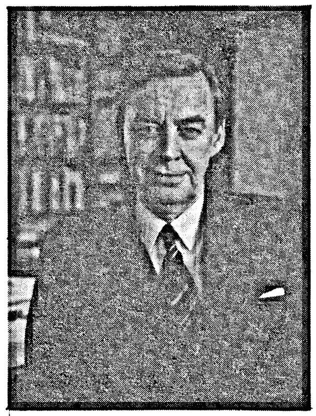
PUBLIC ENEMY NUMBER ONE
Expert views on how to curb inflation



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ACKNOWLEDGEMENT

As background to this lecture, I wrote to some of the world's leading experts and asked them to give me a brief exposé of what each of them would do to curb inflation if he were "A Minister of Finance in 1974".

Their replies form a part of this lecture and I want to thank them most sincerely for their extremely valuable advice to us all.

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Prof. George L. Bach, Professor of Economics and Public Policy, Stanford University, Stanford, U.S.A.
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Prof. Dr. J. Kreiken, Technische Hogeschool Twente, Enschede, Drienerlo, Netherlands.
Mr. David Rockefeller, Chairman, The Chase Manhattan Bank, New York, U.S.A.

Throughout the world inflation has become a problem of unexpected intensity and baffling complexity.

Ten years ago inflation was regarded by the advanced industrial nations, rather like malaria fifty years ago, as a social disease localized in South America.

Today like some medieval plague, inflation is sweeping across national borders. It has infected every industrial community as a social disorder. The rapidly increasing rate of inflation poses an over-riding threat to the economic, social and political stability of the developed world.

President Gerald Ford labelled inflation as "World Public Enemy No. 1" and described it as "cancer" that could cause lingering death for the industrialized world.

What then is this "Enemy" which, taken in little doses, has been prescribed as a tonic by Lord Maynard Keynes, designed to prevent the evils of unemployment, but in larger doses becomes a "corrosive social poison" in the words of Peter Drucker.

Prof. Bach concludes that a compendium of definitions of "inflation" from dictionaries, encyclopedias and textbooks makes the area look like a no-man's-land. He suggest that "inflation" is a rise in the price level, or conversely a fall in the purchasing power of the monetary unit.

Those who reject this simple definition generally argue that rising prices are caused by an over-issue of money and an over-extension of credit and that this over-issue of money is inflation.

That of course is a permissible definition of inflation.

INFLATION BECOMING A WAY OF LIFE

Inflation in Europe as measured in the rise of consumer prices over the last five years has varied from 31% for West Germany to 51% for the United Kingdom.

The percentage rate of inflation based on the most recently available figures compared with the previous year show a wide variance ranging from Rhodesia at 3% to Chile with 709%; the latter, caused by the economic upheaval, brought about the rise and fall of the Allende government.

Few countries at present have rates of inflation of less than two digits. The luckier ones are West Germany with 7%, Norway with 8%, Sweden, the Netherlands and South Africa with about 9%. In Canada and the United States the rate of inflation is 10,4% and 10,7% respectively. In France it is 13%, Australia 14%, and Britain 15%.

Portugal and Greece with inflation rates of 30% and 33% respectively have already experienced changes in government. No doubt, a contributory reason must have been the dissatisfaction caused, particularly in the armies, by the high rate of inflation after years of relative stability.

Peter Drucker notes that it is members of the middle class who become paranoid, believing that "the other fellow" somehow has gained ground at their expense. The political and social dangers were exemplified in Germany in the nineteen-twenties and thirties.

Yet the average citizen seems to be unwilling to accept a limit on his own income. This can be deduced from the recent elections in the United Kingdom, Canada and Australia. Edward Heath asked the voters to endure a power shortage and a three day week to hold coal-miners to a non-inflationary pay increase. The votres declined and the government fell. The labour government gave a big pay increased and in Britain inflation rages on and on.

In Canada and Australia where the opposition used the growing rate of inflation as a battle cry, the incumbent governments were, on the other hand, returned to power.

It seems as if the voter as consumer complains about high prices but the voter as wage earner is always ready to demand more.

IT MAY NOT HURT ENOUGH

This is not at all surprising. Figures available for the United States, show that most Americans have come through the inflation of the past two decades quite well.

* Wage earners have been able to increase their share of the national income from 61% in 1950 to 67% in 1972.
* Between 1950 and 1972 production workers in private industry, some 50 million today, saw their average hourly earnings (adjusted for overtime) increase by 176% while the consumer price index went up by only 74%. Real earnings increased by nearly 60% over the period. The same applied to other workers.
* Payments to the poor have kept up with inflation.
* Social security benefits have gone up.
* In South Africa the wage and salary spiral increased by 120% in the decade 1963—1973 whereas the consumer price index increased by only 60% during the same period.
* The per capita employee's remuneration in both the private and public sectors increased at a faster rate than the cost of living index.

