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THE
AGE
OF
INFLATION
JACQUES RUEFF

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In these lectures, delivered between 1932 and 1961, Jacques Rueff, the distinguished French economist who conceived the financial reform adopted by the government of President de Gaulle in 1958, attacks the concept of the planned economy, which he holds responsible for the inflation which is now ravaging so many countries of the world.

Comparing Germany and England after World War I, Rueff demonstrates how the Germans, to avoid depreciating the inflation-ridden mark by attempting to control foreign trade, took the first step towards the planned economy of the Third Reich; whereas England devalued its currency, accepted financial responsibility, and preserved its social structure.

In this and other lectures, Rueff proves incontestably that a country can rid itself of inflation only by permitting the purchasing power of its population to adjust itself to the total value of purchasable wealth, and by returning to a gold standard.

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Jacques Rueff

THE AGE OF INFLATION

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CONTENTS

Introduction	vii
1. Reminiscences and reflections on the age of inflation	1
2. The case for the gold standard	30
3. The gold franc next?	62
4. Proof “a contrario”— The resurrection of Germany	86
5. Sound money is the only road to the new Europe	106
6. The money problem of the West	113
Appendix	
Report on the Financial Condition of France	129

INTRODUCTION :

MONEY WILL DECIDE THE FATE OF MANKIND

In Sartre's *The Flies*, a disillusioned Zeus compares notes with Aegistheus on the drawbacks of power:

"You and I are of the same breed," the king of the gods remarks to the king of Argos. "I made you after my likeness—what's a king, but a god on earth?—We both enforce order, you in Argos and I in the universe, but the same sad secret which gods and kings share weighs heavily on our hearts: men are free."

Paradoxically, that secret is the sesame that bestows a consistent meaning to the otherwise unrelated notes of which this book is made up. Man is free, not as a result of some institutional provision but because nature made him so, so that no conscious action of his can ever be performed unless agrees to perform it.

Man, the Bible says, is always "in the hands of his own counsel." But the human race whose spirit has often soared to tremendous heights has not entirely emerged from the biological mud of its long pre-history. It is still ruled by the dictates of self-preservation. Within each individual, hunger and thirst, greed and lust, selfishness and violence are at work to ensure survival of the species. Human creatures, left to their own devices, could only form barbarous societies, and the civilizing of these societies has been the consistent endeavor of hu-

man institutions. With the introduction of morals and the rule of law, institutions have gradually confined man's freedom within the narrow boundaries of what is "right" and "allowed." In particular, they forbade him to use and dispose of what does not belong to him, and by institutionalizing the right of property they have created a state of affairs in which any desirable object falls necessarily under the sway of only one individual. With the power to transform a commodity vested exclusively in its rightful owner, exchange has become the normal substitute for violent appropriation. In order to become widespread, however, the practice of exchange called for the use of a convenient token, such as money, which could serve as a visible pledge of the owner's rights—at the same time fixing their extent—between the time when their physical content would be surrendered by a sale and such time as some purchase would replace them by a new form of wealth.

When the total quantity of money in circulation was at the level of the total amount of cash holdings that people wished to retain, then the people, being unwilling to reduce their cash holdings, could only participate in demand to the extent to which they had added to supply; in spite of their freedom of action, aggregate demand would be equal to the aggregate value of supply, and monetary balance would be achieved. When, on the contrary, the volume of currency was larger than total cash holdings, those who held surplus quantities had no choice, in order to get rid of them, but to engage in demand without contributing to supply. The excess of demand over the total value

of supply would create an inflationary surplus, which might be disposed of either within the economy—producing, all other factors being equal, a rise in prices—or abroad, entailing a balance-of-payments deficit.

Thus the real problem in maintaining economic stability is that of keeping the quantity of money at the level of the cash needs of its users. But such an equalization was highly unlikely to occur, and very difficult to achieve. Yet for over a century a comparatively stable monetary setup was maintained by means of the gold standard system. Slowly elaborated and gradually perfected, this subtle device, in spite of many setbacks, proved to be reasonably effective, since the general index of gold prices stood in 1910 at approximately the same level as in 1890—even though the economy had in the interval undergone a tremendous expansion, involving a threefold increase in gold holdings.¹

During that period, despite radical structural changes, the balance of payments had remained stable. It could not have been otherwise, since whenever a portion of the national income was ex-
abroad, a portion of equal value of na-

¹Cf. Report of the Gold Delegation of the League of Nations' Financial Committee (Geneva, 1928), p. 31.

My studies on "monetary control and the insitutional problem of currency" (Sirey, 1953), and "the theory of the discount rate and the balance of accounts" (*Revue economique*, July, 1957) describe the ingenious and little-known processes by which the quantity of currency issued was more or less maintained under the gold standard system at the level of the aggregate demand for cash.

tional production automatically became available for export.

Due to developments which had nothing to do with monetary policy, a number of serious distortions were introduced into the issuing system of all the civilized countries from 1914 onwards, and as a result the functioning of that system was badly impaired. Basically, the first distortions arose from the rupture of the link between the money supply and the cash requirements of the people. These distortions, originated primarily from the deficit in public finances which was created by the burden of war and post-war expenditures. These deficits gave rise to an excess of effective demand characteristic of a state of inflation.

