germany. They profess to facilitate international payments, but the ease of international payments that existed before such international bodies were devised has not been regained. Freedom will make both the Fund and the Union unnecessary and will end the harm they are undoubtedly inflicting upon the world.

PRETEXTS FOR CONTROL

WHEN one considers how dangerous to a country's prosperity exchange controls can be, one begins to wonder why they have been tolerated so far into the present period of peace. The only answer that presents itself is that the vast majority of the people know nothing about this vital question and are quite willing to leave its consideration to others, while the majority of those who do understand the issues involved profit by controls.

What are the arguments chiefly used today to induce us to continue exchange controls? A favourite contention is that, as controls enable rates to remain stable, this helps the flow of trade, for merchants want money to be of the same value when they order goods as when they pay for them. But under the free system rates fluctuate only a percentage or two around a central point; if the real values of currencies are changing this central point will move, but it will not move very far during the period it takes to complete the average trade transaction. Furthermore, banks will always quote a price for forward delivery of a foreign currency, thus taking the risk completely off the shoulders of the merchants.

Far from exchange control providing security for the merchant, it actually increases his uncertainties, for when a currency is changing its value no government is strong enough to keep its price fixed indefinitely. The delay that control does effect will make a change in exchange rates, when it does occur, all the greater and more dangerous. Many merchants lost heavily when the exchange rate between the dollar and the pound changed in one night from 4.03 to 2.80 dollars. Others, of course, gained undeserved windfalls.

An argument closely associated with this is that when exchange rates are free speculators make profits by dealing in foreign currencies. Speculators under such a system have a useful function, for their activities tend to even out the movement in exchange rates. It is true that they probably make profits, and sometimes losses. But the free system never gives them such chances to make spectacular profits as those afforded by the sudden and wide changes associated with exchange control. The speculator never made greater profits than those afforded

Inflation of the Currency— The Root of Devaluation

THE NEW WAVE of devaluations in Latin America serves as a dismal reminder that the hopes which were running high a few years ago of getting the region to rid itself once and for all of the more chronic forms of inflation have come to nothing . . .

The devaluation of the peso from 151 to 171 to the U.S. dollar which the Argentine authorities announced over the week-end is the fourth that currency has experienced since the end of 1963, the cumulative effect of the series having been to reduce its value in terms of other currencies by about a quarter. Its experience is, however, by no means exceptional in a Latin American context.

The main rates of exchange for the Brazilian cruzeiro have been altered about the same number of times since the end of 1963, . . . the cruzeiro currently having a foreign exchange value that is not much more than a third of what it had at the beginning of this period.

Then there is the Uruguayan peso. It has been the subject of two major devaluations since the opening of 1964 and the result is that it is now quoted at only about two-thirds of what it was at the end of 1963. When the severe devaluation that overtook it during 1963 is also taken into account, we find that it has suffered a loss of value of almost two-thirds in no more than two years . . .

It is broadly true to say, in short, that devaluation has now regained its earlier popularity in Latin America . . . But the main reason why exchange rates are again being adjusted at such short intervals lies in the fact that chronic inflation is once again the order of the day, and, this being so, the purchasing power of the region's currencies is constantly being eroded to the point where existing exchange rates become unrealistic.

— Lombard in *The Financial Times*, April 21.

him by Sir Stafford Cripps when he devalued the pound in 1949.

Another argument put forward by the monetary controllers is that overseas investment will be hindered by flexible exchange rates, with detrimental results on the development of the Commonwealth. Experience indicates that exactly the opposite is the case. Since the era of control, investment abroad has been greatly reduced.

At the same time it is argued that a free exchange market would allow capital to flee the country. But as we have seen, capital investment abroad does not mean that money leaves the country; it means that money earned for exports, instead of being used to purchase imports, is used for investment abroad.

All U.S. dollars earned by Englishmen are exactly the same type of dollar. Whether they should be used for investment in U.S. mines and industries or used to purchase consumer goods is hardly a question that should be decided by a clerk in the Bank of England. Is the type of control that encourages the spending of dollars on films and tobacco but discourages the spending of dollars on capital investment in the long-term interest of the rightful owners of those dollars or of the country?