WHO THEN WERE THE LOSERS?

They were:

* The beneficiaries of private pensions.
* Relatively so were shareholders.
* The long-term trend for dividends has been moving sharply down in the U.S.A.

In 1929 dividends accounted for 6,7% of

national income.

In 1939 they only accounted for 5,2% of national income and in 1972 they only accounted for 2,8% of national income.

* Rents show a similar long-term pattern. As a share of national income their long-term trend is down from 6,2% in 1929 to 2,7% in 1972.

* Corporate profits as a percentage of national income have declined substantially, falling from 16% of national income in 1950 to only 10% in 1972.

Industry.

* The existing tax system makes inadequate porivision for depreciation in respect of machinery and equipment.

* Provisions for depreciation are in total inadequate because of inflation.

* It could be that at least $130 billion of the $700 billion total corporate profits in the U.S.A. reported since 1950 were "illusory paper profits reflecting undercharging of depreciation".

* Inflation creates fictitious profits. As a result of the ever mounting cost of raw materials a considerable amount of profit is locked up in stocks which have to be replaced at higher prices. Thus stocks are continuously increasing in value and must constantly be replaced by stocks at even higher prices.

Such profits on stocks do not provide any cash flow for dividends or for new buildings and machinery. But taxes must be paid on these phantom profits.

The result is under-depreciation and overstated profits. In the U.S.A, for example, it has been established that after deducting inventory profits and allowing for the effect of that deduction on tax liabilities, the after-tax profits of non-financial organizations in 1972 were no higher than in 1968.

During the year ending with the third quarter of 1973 (the latest figures available) profits before taxes of all non-financial corporations in the U.S.A. rose 33%, tax liabilities rose 36% and after tax profits rose 30%. But the Department of Commerce's estimate of the inventory valuation adjustment rose 146%; with this removed, adjusted profits after tax rose only 5%.

Meanwhile corporate output was rising 8%; as a result, adjusted after-tax profits per unit of output fell by 3%. The contribution of this factor to the inflationary surge was, if anything, negative.

As a result of escalating inflation, share prices have dropped to new lows in most Western countries with the result that hardly any new issues can be effected and that companies have to revert to loans and deventures at ever increasing rates of interest.

On the other hand inflation is multiplying the capital requirements of business. The interest rates associated with inflation have produced a 70% decline in the U.S.A. equity market since its peak in 1968 and a virtual vanishing of the opportunity to reach new equity capital. (In the U.K. share prices are lower than in 1929).

The result has been an extraordinary and now perhaps dangerous rise in the relationship of debt to equity, and a general critical shortage of productive capital for industry as a whole, and for banks in particular. Rapid inflation of inventory costs and the cost of capital facilities is distorting conventional accounting, and increasingly requiring two sets of accounts: one set to properly reflect real earnings on a true replacement basis. The equity market itself (and the bond market as well) has paid an enormous price for inflation; a substantial degree of adjustment has already been completed, and it is difficult to see still further declines in equities. However, until useful and effective responses to inflation itself are developed, the equity market cannot perform its essential function of attracting and allocating risk capital. (The Conference Board, May 31, 1974.)

Instead of the ready availability of risk capital for new assets, we have speculation in land, in shares, antiques, objets d'art, and the like.

For social and economic reasons it is important that new developments should take place and that new assets should be created.

The taxation policy will determine whether this development will take place or whether the additional money will be absorbed by the purchase of existing properties and shares.

When company tax rises too high, and depreciation allowances are not enough to counteract inflation, the risk of investing in new ventures becomes too great and the investor turns to investment opportunities which he regards as safe, i.e. properties and objets d'art.

Several methods have been prescribed as a solution to the problem, most of which point to state intervention, such as attempted price control or so-called "incomes policy".

Such control measures do not rectify matters — they merely postpone the day of reckoning.

Price control creates a temporary illusion of stability but the unavoidable volume of money and credit created throughout the world by monetary authorities breaks through this temporary entrenchment, prices rise dramatically and currencies depreciate.

EARLY EXAMPLES OF INFLATION AND THE EFFECTS OF PRICE CONTROL THEREON

I am indebted to the book "Must history repeat itself?" by Antony Fisher for the following

two early examples of inflation.
(a) In the Roman Empire.
The classic example of the attempt by government to improve the lot of the people by restricting their choice is that of the Emperor Diocletian about the year AD 300. He was faced with the familiar problem of rising prices in the wake of an increase in the quantity of money and a debasement in its value.