The perturbations and hardships caused by open inflation were so far-reaching that they led all the peoples that experienced them to adopt the techniques of suppressed inflation, which almost put an end forever to human freedom. The Hitlerite system of economic autarky and extensive rationing was introduced, not for ideological reasons or out of a concern for equity or economic development—and even less for social progress—but in order to take advantage over a long period of time of the unavowed financing represented by inflation and to conceal its consequences. The deception practiced with respect to inflation brought about a revolution in a major part of the Western world more far-reaching and lasting than that which communism attempted to achieve.

Another distortion—possibly more widespread and definitely more insidious—was created by the conditions under which the international payments

system was re-established after the two world wars. Between 1914 and 1920 gold prices had doubled. Obviously the value of gold holdings, reckoned at the former price of the yellow metal, could no longer meet the needs of a circulation increased twofold. Apparently though, the monetary conference convened at Genoa in 1922 failed to realize this fact, since it recommended embodying "some means of economizing the use of gold by maintaining reserves in the form of foreign balances."

This recommendation, which was implemented by the Financial Committee of the League of Nations, introduced a *de jure or de facto* "gold-exchange standard" system among all the countries that chose to re-establish convertibility after the first world war. Under this system, the continental central banks retained all the dollars and sterling they received in order to reinvest them in their place of origin. For instance, every dollar paid into one of these banks was returned on the day it was received to the American economy, since it was immediately invested in the United States money market.

Thus the key-currency countries, the United States and Britain, enjoyed the peculiar privilege of being able to buy abroad without having to curb in any way their internal demand. Consequently, their accounts could show a deficit indefinitely, since on the home scene everything went on as if the deficit did not exist. We can see, therefore, that the system had the effect, and almost the aim, of maintaining a permanent deficit in the balance of payments of the key-currency countries. At the same time, the duplication of purchasing power re-

sulting from the expansion of demand in the creditor country, without a corresponding contraction in the debtor country, kept the countries with convertible currencies in a state of chronic inflation, this, of course, was conducive to economic growth—but also to rising prices. Furthermore, under the gold-exchange standard system, new claims kept accumulating on a stock of gold which remained the same. The system, therefore, was doomed, and it eventually collapsed in 1931, during the Depression. Yet it produced one beneficial result, since by 1933 the world was completely rid of an absurd monetary system, and President Roosevelt was able to re-establish the gold standard system in 1934 with a systematic readjustment of the price of gold.

Future students of history will be shocked and angered by the fact that in 1945 the same monetary system that had driven the world to despair and disaster, and had almost destroyed the civilization it was supposed to stand for, was revived on a much wider scope. But while in 1922 the system had been set up deliberately, this time it was reintroduced by tacit, yet unanimous agreement, without any definite decision or even an informal discussion. It is indeed disturbing to see, at a time when the credo of rational action is heard—and rightfully so—everywhere and there exists a new science of operational research, the world embark on a course which jeopardizes its survival without even pausing to appraise the course. In an era when vast resources were devoted to probing the atom, it is hard to understand why no systematic effort was made to investigate the causes of that unprecedented catastrophe, the Depression.

Since 1945 we have again been setting up the mechanism that, unquestionably, triggered the disaster of 1929-1933. We are now watching the consequences, as they follow in their ineluctable course. It is up to us to decide whether we are going to let our civilization drift farther towards the inevitable catastrophe. For those with foresight, our most pressing duty at this juncture is to impress on Western thinking that monetary matters are serious, that they require deliberate consideration and should be dealt with systematically. Although we are already on the brink of disaster, salvation is still possible if we take decisive action. And the recovery must be inspired by deep conviction, based on a systematic analysis of past experience, and incontrovertible conclusions.

Mankind is seeking—and waiting for—a leader who will display the courage and intelligence required to rescue us. If such a leader does not exist, or if political circumstances prevent him from emerging, man's destruction is inevitable as that of a man falling from the roof of a skyscraper. If, on the other hand, such a leader exists, and succeeds in (1) getting together a group of serious-minded men who will make a serious appraisal of the current situation, and not merely pay lip-service to the world's wishful thinking, and (2) in creating the conviction, in countries with convertible currencies, that a recovery is necessary and can be brought about by a very limited number of fool-proof measures, then the world will be saved. And being at last rid of the nagging threat of bankruptcy, it will be able to look forward confidently to a long period of expansion and prosperity. Given

these conditions, the situation will be easily mended, recovery smoothly effected, and the success of the required adjustments assured.

The following studies have been put together in an attempt to prompt a move in the right direction. Some may wonder at the title of this introduction, but it should be taken literally, in its full implication. *Money will decide the fate of mankind*, because individual liberty is only possible—or even thinkable—when confined within the boundaries of a collective discipline, calculated to curb the disorders that uncontrolled action is bound to provoke. That discipline is provided by the legal structure of our societies—in economics by ensuring that total purchasing power is limited to the total value of the wealth offered for purchase. When this rule is broken, inflation and imbalance of external payments set in, bringing disorders that soon become unbearable.

