David Evans

Internation monetary crisis resolved?

Already the euphoria of the December settlement is wearing off. Nixon was quite happy to replace the import surcharge and "buy American" tax incentives with a revaluation and currency realignment with almost the same effects. He also got in a new protectionist measure for the American textile industry before the smoke was clear. The only real concession was a rise in the dollar price of gold, but it remains to be seen whether or not this will mean much since the dollar remains inconvertible into gold.

Although the immediate crisis has been resolved, the only thing done to prevent a similar situation from arising again was to enlarge the "bands" around which exchange rates can fluctuate without IMF intervention to 24%. As will be suggested below, this change will hardly be enough to alter the underlying mechanisms which led to last year's crisis. And the long term price of an apparent American "victory" will probably be high. This crisis has marked the end of American economic and political hegemony in the capitalist world and the West Europeans and Japanese will take a long time to forget the bruising they received from American economic brinkmanship played from a position of relative weakness . . . . especially if the Nixon strategy of exporting unemployment to win an election is successful (see below).

As pointed out in the last notes (ALR 38, November 1971), the international monetary arrangements settled at Bretton Woods in 1944 were inherently unstable and afforded no adequate basis for either changing exchange rates when necessary, or for providing additional international money to finance expanding world trade. With no mechanism for increasing international money, sterling and most importantly dollar deficits filled the breach. Now the Japanese and Europeans have billions of inconvertible (into gold) dollars from the days when the dollar was as 'good as gold' and when the Americans could run their printing presses hot and get away with it. For the present, these funds are still being held in Europe and Japan, partly because interest rates are too low in America. If the Americans are successful in reversing their balance of payments deficit, these dollars will have to be used to buy American goods. But what if they are also used to buy some American real estate and factories, either in their own countries or in the United States itself? For just as the Americans borrowed from the rest of the world to help them buy up foreign property and to fight in Indo-China, so the process can be reversed, Will Nixon allow this? He won't like it, and it's safe to predict that he will do everything he can to prevent it. Such a move by European and Japanese corporations would present a longer term threat to the position of American corporations than the present boost to their competitive position gained by the currency realignment. But suppose the Japanese and Europeans are successful in getting rid of some of their dollar holdings, who then will print the international money for future capitalist trade expansion? It is here that the crucial weaknesses of the Bretton Woods system may reveal itself once again; since the Americans have lost their hegemony, they may be prepared to see the IMF take over this role (just as Lord Keynes wanted it to do in 1944) and expand the issues of so-called paper gold — the Special Drawing Rights or SDR's. Yet even if this were achieved, there remains the question of future mechanisms for exchange rate changes.

If market forces were allowed to rule, then a system of freely fluctuating exchange rates would solve both the problem of reserves and exchange rates. But it is hard to imagine such a system being accepted by any but a handful of small countries such as Canada (and, would you believe it, Cairns has suggested it for Australia). For example, it would have meant during the 1960's that the American dollar would have devalued with the escalation of the Vietnam war — and maybe very sharply, given the attitude of Europeans to that war. It's quite likely that such an exchange rate change would have shown more clearly than Johnson could have afforded the real economic consequences of that act. As it turned out, he could perpetuate the myth that America could have extra guns and (remember) (sic) "great society" programs without increasing taxes. The way in which he paid for it was by forcing the Europeans and Japanese to lend him a bit more via increased dollar deficits, and by squeezing the poorer classes at home via stepped up inflation. An alternative solution to the exchange rate problem would be to keep the wider bands around the fixed exchange rates, changing the middle fixed rate according to the circumstances. Perhaps most likely, however, is a return to the old system with its recurrent crises; already there is evidence of pressure to narrow the "bands" at least for the European currencies. It remains to be seen whether or not exchange rates will be changed in response to underlying economic forces quickly enough to avert new currency crises; I doubt it. For to take the question of exchange rates too far outside the arena of manipulation for (attempted) economic or political gain is too much to ask. In this respect, Nixon's New Economic Policy may achieve the aim of lowering unemployment at home and providing short-term protection for American capital (thus ensuring his re-election) at the expense of increased unemploy-
ment in Europe and Japan, not to mention the Third World. (The devaluation of the American dollar increases American exports and lowers imports, thus expanding production at home. The opposite occurs in the rest of the world.) But the game can be played the other way as well, raising the possibility of competitive devaluations . . . . the latter prospect depends largely on how far rising unemployment and falling profits go in Europe and Japan during 1972. The predictions for a 1972 recovery made recently by the OECD* are only rosy on the surface, leaving the question of recovery in West Germany and Japan very much in the air. More recent figures on unemployment than the OECD survey on European economic conditions (The Age, 22/1/72) confirm the over-optimistic character of the former.