As the historian Duray tells us:
'Under the impression that to give to a piece of metal whatever value they liked, it sufficed to engrave the Emperor's name upon it, the Roman Government had ended by putting in circulation pieces of "silver" and "gold" which contained neither silver nor gold ..... Very high prices resulted therefore from the depreciation of the currency'.

The modern reader will not, therefore, be surprised to know that in the preface to his famous Edict of AD 301, Diocletian declared:
'All men know that articles of traffic and objects of daily use have attained exorbitant prices, four or eight times their true value, or even more than that; so that, through the avarice of monopolies, the provisioning of our armies becomes impossible'.

The historian Abbott wrote as follows:
'In his effort to bring prices down to what he considered a normal level, Diocletian did not content himself with such half measures as we are trying in our attempts to suppress combinations in restraint of trade, but he boldly fixed the maximum prices at which beef, grain, eggs, clothing, and other articles should be sold, and prescribed the penalty of death for anyone who disposed of his wares at a higher price'.

By today's standards Diocletian's task was relatively simple. We are told that he had to fix prices for no more than between 700 and 800 items, which were all that were commonly traded in those days, along with the wages of teachers, advocates, bricklayers, tailors, weavers, physicians and men of humbler callings.

The modern reader will hardly be surprised to hear that the result of such coercive efforts to dictate artificial prices for goods and services was total failure.In the more dramatic words of Lactantius, a contemporary historian writing within a decade or so of the event, the considered verdict on Diocletian was as follows: 'After many oppressions which he put in practice had brought a general dearth upon the empire, he set himself to regulate the prices of all vendible things. There was also much blood shed upon very slight and trifling accounts; and the people brought provisions no more to markets, since they could not get a reasonable price for them; and this increased the dearth so much, that at last after many had died by it; the law itself was laid aside'.
(b) In france
When in the early 1790's the appalling inflation caused the government to run out of foreign money, it resorted to a most fantastic auction of the contents of the palace of Versailles, lasting three hundred and fifty one days. But selling assets can stave off bankruptcy only for a short time.

Dickson White reports:
'Enterprise received a mortal blow ..... This state of things, too, while it bore heavily upon the moneyed classes was still more ruinous to those in moderate, and most of all to those in stricken, circumstances ..... These evils though great were small compared to those far more deep-seated signs of disease which now showed themselves throughout the country'.

Thrift gave way to gambling and extravagance among the rich, while the washer-women of Paris responded to the high soap price by demanding that the merchants who sold it should be punished by death. Marat thereupon suggested that the people might help themselves literally by hanging shopkeepers and plundering their stores.

In 1793 came the first real price and wage controls, Robespierre's so-called 'law of the maximum'. When it did not work, and goods disappeared from the markets, the guillotine was worked overtime in a vain attempt to enforce the law. Punishment for selling paper assignats against gold or silver at less than their face value was 20 years' imprisonment in chains. Investment in foreign countries carried the death penalty.

Nevertheless, no government decree could prevent the louis d'or from recording the decline in the value of assignats. The gold louis, originally equivalent to 25 francs, was worth about 1 000 paper francs in September 1793 and over 7 000 six months later.

Dickson White's conclusion confirmed the findings of Mary Lacy in 1922 and of Professor Milton Friedman more recently. 'To cure a disease temporary in its character, a corrosive poison was administered, which ate out the vitals of French prosperity ..... It ended in the complete financial, moral and political prostration of France'.

A footnote to the inflation in revolutionary France, where price-fixing finally became a characteristic feature of the Reign of Terror, is that when Robespierre finally passed through the streets of Paris in the tumbrils of the executioners, the mob jeered "There goes the dirty maximum" '.

HYPERINFLATION REALLY HURTS

The prime example of hyperinflation in modern history was the German inflation after the First World War.

At the conclusion of that war the amount of money in circulation in Germany was about five times what it had been in 1914, the price index had increased by about 100% and the public debt had increased twentyfold — not materially worse than that of France.

On May 21, 1921, however, the reparations committee fixed its bill at many times more than experts dreamed feasible namely at 132 billion gold marks or 33 billion dollars. Germany had to pay these huge reparations over a period of thirty years in annual instalments of 2 billion gold marks plus about 26% of the proceeds of German exports plus other reparations in kind.

At that time in May 1921, the German budget was nearly in balance and the value of the mark was being maintained. The reparation payments made it necessary to sell marks to buy foreign currency to pay the abovementioned reparations.