The experience of recent decades has shown repeatedly that inflationary situations have inevitably entailed comprehensive rationing, price and wage control, compulsory distribution of the means of production (including labor), extensive import quotas, prohibition of foreign travel—in short, widespread control over individual activities, culminating in the abolition of freedom itself, which in any case had already become non-existent and wholly undesirable as a result of the disorders and sufferings that its undisciplined exercise had brought about. Today, as in the past, a sound money system is the condition of man's freedom and the key to his future.

1.

REMINISCENCES AND REFLECTIONS ON THE AGE OF INFLATION

Coining a name for the period in which one lives is a risky business. I drew this conclusion from a story told me by one of my daughters, who had heard it at school. It was about a boy who was taking his College Board examinations, around 2000 A.D. One question was about Hitler, of whom the boy had never heard. When he got home, his father asked him:

“Well, how did it go? Was it all right?”

“No,” the boy said, “they asked me who Hitler was, and I didn’t know. Do you?”

The father did not know either. So they consulted the new family encyclopaedia and found the following entry:

“HITLER. Gang leader who operated in Stalin’s time.”

Well, in spite of that cautionary tale, I am convinced that future historians, as they analyse the underlying causes of our crisis, disorders and the disruption of our social structures, will look upon the time in which we live as the Age of Inflation.

Lecture delivered at the Centre Universitaire Méditerranéen, Nice, February 13, 1956.

Inflation has been a permanent feature of the environment in which I've acquired my economic experience, ever since 1921, when at the École Polytechnique I used to attend the lectures of my teacher, Professor Clement Colson. There was at that time no proper knowledge of the nature of the inflationary process. It is impossible for present-day undergraduates to imagine how shocked our fathers would have been had they been told that the currency in which they had accumulated their modest savings was liable to lose a substantial part of its worth. The devaluations to which we have now become used would have been quite inconceivable to them. No wonder, therefore, that as soon as World War I was over the governments of all the belligerent nations, without the slightest hesitation, affirmed their wish to restore the pre-war parity, to bring their currencies back to the *status quo ante*.

As I said, the economic thinking of that period ran along rather simple lines. Inflation, in particular, was viewed merely as an increase in the amount of currency in circulation. The situation, therefore, could easily be mended. Since the amount of currency had increased during the war, it would be reduced gradually, and after a number of years pre-war parity would automatically be achieved again.

Thus immediately after World War I the French government had a bill passed, under which the treasury had to pay back two billion francs *per annum* to the Bank of France against the advances made by the bank to the state. I shall show later that this bill was adopted out of sheer ignorance,

that it was based on a complete misapprehension of the inflationary process, and that like all unrealistic measures it was defeated by actual developments, though understood only a long time afterward. In such matters, theory is slow in catching up with practice—sometimes it never does.

Britain was the first to achieve pre-war parity; in 1925, she re-established the metallic convertibility of her currency at the 1914 level. This she achieved without too much difficulty since the pound was undervalued by only about 10 per cent. But while British prices more or less followed the level of currency (that is, they went down to the extent to which the value of the monetary standard was raised), wages—which were frozen as a result of a complex set of factors, among which the rates of unemployment insurance were not the least important—did not align themselves with the general level of prices from 1923 onward. Because of this disparity, Britain experienced for a long period an unprecedented rate of unemployment. From 1919 to 1940 she never had less than one million unemployed.

Chronic unemployment was a completely new development—and possibly also one of the most important ones—for it raised doubts about the soundness of the existing economic regime. It brought about a deep transformation in economic thinking and in political trends. It was chronic unemployment that produced Hitler in Germany and Lord Keynes in England, and both events, in very different ways, had immense consequences.

Frances's efforts to restore pre-war parity only re-

4 THE AGE OF INFLATION

sulted in sinking her deeper and deeper in an inflationary situation which lasted until 1926, when Premier Poincaré managed to stabilize the Franc *de facto* before stabilizing it legally in 1928, at one-fifth of its pre-war value. This measure gave rise to fierce controversies. It is hard to realize the shattering psychological effect produced by the adjustment of the franc at a level different from that which prevailed before the war. Everyone wanted to go back to pre-war parity; it was somehow in bad form to contemplate stabilization at a reduced level—which was equivalent to our present-day devaluations. In 1921 my teacher Professor Colson, at that time Vice-President of the Council of State, was nearly discharged for venturing to suggest at a meeting of the Academy of Moral and Political Sciences that there might be a case for stabilizing the franc at a revised level.

Britain and France restored convertibility through purely national processes. All the other European countries except Germany readjusted their currencies through the League of Nations' Financial Committee. Thus between 1925 and 1930, Austria, Hungary, Estonia, Bulgaria, Greece, and Danzig stabilized their currencies.

HOW THE GOLD-EXCHANGE STANDARD SYSTEM SET THE STAGE FOR THE DEPRESSION

The work of the League of Nations' Financial Committee is characterized by the fact that it was acting on a recommendation of the conference of heads of governments, ministers, and experts in Genoa in 1922. In resolution 9, the conference

recommended the adoption of a policy "of economizing the use of gold by maintaining reserves in form of foreign balances."