It is sometimes argued that if a currency were completely free so that it could fall indefinitely this would involve the danger of 'a vicious spiral of falling exchange rates, rising domestic prices, worsening external balances, and further depreciation.'

This argument implies a complete misunderstanding of the factors that decide exchange rates and the value of currencies. In buying or selling currencies dealers do not, except in the very smallest degree, create values or prices; they only register values that already exist. The value of a country's currency is decided solely by its internal management. If a government is so dishonest that by inflation it continues to reduce the purchasing power of its currency it is desirable that this depreciation be reflected in exchange rates. Otherwise loss of trade and subsequent sudden devaluation will reveal the true value of a currency in a way the people will not like. This is, in fact, what happened in Great Britain in 1949.

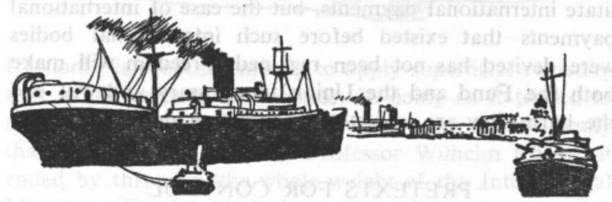
It is sometimes claimed that a return to freedom may cause those countries that still have accumulated currency balances in Great Britain to rush to exchange them, with detrimental results on the price of the pound. But the holders of such balances would themselves lose by such precipitate action.

This leaves us with the most popular, as well as the most foolish, argument put forward by the currency controllers; that is, that if the currency were freed rich people would take advantage of that freedom to import luxuries, thereby leaving insufficient foreign currency available for the people to purchase necessities.

Very nearly one quarter of the commodities consumed yearly in Great Britain are bought originally with overseas currency. The volume of money available to purchase overseas exchange is distributed amongst the various income groups of the British people in almost exactly the same way as the volume of money available to purchase home produced goods. This means that those having incomes below £800 a year have a far greater amount of money with which to buy foreign exchange than have the rich. They do not, of course, buy overseas exchange directly but they do so indirectly, and guide the use of it, every time they visit their local cinema to see an imported film, or enter a shop to buy imported meat, flour, tobacco, fruit or any other commodity on which overseas exchange must be expended.

If overseas exchange were freed tomorrow the rich could make only a very small dent in the total supply. They could, in fact, purchase the same proportion of luxury goods from abroad as they now purchase from the home market. The man who says we must not free the exchanges because the rich might buy luxury goods, should, if he were logical, also say that the rich must not be allowed to purchase luxury goods in Great Britain because it will leave the poor short of supplies.

To sum up this argument, which, incidentally, is the decisive one with a vast number of the population, it amounts to nothing less than this — that because some men are rich no man shall be free to choose what he buys with his money.



It is quite certain that the arguments of the monetary controllers would not long survive if it were not for the fact that they are directed either to the ignorant or to those who already accept the idea of state control over all branches of human activity. The one thing necessary to force the government to abandon all exchange control is the enlightenment of the public.

Every year an expanding trade is becoming more essential for Great Britain's prosperity and the standard of living of her people. Everything that makes it easy for her people to trade is desirable, and everything that makes it difficult for them to do so is dangerous. Before the totalitarian idea of exchange control was forced upon us by the exigencies of war, an English merchant could trade with practically the whole world and not concern himself with the exchange of currencies. He was concerned only with buying and selling goods; payment offered him no problems. Hard currencies and soft currencies were unheard of. Competitive lowering of exchange rates was unknown. Balance of payments problems did not arise. Sudden trade restrictions such as those imposed in late years for lack of currency accommodation were impossible. Capital could be transferred between countries with complete absence of trouble. In fact, the exchange of currencies throughout the whole Western world offered no difficulty whatever. The problem of international payments in the modern world had been well and truly solved.

Perhaps no branches of our commercial life gained more from the free exchange of currencies than our banking and insurance companies. Banks earned large sums of foreign money in discounting bills and financing foreign trade that never touched the shores of Great Britain. They were assisted in this by the fact that the currency in which they chiefly dealt was accepted all over the world and required the consent of no one if it were desired to transfer it from London. In the same way, our insurance companies could do a world-wide business because the money they paid out was instantly transferable. The yearly earning of overseas exchange by our banking and insurance companies was sufficient to buy more food than could be produced in many British counties added together.