As a result the mark fell from 14,8 mark to the dollar to 62,6 mark to the dollar by November 1921 and the wholesale prices tripled. More mark than before were now necessary to make these payments.

In spite of reduced reparation payments and a later agreement to suspend reparations for six months, the mark kept on falling.

The mark fell from 1/3 of an American cent six months later in June 1922 to 1/100 of an American cent in December 1922. And for the entire year prices increased by 4 000%.

The printing presses were now put to work to print currency because governmental expenditure and the need of the banks to extend credit required ever more money.

Finally the printing presses were turning our 400 000 000 000 000 000 (four hundred thousand million million) marks a day and by October 1923 about 15½ billion paper marks equalled one Gold mark.

A friend of mine used to recall how girls employed at a bank to count this inflated money earned more per day than the amount they could count per day.

The effects of this hyperinflation were shattering. Germany hastened to make purchases as soon as they received any money to ensure that they could buy something before the money devalued any further.

A story is told of a woman traveller who left a suitcase full of marks on the station platform whilst buying a ticket. On her return she found that the suitcase had been stolen and all the money dumped on the platform.

The mortage indebtedness of Germany which was 40 billion marks in 1913 was worth only one American cent in 1923, that is within 18 months after the onset of this huge inflation.

Bonds, mortgages, insurance policies, savings bank accounts became practically worthless. The holders of these securities were mainly of the middle class and this most valuable and socially stable group was virtually ruined.

ECONOMIC THEORY CASUALTY?

The present rate of inflation is negligible compared with the German example mentioned above, yet it is increasing and one would have expected that after all these experiences mankind would have found better means of curtailing such growth in inflation.

It has even been suggested that economic theory itself is one of the casualties of the present soaring inflation coupled with stagnation, increasing interest rates and sagging stock markets.

On the other hand it has been suggested that governments themselves are to blame for not holding to a particular policy long enough.

In 1936 John Maynard Keynes, for example, offered a solution to a world sunk in what seemed like a permanent depression.

He presented a policy which was designed to give statesmen a means in time of slump for increasing total demand by increasing expenditure and/or cutting taxes enough to create full employment.

And in time of boom to reduce total demand enough to close the inflationary gap.

Neo-Keynesians refined the prescription and out of it came the "New Economics" of the Kennedy and Johnson eras — the belief that government could steer the economy at high speed along a non-inflationary road by means of monetary and fiscal policies.

But in a rapidly changing world this theory has been found wanting. It seems as if the neglect of the supply side of the market is one of the major shortcomings of Keynesian Economics.

Inflation has become dominating, supply shortages have arisen and international money-flows often override national economic policies.

Prof. Samuelson, the Nobel prizewinning economist, recognises that Keynesian doctrines, combined with the normal political demands are often inflationary. "We live in an age after Keynes", he says. "Electorates all over the world have eaten of the tree of modern economic knowledge, and there is no going back to an earlier age".

The intended counter to the Keynesian theory was Prof. Friedman's monetarist theory, namely that a Federal Reserve Policy of regulating the annual growth of money-supply to 3 to 5 per cent would assure reasonable price stability, high employment and fairly steady growth, if practised over a long enough period.

The third major economic doctrine prominently urged by Prof. Friedman, but also supported by a broad range of international economists, was the idea that floating exchange rates, free to move up or down in relation to changing national balance-of-payment surpluses or deficits, would restore equilibrium in the world monetary system.

But hitherto all these theories have not stopped the bias towards inflation.

THE CAUSES OF INFLATION

If we consider inflation as a matter of "too much money chasing too few goods and services" we can firstly look at how this is being brought about.

It is brought about by governments spending more than they receive by way of taxes and other sources of government revenue. This is of course operating with an unbalanced cash budget so that more dollars are put into the hands of people than taken from them. The question is what forces governments to follow this policy.

There are various reasons for this state of affairs.

1. The revolution of rising expectations causes voters to demand ever more and the needs outrun the ability to produce.
2. Hot wars have been major contributors to inflation in the past. Even the Vietnam war alone caused about $125 billion of military spending.