In spite of its apparent obscurity, that recommendation had very definite consequences. Previously, the central banks' reserves had to consist exclusively of gold, or assets made out in the national currency. Resolution 9 was in fact requesting the nations to authorize their central banks to maintain also, in their assets, those currencies which could be exchanged for gold, that is, sterling and dollars. The experts were unanimous in making that recommendation, and at the time no one anticipated that it was going to rock the foundations of Western civilization.

I have a definite distrust of experts—even though I have often been looked upon as one myself. The trouble with them is that, although they are always expert in something, they seldom are in the particular field in which they are consulted

The System under which central banks are allowed to hold foreign currency balances abroad is called "gold-exchange standard." Under that system the Bank Of France, for example, on receiving funds from the United States may leave the dollars on the New York money market instead of calling the gold they represent and entering it among its assets. The difference seems trifling, yet has considerably impaired the stabilizing action of the monetary system.

Under the gold standard system, Whenever capital is transferred from one country to another, the former's credit potential is reduced and the latter's is

increased. But under the gold-exchange standard system it is possible for capital to be transferred to another country without leaving the country of origin. The difference is not very important when capital flows are limited. But in 1924 they were extremely large, as a result of a renewed confidence in Europe. After a massive flight from Germany, France, and even Britain, from 1924 on capital began to return to Europe, in particular to Germany, in a spectacular surge. Under the gold standard system the return of capital would have involved a corresponding shift of gold; the metal would have left the United States for Europe, or it would have been earmarked for the new possessors. In any case, it would have been removed from the reserves of those who parted with it. But under the new system repatriated capital, while included in the reserves of the receiving countries, was not actually taken out of the United States. The receiving banks recorded the capital in their balances as a basis of credit, while actually leaving it in the United States or Britain, where it continued to be used as a basis of credit.

Thus the system was to duplicate the monetary potential of the metallic counterpart of national currencies. This in turn generated the vast inflationary process which led to the great tide of prosperity and expansion that swept the world until 1929. I draw your attention to this fact because it is important that we know why our economic regime no longer satisfies anyone. Its two prime faults are, on the one hand, to have left one million men in Britain unemployed for twenty years, and on the other hand

to have countenanced that appalling tragedy, the Depression.

The seriousness of the Depression was due entirely to this duplication process. The swollen stream of capital that flowed back to Europe was accompanied by an actual duplication of credit facilities all over the world—by a very large increase in the volume of potential purchasing power. These conditions generated the unprecedented prosperity of the 1928-1929 boom. This is not surprising, considering that the level of demand, through a well-known process of multiplication, had much more than doubled.

Thus the brake exerted by the monetary system had been, if not removed, at least considerably loosened. The uninitiated tend to forget that a monetary system is basically a regulating device. Monetary systems, like most economic systems, are feedback mechanisms which act as regulators to maintain a certain balance. The more play allowed in such mechanisms the more the balance is jeopardized—a simple truth the experts at Genoa obviously failed to grasp.

Once play was allowed in the mechanism, it became possible to surrender gaily to the great tide of prosperity and inflation. But the day the snag occurred, crystallizing, as in an oversaturated solution, individual reactions, it was necessary to go as far down the road of depression as one had advanced on that of expansion. Black Friday, 1929, gave the first warning of the impending crisis, which in successive waves was to spread to every country in Europe. The Depression gave rise to the feeling

that there must be something basically wrong with a system that permits such a catastrophe to occur at all.

With the advent of the crisis, the nations had to face again the monetary problem they thought they had solved. They were engulfed in a great depression, a direct result of the ill-advised decision to adopt the gold-exchange standard. They reacted in two different ways, which can be related to the two main trends that can be distinguished even now in the economic and monetary policies of the various countries.

THE GERMAN WAY—RATIONING AND EXCHANGE CONTROL

The 1929 crisis had deeply shaken the confidence of investors who had transferred capital from the United States or Britain to continental Europe, in particular to Germany. The failure of the Austrian Kreditanstalt in 1931 started the withdrawal, first from Austria, then from Germany, of that capital.

In the spring of 1931 it looked as though Germany were facing another depreciation of the mark, similar to that which had so critically affected her economy after the First World War. The seriousness of this situation cannot be properly appreciated unless one knows—as do those who lived through it—what deep scars the great 1922-1923 inflation had left in the German people. Those who were familiar with German affairs were convinced at the time that the Germans would not endure another inflation—that they were prepared to go to any lengths to protest a repetition of such a state of af-

fairs. The other big powers, aware of the implications of a new German inflation, tried to avert the threat.¹

War damages were due to France, the main claimant, and to other victors of Germany. Reparation for these came in addition to Germany's external obligations. The first move to avert the threat to Germany was made by President Hoover in June, 1931. He observed that the reparations imposed on Germany placed an additional burden on her balance of payments, and proposed a reduction of Germany's foreign obligations, hoping that a further depreciation of the mark would thus be avoided. In support of his proposal he announced the "Hoover Moratorium", which suspended for one year the payment of war debts to the United States by its former allies, on condition that the allies, in turn, should suspend the German reparations for the same period of time. He hoped that during this respite a means would be found to ward off the new devaluation of the mark.

The governments reacted as they always do in such cases; they called an international conference, which met in London in July, 1931, during the holiday period. This detail is important, for the

¹ In those days I was financial attaché to the French Embassy in London—a good place to watch developments since most of them took place there. Written history is seldom complete; many of its sidelights are lost because the participants did not have the time or the inclination to record them. In this case, the details I give are essential to a full understanding of the course of events.