Of course, there are many other dimensions to the crisis. For the New Economic Policy was a package deal with defence and trade policy (protection) negotiable issues as well. While there is no space to go into detail here, some trends seem clear: more defence expenditure by the Europeans and Japanese to offset possible reductions in direct American military presence, the intensification of struggles for competitive advantages in each others' markets (including those of the Third World), and tougher deals for Third World countries in any dealings they may have with the international financial institutions and the so-called “aid” givers. In the case of Japan, the line between self-defence forces and a developing off-shore capability becomes increasingly blurred . . . . the mutterings about flag following trade and investments have already begun.

In short, if the new currency parities work, there is likely to be a renewed money crisis centring around the question of how to finance expanded trade; the Europeans and Japanese will be even less willing than in the past to allow the dollar to do this. If (as seems more likely) the new currency parities only work for a relatively short time, then a new fight over the same kinds of issues as in the last crisis will emerge. In either case, there is likely to be a continued erosion of the ability of the “system” to deliver the goods via rapid growth and “acceptable” levels of unemployment.

The Australian reaction

While the leader of the Country Party, Mr. Anthony, was quietly away at his farm, the Liberals and the financial press were confident that the Country Party would accept the Treasury and Liberal line of Sticking to Sterling. However, once Mr. Anthony was in Canberra, we saw a raw display of divisions in the ruling circles. Already, the Treasury proposal to stay with sterling was a compromise; in fact, a strong case could be made for revaluation against sterling. The Country Party (also representing the mining interests)

* Organization for Economic Cooperation and Development. reported in the Australian Financial Review, 23/12/71.

would only accept parity with sterling in return for a cut in tariffs. But the Libs. would have none of this; they have a good deal of pressure exerted on them to maintain or increase tariff protection. So the result was a devaluation against the parity rate for sterling (accompanied with a bit of gobblydegook about the Australian dollar having parity with sterling, while effectively it was revalued over 2% against sterling parity by the use of the 21% band allowed by the IMF. Since then, sterling has floated down a bit towards its lower band, wiping out some of Mr. Anthony’s devaluation).

As the 12 economics professors stated in their various letters to the press (over the year, the ranks changed a bit, but there always seemed to be 12), only a large tariff cut and/or an appreciation of the Australian dollar against sterling would have served the “community interest” — the unstated assumption being the “community interest” of a more ideal form of capitalism than exists today in Australia. The twin concerns of the professors when advocating policies to deal with the currency realignments were inflation and inefficiencies in the economy — appreciation of the exchange rate would help check inflation by lowering the price of imports, and/or lower tariffs would move capital and workers from some of Australia’s notoriously highly protected and inefficient industries. But the professors chose not to make known any detailed analysis on which their conclusions were based and they did not explain how workers could be asked to accept policies which would cost them jobs in the short-term. For as everyone knows, the assistance for compensation and retraining of displaced workers in this society scarcely exists. Nor did they explain how the farmers, mining companies, banks and most manufacturers would be prepared to accept the lower short-term profits their recommendations imply. Worse for the professors, there was no one in Cabinet to press for their ideal of the “community interest”, and as pointed out in the financial press, their cries were in the wilderness. Perhaps their efforts would be better spent explaining the mechanisms which lead to decisions against the interests of the majority under capitalism rather than expressing hopes about what ought to be done . . . . but then such a critical (and more scientific) role is, not surprisingly, one they shy away from.

Perhaps the biggest surprise of all was Jim Cairns, who came out in favour of letting the Australian dollar float. An idea obviously borrowed from Canadian experience, such a move would do much to reform capitalism as it exists in Australia today, for the implications run much deeper than merely allowing market forces to decide the exchange rate. It would oring much sharper competitive forces to bear on Australian business than are allowed to operate at present, and it would be much harder to manipulate tariffs to protect industry at the desired levels. But it is precisely for these reasons that the Cairns proposal would
not be acceptable . . . . short of the Yellow Peril or socialism, it's hard to think of suggestions more calculated to terrify the Australian capitalist!