   In the atomic age cold wars have led to enormous continuing expenses on unproductive armaments and huge costly armies, navies and air-forces have to be on the alert.
3. The ever-increasing relative size of Government has important effects on the rate of inflation.
4. The trend to the left and increased government responsibility for the welfare of the masses.
5. The existence of various pressure groups like labour, business, farmers, crying for a greater share of the national income has had an inflationary effect. Thus trade unions — which Prof. Koontz describes as "businesses whose business is the control and sale of labour" — have been able to demand wages and fringe benefits for their members often regardless of any increase in productivity.
6. The desire for a better "quality of life" in the richer countries is leading to demands for protection of the environment and greater anti-pollution measures.
7. The quest for shorter working hours — a five- and now a four-day week — has inflationary effects.
8. The energy crisis brought about by a sudden escalation in the price of oil also had a material inflationary effect. If we take into account that the U.S.A. alone used more energy in the decade of the sixties than did all mankind before then, it is obvious that the energy crisis is of major importance. In this respect it is interesting to note that the U.S.A. uses as much energy on air-conditioning alone as China uses for all its energy requirements.
9. The shortage of raw materials, as foreseen in the publication "Limits to Growth" published by the Club of Rome, has aided and abetted the escalation of raw material prices. It is also noteworthy that certain raw materials are available only in a few countries and these countries have seen the example of the oil producers in arbitrarily raising prices.
10. The growth of the tertiary sector has been extremely inflationary; contrary to common belief prices of manufactured goods did not rise significantly in the period 1958—1968. According to OECD the prices of manufactured goods in the 17 most important industrialised countries rose in the range of 1% to 2,5% a year.

    In contrast prices in the service and construction sector have risen considerably: together these accounted for from 70% to 90% of the total price rise in the major countries in the period 1958—1968, according to OECD.

    In France, for example, during the period 1962—1970, the index for services rose by about 10% per year whilst manufactured products, by contrast, rose only about 3% per year.
11. Prof. Gouvêa de Bulhões states that the major reason for the recent increase in the rate of inflation in Brazil was the recession of the capital market.

    In 1971 there was a disaster on the stock exchange. There was no panic, but the abrupt fall in the value of shares scared away savings from the capital market. Companies which were deprived of the opportunity to obtain new share capital went for bank loans within and from outside the country. Huge sums in loans were obtained, bringing with them as a consequence considerable increases in interest to be paid. As a result, he says the savings available were used to finance the expansion of expenses and to feed fixed asset (property) speculation in the cities and the country areas.

    This indeed has become the situation in most Western countries.

    The state of the share market is thus both a cause and a result of escalating inflation.

    It is hardly possible to obtain new capital in any country by an issue of new shares. With the escalation of material and plant prices companies need additional funds which can only be obtained at increasing interest rates. Inflation thus feeds upon itself.
12. The creation of non-national currencies by

national monetary systems fuels inflation.

In an article first published by Le Figaro on July 6th, Jacques Rueff, the distinguished French monetary expert of international renown, formerly deputy governor of the Bank of France and General de Gaulle's close adviser on currency problems deals with the role of the Eurodollar and Euro-currencies which in his opinion is the root cause of the present wave of inflation in the Western world.

Jacques Rueff writes that the sluices of inflation are opened in these ways:

1. A First Breach: Inconvertible currencies: Money can be created locally by central banks to finance government deficit-spending responsible for inflation.
2. A Second Breach at present stopped: The gold exchange standard.

   Rueff says that the purchase of large quantities of unwanted dollars by non-American central banks was the immediate cause of Western inflation.

   After convertibility of the dollar into gold was stopped on March 7, 1968 (and by law on August 15, 1971), the holders of unwanted dollars could only get rid of them by demanding real goods, shares of non-American currencies. This unleashed demand on all markets of the West, provoking huge movements of capital across all frontiers and, in all countries concerned, bringing about rapid price rises.

   Thus in the United States the annual increase of wholesale prices which was on average 2,9 per cent from 1959 to 1969 rose progressively to 6,5 per cent in 1972.
3. A Third Breach which remains wide open: The Eurodollars and Euro-currencies.

   On March 13, 1973 after our exchange crisis which had provoked the closing of all Western exchanges the expanded Group of Ten (EEC plus Sweden, Japan, the United States and Canada) decided that "the central banks of the associated countries would no longer intervene to support the dollar", which meant that they would no longer buy the dollar when offered. This action should have deprived world inflation of its principal source.

   But from this date a process of monetary creation which produced Euro-currencies and especially "Euro-dollars" was greatly accelerated.

   On December 31, 1973 the foreign commitments of the eight most important countries amounted to $191 000m — an increase of $60 000 m over the year.

   It is these dollars, which, added to the national currency issued and endowing them, for the same amount, with additional purchasing power, that have unleashed real floods of demand in all the countries of the West.

   As a result the supplementary currency created by Euro-banks restored the abolished mechanism of the gold exchange standard, and prolonged and amplified its effects. Adding its effects to those of the oil crisis — which it helped substantially to provoke — it accelerated the rise in prices everywhere. Thus in the United States, wholesale prices rose on the basis of an annual rate of 18,2 per cent in 1973 against 6,5 per cent in 1972 and of 19,1 per cent in the first quarter of 1974.