10 THE AGE OF INFLATION

United States delegate, Secretary of State Stimson, had just departed for a vacation in Europe. And of course in those days one did not (unless his name was Lindbergh) fly across the Atlantic; one had to cross it by ship—and that went for Mr. Stimson, too. It so happened that President Hoover declared his moratorium while the secretary of state was at sea, and on arriving at Southampton he was met by a U.S. Embassy Official, who informed him that he had been appointed United States representative to the conference, and asked him to report at Whitehall the next day at 10:00 A.M. for the opening session.

At Whitehall the next day, British Prime Minister Macdonald was in the chair. Germany was represented by Chancellor Brüning, who was considered to be the last upholder of a policy of peace in Germany, and who was trying with the support of the Anglo-Saxon governments to fight inflation. The French delegate was Pierre Étienne Flandin, and I had the privilege, as financial attaché to the embassy, to sit behind him. The conference was very short. Premier Macdonald said, "Gentlemen, we are here to prevent another depreciation of the mark. Are there any proposals?" Of course, the meeting had been convened on short notice, and there had been very little preparation. The delegates sitting around the horseshoe table looked at each other. Only one—Mr. Stimson—raised his hand: "Gentlemen, the threat hanging over the German currency is due to the flight of short-term capital invested in Germany in the face of a potential new inflation. Since it is the outflow of such

capital that endangers German currency, there is only one solution, which is to tie it up in Germany or, in other words, to prevent it from leaving the mark area”

The proposed step was quite unprecedented. There had never been a general immobilization of capital within a country. The French delegation held a hurried consultation. We told Mr. Flandin that this was a bold proposal, and that, in any event, its possible implications required careful consideration. Mr. Flandin raised his hand. “That’s an interesting proposal,” he said, “but do you think it is practicable?” Mr. Stimson was visibly annoyed. “Gentlemen,” he said curtly, “I would like you to know that when the representative of the United States government suggests a solution he has made sure beforehand that it is practicable.” “If he says so, it must be so,” the Chairman observed. “Well, what shall we do?” The conclusion, of course, was that, since it was a matter of freezing short-term foreign capital invested in Germany, a committee of experts be set up to find out how it could be achieved if it were possible at all.

Accordingly the “Standstill Committee” was formed in Basle, Switzerland. Its task was to draw up the legal framework of the tie-up operation, to hit upon a scheme which would make it possible officially to stop short-term capital from leaving Germany. This would break the covenants under which it had been brought into the country. The decision to set up the Standstill Committee was to have unforeseen far-reaching consequences. It was to represent a definite turning point in the develop-

12 THE AGE OF INFLATION

ment of Western civilization, which so far had been based on respect for contracts and monetary freedom; and it would eventually result in the establishment of an entirely new system, under which it would be possible to follow an internal inflationary policy without depreciating the currency. In fine, it was the first step toward the institution of exchange control. This concept was so novel that no one realized that the imposition upon Germany, by international agreement, of a system through which capital invested there could be held compulsorily within the country meant, in fact, exchange control.

Thus when Hitler assumed power he found already established the system that would enable his regime to function and endure. Contrary to general belief, Dr. Schacht did not invent Hitler's monetary policy. It was devised and established, almost unconsciously, by the Standstill Agreements, and it was to have tragic consequences.

Hitler wanted to rearm Germany as quickly as possible, so he had to be able to spend without limit. Under the previous system he would have been unsuccessful, for inflation would have entailed the depreciation of Germany's currency and the German people would not have tolerated a recurrence of galloping inflation. But the new system, in making it possible to keep the newly created purchasing power within Germany, avoided the normal effects of a budget deficit—in particular a rise in foreign exchange rates. Dr. Schacht applied the principle of capital immobilization with exacting thoroughness, and to the extreme limit. The

seeds had been sown; all that was required was to wait for them to germinate.

In practice, the whole process was comparatively simple. Hitler's spending, without income, was pushing prices up—a typical inflationary pattern. Rising prices were politically undesirable, however, so existing levels were forcibly maintained under drastic penalties, eventually including death.

Since rising prices did not offset excess demand, rationing on an ever increasing quantity of commodities was instituted. In 1934, when I was sent to Germany to negotiate a preliminary clearing agreement between France and Germany, Dr. Schacht said to me: "Of course, we've been short of many things. Now I hear that since yesterday, oddly enough, we're also short of zinc bathtubs. However, it doesn't matter: today I am issuing an order rationing zinc bathtubs."

The pattern is too familiar for anyone to wonder about the outcome. If you give people a purchasing power beyond the capacity of the market to meet it, they ask for more than they can get. As they are unwilling to retain this purchasing power in the form of currency, in which they lack confidence, they shop for anything that is not rationed. Zinc bathtubs in this case had been overlooked, so people wanted them. That was how Dr. Schacht discovered that everything had to be rationed.

It is now well known that in inflation-prone countries where there has been some rationing there is one commodity—antiques—which remains sensitive to monetary inflation, because it is never subject to rationing. It is claimed that antique

14 THE AGE OF INFLATION

shops directly register the ups and downs of the treasury, the greater the deficit, the greater the demand for antiques. The antique trade is thus one of the most accurate barometers of the monetary situation in countries subject to suppressed inflation.