What does all this mean? First, with the Australian currency under-valued, we will continue our ludicrous accumulation of reserves. Second, although it will boost manufacturing profits, help cushion mine owners against falls in prices and orders, and help the farmers pay off the banks and stock companies a bit faster, it will make Australian assets cheap to buy. Not surprisingly, in the first week in January, there was a minor rally on the stock markets as the short-term money started coming in from Europe to wait for future revaluation of the Australian dollar. Of course, the Australian capitalist does not like to have increased take-over bids or new competition from yet more overseas investment, nor do the Libs. like the idea of selling off a bit more of the farm cheap in an election year. What to do? Rather than allow the economic forces to do the work they set them to do by devaluation of the currency vs. our major trading partners, the so-called believers in the workings of the free-market look around for direct controls to stop what they don't like . . . . and controls of capital movements under capitalism have about as much chance of success as removing loop-holes in our income tax laws.

But what about the budget which was designed to stop inflation and cure the economy of its ills? Maybe by accident Mr. Snedden got himself off the hook of being accused of too much budgetary contraction by going along with an inflationary exchange rate settlement. However, as already suggested, the main immediate effects of the exchange rate change will be to cushion the already highly profitable miners from relatively small losses and help the farmers to pay off the banks. As for the manufacturers, they will be better able to pass on the effects of wage increases in price increases since import prices have risen. With no up-turn in investment in sight (who said capitalists don't have enormous power over the majority of people?) the immediate effects on rising unemployment will be minimal. There could have been no better prescription for setting up the conditions for continued 'stagflation' — relatively high inflation and unemployment. The December figures on unemployment and a rate of inflation over 10% per annum serve to reinforce the prediction that stagflation more similar to North-American and European experience will become a more permanent feature during the 1970's.

Tid-bits

That Melbourne underground. Noticed the first of a new round of increased cost estimated? Up from $80 million in 1967 to $114 million (perhaps more later). But why the underground anyway? Certainly not for servicing Melbourne's public transport needs. For the problem with trains in Melbourne is that the Flinders Street yards can't turn them round fast enough. For a mere 60% less than the cost of the underground*, the yards could be extended and a decent train service could be restored for Melbourne — and a few new trains provided too. (There is plenty of space for the monuments of capitalism within walking distance of Flinders and Spencer Street stations.) Then why the underground? Certainly not for the people who use the trains, for the journey in and out of Melbourne will cost more and take even longer after the loop is installed (on either the inward or the outward journey, you will have to travel around the loop, rather than in and out of Flinders or Spencer streets . . . . a mere two or three extra stops on the way home). If the original reason for the loop lay in the vanity of the councillors and politicians who feel that Melbourne must have a flashy underground to match the flash real-estate above, the reason for their unwillingness to change almost certainly lies in the fact that too many powerful people are poised to gain from the sky-rocketer real-estate values on the proposed loop route. . . .

Are you surprised that the doctors have got their fingers in the cookie jar again? Then go and see a psychiatrist! While the Libs, cry about unnecessary visits to the doctor and make it that we have to pay more for prescriptions to stop us getting hooked on good things, they line the pockets of specialists by making the cost of a GP and a specialist visit the same for a referred insured person, thus encouraging unnecessary visits to a specialist. Like their American colleagues, our doctors are learning the advantages of "socialised" medical services where the tax-payer picks up the bill they write for themselves. The 46% increase in doctors' incomes via health funds over 15 months is made up of about a 22% increase in fees, the rest in new services covered by health insurance, reinforces the comments on the increased incidence of over-common fee charges. The AMA's answer that sometimes the doctor provides more than 'average' service so should be paid for it also implies that the doctor should not charge the so-called "most common fee" for the one minute check-up.

And what about all the talk about using the price mechanism being applied to achieve a sensible resource allocation in the med. biz? What about the bloke on $10,000 a year who pays less to insure himself (or his wife) for a private bed in a hospital than a bloke on $5,000 who insures for (hold your breath) an intermediate ward, not to mention medical costs for the majority of Australians who earn less than $5,000. . . . ! All because health fund contributions are tax deduct-ible — the more you earn, the less it costs to get sick . . . . sick.

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* Estimate based on Victorian Railways costing, reported by Dr. Stuart Joy (now Chief Economist for British Railways).