   "At present, the mechanism of Euro-currencies has become the main instrument of inflation which ravages the West", he says.

13. The end of the gold standard caused inflation. Increasing inflation conclusively proves that faith is being lost in all paper money. Lenin taught us that to destroy the free enterprise capitalistic system, belief in its money must be destroyed. Our present course is the best one to take to destroy ourselves, as Bruno Saager so aptly puts it. That is why he advocates a return to the gold standard for South Africa, the biggest producer of gold.

HOW HYPERINFLATION WAS STEMMED IN THE PAST

The German hyperinflation after the first world war was stopped by a dramatic though legitimate confidence trick. In October 1923 a new bank, the Rentenbank, was established for the purpose of issuing new paper bank notes based on large agricultural holdings and business enterprises. Each new Rentenmark was declared the equivalent of 1 000 000 000 000 old marks or of approximately $0,24. That this new money was accepted by the Germans at its face value was remarkable, for it was convertible only into land and buildings, and, as these could not be had, it was inconvertible. It was thus little more than paper. Yet this Rentenmark was acceptable to the people and remained at par until the government balanced its budget and could bring, through the Dawes Plan of 1924, some order out of the chaos of reparations and could see the Reichsbank secure loans to provide a backing for the new currency.

After the second world war Western Germany effected its reform in June 1948 in order to bring order into what had become a chaotic inflationary situation.

It made an exchange of one new mark for 10 old ones in cash or bank deposits but gave individuals at once only 40 marks and after 2 months

20 more and business concerns 60 marks per worker. Half of the rest could be withdrawn for use, up to a maximum of 5 000 Deutsche Mark for private persons, while the other half was blocked until 1st October 1948. By that time 70% of the blocked amount had been cancelled, 20% had been freed, and 10% had been invested in longterm securities. In this way currency was reduced from 13,5 billion Reichsmark to 2,6 billion Deutsche Mark and bank deposits from 131 billion Reichsmark to 3,2 billion Deutsche Mark. The money was now so strong that the black market had disappeared and everyone was working flat out to obtain the new Deutsche Mark.

Professor Gouvêa de Bulhões, father of Brazil economic resurrection, states that the cause of the Brazilian inflation until 1964 — a chronic inflation relatively moderate for many years but greatly intensified from 1959 — was mainly the budget deficit. In the beginning of 1964 the expected income was not even half that of the expenditure. The government did not have the courage to face the inflationary cause but due to still bigger cowardice attacked the results of inflation. They froze the exchange tax, public service tariffs, rents, and various agricultural products. As a result exports declined, electricity production ceased to expand, transport and communications began to collapse and the scarcity of agricultural products was accentuated.

The first measure of the revolutionary government was to balance the budget. The government collected the outstanding taxes and those who did not pay were, apart from a fine, liable for a debit relative to the price index rise.

An accentuated inflation eliminates savings but savings are essential for financing non-inflationary investments. Under these conditions as a stimulus to development and parallel to the restrictions imposed to gradually reduce inflation, a policy of "monetary appreciation of capital" was adopted.

The key tot the Brazilian system is a broad process of "Monetary correction" that automatically indexes the capital market and business to inflation.

What this means in practice is that capital and fixed assets, savings, loans, and government bonds, rents, mortgages and pensions, most contracts and financial papers are revalued yearly on the basis of the wholesale price index. The gains from this monetary re-adjustment are tax-free since they are not considered real profits.

This system is designed to protect business and savings against losses from depreciation of currency.

An accompanying measure known as the crawling peg system keeps the cruzeiro at a realistic rate of exchange to protect Brazil's international trading position. Frequent mini-devaluations based on a regular assessment of inflationary trends has served to discourage speculation, curb the flight of capital and regularise trade.

Every May 1st the legal minimum wage is raised on the basis of the wholesale price movement over the previous year, estimated inflation for the coming year and the rise in productivity.

The system is credited with spurring investments whilst reducing Brazil's soaring inflation rate of more than 90% of a decade ago to about 15% last year.

"If the United States and Europe do not succeed in curbing inflation in the next three years, they will have to adopt monetary correction as we have" says Prof. De Bulhões.

Brazil's unorthodox plan for getting along with inflation has attracted international interest. Prof. Friedman has suggested that "Indexing" be used in the United States and also in other countries suffering the pangs of surging inflation.

The opponents of monetary correction believe that it is unfair to the working classes and makes inflation more acceptable.