In addition to this, Great Britain possessed a great entrepôt trade in which she acted as a wholesale house for the world.

But perhaps the greatest service that the free exchange of currencies performed was to enable the slow development of a world market in which all nations and all races mutually exchanged their goods and services. The people of the West have never understood this world market, which was steadily being developed before 1914, and, although impaired, still existed between the two wars, and which it must be our object to restore today.

A warning against delay is necessary here. Inflation at the present time is still steadily lowering the value of the British pound. Unless this trend is checked, another devaluation such as that of 1949 will be inevitable. It is possible that the British Government may wait for this devaluation to be forced upon it, and then instead of fixing a new and lower price for the pound, it may simply set it free. The subsequent fall in its price, registered in the exchange rates, will then be associated in people's minds, not with the inflation that caused the pound to depreciate, but with the freedom that revealed its true worth.

It is by such errors as these that the people's ignorance of monetary and economic science can be turned, by the malicious, into prejudice against freedom itself.

Outlook for the Fall

By PETER TRACEY

EITHER businesses must raise their prices, or go bust and lay people off, or the pound must be devalued.

This is the prospect that faces Britain in the autumn "as the leaves of illusion turn first yellow, then brown, and a lot of our 'public faces' turn very red," says Graham Hutton, writing in *The Daily Telegraph.*

Mr. Hutton is very critical of the policies being pursued by the present Government, especially the high corporation and capital gains taxes and the discrimination against overseas investment. He does not see how we are going to "knock hell" out of the Americans when the people who are going to do it — the private businessmen — are having hell knocked out of them by their own government.

While the Americans bask in the longest boom on record, with lower taxes all round, and prices relatively stable, the British businessman is faced with higher taxes, higher rates, higher insurance contributions, higher postal charges, and an official exchange rate that is weighted heavily against him.

It's a wonder the poor chap does as well as he does.

Also writing in the *Telegraph,* Alfred Sherman reviews a new book by Lionel Needleman called *The Economics of Housing.*

Mr. Needleman believes that the present rate of slum clearance (60,000 to 70,000 houses a year) is lower than the rate at which fresh houses are becoming slums — and I am sure that he is right.

Private enterprise, he says, cannot solve the problem — and here I am sure that he is wrong — but he does not give a good reason as to why it cannot. Could rent control have anything to do with it? Mr. Needleham says: "Like all other forms of price control, rent control by itself only masks some of the symptoms of shortage . . . and may actually prolong the shortage by discouraging private enterprise from building new houses." He also makes the interesting point that rent control increases the rate at which houses need to be replaced because the owners cannot afford to maintain them properly. "A few years of neglect may mean that houses have to be replaced twenty or more years before they would otherwise have been."

Mr. T. V. Prosser, head of the National Building Agency (an organisation, I would imagine, of extremely doubtful value), writing in the *Evening News,* advocates some revision of existing planning procedures, particularly the five year plans. In his view the solution to the housing problem is to build large new towns on agricultural land and to give the farmers an equivalent area in reclaimed industrial wasteland and common land.

While I agree with him about the planning, why not use the re-claimed land for housing and leave the agricultural land as it is?

A tax on land values would soon put some life into this land that "has been considered not worth while regenerating" and stimulate sufficient building within existing urban boundaries to obviate the need for any more highly expensive and generally unsuccessful new towns.

THE BEST OF TITLES

It is obvious that the bare land with its contents and the waters that flow through and about it constitute the nature-provided environment of human beings and are rightly the subject of their equal claims. Also that the value-for-use of these natural resources is conditioned on population. It follows population as its shadow. It appears with the people and disappears when they go. This value, therefore, should, by the best of titles, be retained by the community as its most excellent source of public revenue. The more the community draws upon this vast, community-conditioned fund the less will be the forced contribution from labour and capital. This means that the greater and better distributed will be the purchasing power of the people. — H. J. Davenport, Professor of Economics, Cornell University.