By gradually expanding his policy of rationing, Dr. Schacht built the entirely new system which is now ascribed to him. There had been inflations before, but there were no precedents for the suppressed inflation of the Hitlerite regime. Suppressed inflation makes it possible to spend without limit, to pay high wages, to build—in short, to create purchasing power without worrying about the value of the goods supposed to balance it, providing that comprehensive rationing limits expenditure to the value of the goods available on the market.

Such a system accumulates immense reserves of purchasing power, which are kept off the market by rationing measures. It leads to extraordinary situations like the one in Germany in 1948, on the eve of the monetary reform, in which everybody had so much unutilizable purchasing power that it no longer made sense to work. Whoever visited Germany before 1948 will remember the lifeless factories, the deserted fields, the empty shops—the entire country paralyzed because no one had any reason to produce more than he himself could purchase. The problem for the Germans then lay not in earning more but in finding a little black market nook where they might spend a small portion of their unused purchasing power.

When the monetary reform took place in West Germany in June, 1948, 90 per cent of the unused

purchasing power was written off with a stroke of the pen. Overnight the German people came out of their inertia, found fresh incentives, and recovered their wholehearted faith in the future of their country.² The German currency reform, by demonstrating *a contario* the importance of a sound monetary system, proved that there could be no free, civilized way of life without a genuine, inflation-free currency.

This, then, was the German solution, the offspring of that fateful 1931 conference whose express purpose was to avoid, at any cost a new depreciation of the mark.

THE BRITISH WAY— DEVALUATION AND FINANCIAL RESPONSIBILITY

The German developments naturally affected the British Currency, for a substantial part of the capital tied up in Germany originated in Britain. The freeze-up placed British banks—which relied upon the assets in Germany to preserve their liquidity—in a dangerous situation. A few weeks after the 1931 conference, the backlash of the move to immobilize short-term investments in Germany hit the British currency. Other capital began to move out and reserves became insufficient to maintain convertibility of the pound.

Britain faced the situation squarely; she put up a fight. The controller of the finance in Her Majesty's treasury, Sir Frederick Leith-Ross, flew to Paris to

² The German monetary reform is analyzed in Chapter 4.

ask us for a loan to sustain the pound. He was a good friend of mine, and when I met him at Le Bourget he looked so depressed that I took him at once to one of the local restaurants and tried to cheer him up over a juicy steak. "The worst part of it," he confided, "is that we in the British treasury are not really used to this sort of request." Yet our friendly attitude helped to make his errand as easy as possible. We granted the Bank of England a loan which we considered sufficient for it to weather the outflow of pounds. Unfortunately, the loan was used in a few days; against the universal will even a government cannot prevail. Britain, try as she would, was unable to keep sterling from falling. She chose to depreciate her currency rather than impose the controls that characterized Hitler's monetary policy.

Of course Britain could have upheld her currency by means of some system of suppressed inflation, as Germany did. But in order to do that it would have been necessary to sacrifice the freedom of the British people, just as the German's freedom was sacrificed so that Hitler might have his way, and to violate Britain's commitments to sterling creditors; Britain faced the realities. Her decision to depreciate the pound proved to be of vital importance. In choosing freedom, Britain truly saved Western civilization from disaster.

Most really important political decisions are taken on the spur of the moment, and the events which prompt them are unforeseeable. In the minds of the men who run a country there are lines of thought and principles which lead to a particular course of

action. The explanation for it—the theory—is only worked out later. Britain endeavored to avoid depreciating the pound, calling upon all the resources at her disposal. But when events combined to defeat this effort, the decisive turn was her rejection of a system to protect the currency which would have done away with individual liberty and respect for contracts.

Both the British and the German solutions clearly point to the choices that have to be made by any state threatened by inflation: either to keep up appearances at the expense of human liberty and prop up a currency which is no longer real because it no longer represents an unrestricted purchasing power; or to face reality by depreciating the currency—at the same time endeavoring to limit the scope of the depreciation by removing the causes of inflation. These basic alternatives were at the core of most of the political problems that arose during the post-war period.

France, like the other nations, also had to make a choice between alternatives. First she tried, together with several continental countries, to maintain existing currency levels by setting up the so-called “Gold Bloc.” But the causes of inflation in France lay deeper than those which affected Britain’s currency, since in addition to external factors there were the effects of sizable budget deficits resulting *inter alia* from the armament effort imposed by the prospect of a new war. After holding out until 1936, steering clear of both currency de-

preciation and exchange controls, the French government was forced to recognise the futility of trying to shirk the consequences when the causes could not be altered. At that junction—to its credit—France chose the British way, enabling it to enter the war with its exchequer in pretty good shape. The fact that French finances, between November, 1938, and July, 1939, underwent a thorough improvement has not been given sufficient recognition.

World War II caused a considerable worsening of the budget deficit in those countries which had maintained monetary freedom: in Britain, as a result of the armament effort, in France after its defeat, because of the obligation imposed by Germany to pay the costs of military occupation—amounting to 500 million francs a day. When a nation's survival is at stake it is difficult, if not impossible, to preserve financial order.