The new finance minister Mario Henrique Simonsen contends that "monetary correction" is successful and necessary for growth. It is better to divide a big cake than a small one, he says.

Unfortunately Brazil has been hard hit by the energy crisis as it has to import 80% of its oil and the inflation rate has increased to 28,5% recently.

A SUMMARY OF THE EXPERT VIEWS TO CURB INFLATION

Prof. Kenneth Arrow states

1. Nobody understands the roots of the present inflation. He urges
   1. A pragmatic policy of cooling demand in great moderation.
   2. Seeking stability on the currency front.
   3. Removing obstacles to the free flow of trade.

Prof. Bach

1. Checking inflation rather than accepting a constant inflation policy offers the greatest hope.
2. We must push forward as far as possible toward a better widespread understanding of the illusory gains from inflationary income struggles.
3. Real costs of unavoidable inflation can be held to a reasonable minimum through the development of more inflation-protective social instructions for those passive economic groups who are most helplessly susceptible to the capricious erosion of rising prices.

Dr. Courtney Brown

1. Abandon the public objective of maximum growth through forced feeding of the economy with deficit financing and large expansion of money and credit.

Dr. Busschau

1. Cut expenditure, slow down rate of own inflation, and let currency float upwards.

Prof. Ernest Dale

1. Favours the consistent maintenance over time of a new national goal to return to a stable price level, which will, during a transition period, entail individual sacrifices.
2. We can demand that government put forth clear and concise programmes, including the sacrifices we have to undergo.

Prof. Gouvêa de Bulhões

1. Cause of Brazilian inflation until 1964 was mainly the budget deficit. First measure of new government was to balance the budget.
2. An accentuated inflation eliminates savings, but savings are fundamental to the financing of non-inflationary investments. Under these conditions as a stimulus to development and parallel to the restriction imposed in order to gradually reduce inflation, a policy of "monetary appreciation of capital" was adopted.
3. Second inflation 1973.

The major reason for the increase of the rate of inflation was the capital market recession. The difficulty of raising capital in the form of stocks or long-maturing bonds, increased the amount of backing credit, both domestic and foreign. The result was a sharp monetary expansion. The objective now is to curtail this expansion and to foster savings.

Under the social integration plan a percentage of government revenue (budget surplus) is directed to a savings fund. The resources should be applied to the acquisition of stocks on the capital market. The dividend of these stocks will supplement wages.

Prof. Peter Drucker

1. The first duty of government is now: maintenance of the purchasing power of the currency.
2. All businesses should be expected to keep their accounts in constant values.
3. Would declare a moratorium on all new government programmes and the expansion of existing ones.

Prof. Otto Eckstein

1. Restore competition.
2. Pursue fiscal and monetary policies to keep demands within the bounds of productive capacity.
3. Work with leadership of business and labour to ensure an orderly and balanced process of collective bargaining.
4. Work with other nations to achieve mutually suitable patterns of exchange rates and divisions of scarce resources without speculative boarding.

Prof. Ludwig Erhard

1. Problem of inflation should be given priority.
2. Policy-makers must not be reconciled to accepting the Phillips curve as irrefutable.
3. Look for some mechanical rules which take into account individual behaviour and aim at long-range price stability.

Prof. Frankel

1. Government should balance its books.
2. Should force nationalised industries to pay their way.
3. Should keep the money supply at the same level as the expansion of the nation's wealth.

Prof. Milton Friedman

1. Reduce the rate of growth of the quantity of money.
2. Keep it to a level that would be consistent with matching roughly the real growth of the economy.
3. In order to reduce the temporary adverse effect I would also introduce indexing of all sorts of contracts starting with the individual income tax schedule of the government and of securities issued by governments but also encourage private indexation both in wage and other contracts.

Mr. Bruce Henderson

1. Increase productivity by increasing capital intensity.
2. Do so by changing tax laws.
3. Let corporations pay income tax with promissory notes. Two conditions:

(1) They must keep interest payments current.

(2) They must repay at least as much of that debt as they pay in dividends at any time.

It would increase capital and competition.

The government revenues would increase because the government would get its share in tax of the increased profit on the increased funds available to the corporation.

4. To offset the loss in current revenue the government should authorise the issue of tax-free retirement bonds to the public at the same rate of interest charged to the corporations. This would help to reduce inflation.
5. I would restrict the growth of the money supply to a rate which is equivalent to the growth of physical output of the economy plus an amount less than the current inflation rate.

Dr. Holloway

1. Refrain from introducing unearned money into circulation.

Eliot Janeway

1. Move quickly to encourage the overflow of excess liquidity in the Euromarket to move into the U.S.A. by removing withholding taxes on payments of rent, royalties, interest and dividends to non-American citizens making long-term investments in the U.S.A.
2. Cut back in foreign spending in dollar and gold holding countries.

Prof. Harry Johnson

1. Let exchange rate be free.
2. Let interest rate find its own level.
3. Decide on an appropriate restrictive path of growth in the money supply (don't slam on brakes, let motor slow gradually).

Prof. Harold Koontz

1. Limit government expenses to cash receipts.
2. Enforce competition.
3. Regulate prices of utilities and reward productivity.
4. Stimulate development of natural resources (energy).
5. Remove shackles of productivity such as restrictive tax, etc.
6. Where private enterprise cannot or will not undertake, put under government ownership.

Prof. Kuin

1. Balance budget.
2. If inflation exceeds 5% budget will have to provide for a surplus.
3. When rate of inlfation exceeds 10% a six months freeze should be imposed.
4. If inflation exceeds 10% all long-term debts should be indexed.

Prof. Meltzer

1. Reduce government expenditure and government employment to achieve a budget suprlus.
2. Use the surplus to retire debt held by private sector.
3. Reduce monetary expansion gradually but steadily.
4. Maintain floating exchange rate system without intervention.

Mr. Nobuo Noda

1. I would abolish import duties on oil and oil products.
2. Would remove commodity taxes on beer and tobacco.
3. Reduce corporate income tax.
4. Would take measures to stabilize price although the price level would probably be higher within the near future, on a new price system which should be well-balanced among all products.

Lord Robbins

1. Price controls not effective. Bound to break down.
2. Ultimate cause of inflation is continued increase of money.
3. Cure therefore: slowing down and eventual cessation of this increase over and above a rate made appropriate by the increase of production.
4. However, rate should be compatible with political stability.

Monsieur Jacques Rueff

1. I would demand the suppression of the system of Eurocurrencies, which is the root cause of the present wave of inflation in the Western world.

Mr. B. Saager
1. The only minister who can control inflation is the minister of the largest gold-producing country.
2. Introduce gold standard.
3. Fix price of gold at R5 000 a kilogram.
4. Remove all foreign exchange restrictions.
5. This is first step in the direction of an orthodox monetary order — monetary reserves should consist of gold or currencies convertible into gold.

Prof. Samuelson
1. Direct wage and price controls are not effective.
2. Explore manpower and labour — market programmes to reduce the structural elements of unemployment.
3. Does not recommend a policy of insisting on absolutely stable prices at whatever cost to current employment in short-run growth.

Dr. S. Schweizer
1. Break monopoly of trade unions and do not allow real wage increase beyond increase of productivity.
2. Would not, except for the very lowest classes of income, give full compensation for an increase in cost of living.
3. Would not allow social benefits to be extended to any class unless other classes prepared to accept lowering in standard themselves.
4. Would establish a clear restrictive relationship between public expenditure and G.N.P.

Prof. Schiller
1. Retain floating rates of exchange.
2. Continue with a policy of scarce money.
3. It is possible to bring the increase of money volume in adequate relation to the increase of real national product.
4. Follow a restrictive policy of public expenditure.
5. Instruments of public revenue and creation of a surplus i.e. temporary freezing of public money of great importance.
6. Most difficult is incomes policy for stability.
7. Controls only cause damming-up effect.
8. Countries with strong balance of payments must aid others.
9. Must ensure that the industrial business cycle of the Western world does not change into a world-wide recession.

Dr. A. Schaefer
1. People have to work harder.
2. For a period of two to three years all wage increases should be held away from consumption by compulsory savings.
3. These mandatory savings should be equipped with a relatively high interest rate and enjoy tax relief.

Dr. Stopper
1. Maintain a restrictive set of fiscal and monetary policies.
2. A reasonable incomes policy (wage and price policy) should be implemented.
3. The drop in purchasing power due to oil and other commodity prices should be used for anti-inflationary purposes.
4. The increased cost of living due to a worsening of the terms of trade must thus be fully compensated by wage increases.
5. Break the link between money-wages and the cost of living indexes thus reducing domestic inflationary pressure.
6. Prevent possible rise in unemployment by stimulating investment in the fields of energy substitution, energy saving and environment protection.

Lt.-Col. Urwick
1. Curb money supply.

Prof. Walters
1. I would gradually reduce the rate of money expansion from present figures of 20 per cent to about 5 per cent.

May I end with a quotation from Prof. Bach. "Inflation comes not from Heaven but from policies of men, and there is much that we can do to affect its speed and to channel its differential effect on different groups — if we wish to do so".