Thus all the belligerent countries became involved in an inflationary process which compelled them—in varying degrees—to resort to some form of suppressed inflation, along German lines. The implementation of such a system of controls is easier—even in a democracy—in wartime; the controls are then more readily accepted as part of the hardship imposed by the defence effort.

By 1944, Britain, France, and all the belligerent countries had joined with Germany in comprehensive price controls and rationing, and at the end of World War II all of them were confronted with the same problem—how to return to normal. Some of them, like Belgium, the Netherlands and, in 1948, Germany, restored monetary freedom by abol-

ishing by government fiat all or part of the redundant purchasing power. France, on the other hand, followed the example set by Britain in 1931, unfortunately without turning off the inflation tap—thus leaving herself open to a gradual depreciation of her currency. The British, with typical caution and great deliberation, set about removing the controls, at the same time allowing a certain measure of inflation and price increase.

THE CHOICE TODAY—
CONTROL THROUGH “NATIONAL ACCOUNTS”
OR THROUGH MONETARY POLICY

The preceding analysis proves out the dictum of Ecclesiastes that “He that diggeth a pit shall fall into it.” Once an inflationary situation has been allowed to develop, no human agency can possibly avoid the consequences, which will either be apparent (currency depreciation), or hidden (suppressed inflation). The only way to avoid these disorders is to remove their cause, budget deficit.³

Deficit spending means deliberately living beyond one's income, creating demand for money without a supply—or as far as the government is concerned, spending without collecting—in all cases getting something for nothing. It eventually imposes a choice between the German and the British ways of coping with the resulting disorder. If one

³The word “deficit,” as used here in accordance with continental usage refers to an excess of expenditure over the total taxation and loans resources available to cover it. In its Anglo-Saxon usage it only means an excess of expenditure over income from taxation, representing a need for borrowing to be filled on the market.

cares for neither and yet seeks order and stability, there is only one solution: to remove the cause of disorder by restoring a proper balance between the aggregate purchasing power and the total value of the goods available.

We now have to determine the means by which such a balance can be obtained to maintain economic and monetary stability, examining in the light of new advances in economic theory how the various countries are tackling the problem of deficit control.

The sole cause of all the evils of inflation is the inability of a government, a community, an enterprise, or an individual to spend more than it actually collects—to secure a certain amount of purchasing power without placing on the market something of equal value. Yet it is not so easy to spend without cash; although the practice of living beyond one's means is far from being exceptional, not everybody is able to manage it.

Let us consider, for instance, the situation existing on the village market. (In economic matters one should always, as far as possible, pose a problem in concrete terms, reducing it to the scale of the village market place, where the women congregate to sell their eggs or butter in order to buy meat or shoes.) If a housewife wishes to return from the market at the end of the day having the same amount of cash in her purse as she had taken to market, it will be impossible for her, barring exceptional circumstances, to do any spending—to demand without contributing to supply. If she arrived with, say, 500 francs, and wants to go home with the same

amount, her capacity to buy so much butter, for example, will depend on her selling so many eggs. Thus the village market economy will remain perfectly balanced because there will never be a disproportion between demand and supply, between purchasing power and purchasable wealth.

I observed before, however, that the housewife would be able to participate in demand only to the extent to which she contributed to supply, *barring exceptional circumstances*, which I will now specify. First of all, she would be able to take away more wealth than she brought if she were willing to go home in the evening with less cash in hand than she had in the morning. Suppose, for instance, that she originally had 500 francs; if she were prepared to go home with only 250 francs, her purchasing power would amount to the value of the eggs she would have supplied by the end of the day *plus* 250 francs.

The second exceptional circumstance might occur when the housewife meets a banker. If she were lucky enough to win his confidence, she might secure a loan of, say 500 francs, to be repaid in three month's time. If this happened, the housewife's purchasing power would rise to the value of the eggs sold *plus* the 500 francs lent her by the banker.

This gives the essentials of economic equilibrium; total demand equals total value of supply plus the difference between the variations, of the total actual cash holdings and the total desired cash holdings.

If we now consider France as one big market place, we arrive at the following relations: total

demand during a given period equals total value of the commodities supplied plus the difference between the variations of the total quantity of currency in circulation and of the total desired cash holdings. Total demand is then equal to the total value of supply; there can be no inflation as long as the quantity of currency in circulation varies as the total volume of the desired cash holdings. In other words, as long as any increase in the money supply is desired, it has no effect on prices. There is no inflation as long as the money supply reflects a need for more liquidity.

The issuing of additional currency starts off an inflationary process only when it is not accompanied by a desire on the part of those who receive it to keep it. Unwanted surplus liquidity creates an excess demand, which *does* have an impact on prices.

This incontrovertible fact shows that there are only two lines along which a policy for stabilizing the general level of prices can be developed. As the difference between total demand and the total value of supply is identical to the difference between the variation of the quantity of currency in circulation and that of the total desired cash holdings, one can be sure that the two differences will always vary simultaneously, and that therefore neither will vary without the other also varying by the same amount.

Thus to prevent any economic imbalance the authorities can either control the first term of the equation or the second. In the first case, they seek to alter the difference between total demand and the total value of supply, and their action pertains

to economic policy; in the second case, they set about to modify the difference between the total money supply and the total volume of desired cash holding. In other words, they practice a monetary policy.

Before the war, this last option was not clearly seen; the quantity of money in circulation seemed to be the only factor to worry about. It was not known then that the level of desired cash holdings could affect the money supply. In 1919, for instance, it was decided to pay back the Bank of France two billion francs per year, in the confident expectation that in this way it would be possible to return gradually to pre-war conditions.

Today, however, monetary policies are no longer in vogue.⁴ Until recently, they were all but completely forgotten. Those specialists who continued to think in terms of currency were regarded as old-fashioned. The economists only thought in terms of control over purchasing power. This change of outlook was not without real grounds. In former times, the question of controlling purchasing power did not arise, for very few incomes were fixed a priori. Governmental deficit was non-existent or negligible. Civil servants' salaries were dependent on and commensurate with tax collections. Insolvent enterprises were soon reduced to bankruptcy. The wage bill could not exceed the company's income. The scope of investments was limited to the size of the loans that could be secured on the market; investment could only take place when a lender gave up

⁴ In 1956

his spending capacity in order that the borrower might spend in his stead. For all those reasons the aggregate purchasing power always stood roughly at the level of the total value of the wealth available on the market.

Since the war, however, the formation of purchasing power has undergone a radical change. A great many incomes are now Fixed a priori; they no longer are consequences, but have become causes. In the first place, government expenditure, including, notably, public salaries, is no longer conditioned by government revenue but is predetermined for reasons of political expediency or union pressure. I am not saying that these considerations are not legitimate, but in practice they tend to be final, and the level of remuneration of civil servants is determined—regardless of the size of the tax revenue, which normally is supposed to foot the bill—at collective bargaining sessions convened by the government. For that reason they tend to generate inordinate purchasing power. Likewise, in nationalized enterprises, and indeed in most private enterprises, levels of pay are determined, indirectly, by the “minimum guaranteed wage,” that is to say on an a priori basis, without taking into account the value of the wealth introduced into the market by the enterprise—the commodities it produces as a counterpart for the income it distributes.

Also, the great vogue enjoyed by Keynesian theories has made capital expenditure an indispensable component of expense budgets. The government undertakes to provide a number of public, semi-public, or even private enterprises with the re-

sources they cannot or are unwilling to borrow on the market. The government programs, therefore, include the financing of various modernization or fixed capital investment plans which are deemed necessary or useful. Doubtless, such investments are usually worthwhile; the fact remains, however, that they constitute hard and fast commitments which are unrelated to the resources made available through savings.

In consequence of all those changes, however justified they may appear on other grounds, demand has become divorced from supply. It is no longer directly generated by supply, and can, therefore, exceed it significantly for long periods of time. Realization of this fact has led a whole school of economists to the conclusion that there is only one way of restoring the balance—by adjusting systematically total demand to total value of supply.

So “national accounting” has been introduced, has become indispensable in all the major countries. The purpose of this new device is to achieve a balance, not, as before, between government income and expenditure in the framework budget balance sheet, but between “input” and “output” in the framework of “national accounts.” All countries, the United States, Britain, and France in particular, undertake every year the preparation of such accounts, through which they seek to establish and enforce a balance between total outlays and the aggregate value of goods offered on the market. In France at the present time, the Budget of the Nation is regarded as the mainstay of economic equilibrium.

In theory, such a national accounting system could be very effective. The trouble is that, in dealing with human realities, fact does not necessarily abide by calculation. In attempting to strike a balance between such vital quantities as wages, on the one hand, and production, on the other, equations, even if their accuracy is unimpeachable, have not real hold on reality. This we can see by the fact that despite the ingenious balancing performed in the ledgers of national accountants, inflation is still rampant in all major Western countries.

It may be easier for Soviet Russia to adjust incomes by decree to the value of the wealth made available, but whether it is or not is not at all certain. I say this because in 1945 I had the privilege of spending some time in the U.S.S.R. as French representative to the Reparations Commission, which was meeting in Moscow. While there I discovered free markets where consumers could spend any income in excess of the value of the commodities available through the official supply network. This shows that, ironically enough, Soviet Russia, unlike any other country in the world at that time, was relying on the price mechanism to make up for any loophole in the economic equilibrium. On those free markets farmers were able to sell, at prices wholly determined by supply and demand, any produce that they might have had left after delivering to the state the statutory quantities. The demand for the free market served to offset the excess of planned incomes over the value of planned rations. Thus even in Soviet Russia it has

not been so easy to adjust total demand to total value of supply. This also indicates a grasp of the market mechanism on the part of Soviet economists which has not always been shared by the pundits of capitalistic economics.

Monetary management is another solution to the problem of maintaining economic equilibrium. Its basic principle is that no money should be issued without being matched by a supply of wealth of equal value; it rules out the discount of "fictitious claims." Monetary management means, primarily, control over the second term of the equation given above in order to ensure that the total money supply is equal to the total volume of desired cash holdings. In the past, this control was effective indirectly, through a strict limitation of the types of bills acceptable for discount, particularly in terms of solvency and maturity. It was, therefore, comparatively easy to exercise—hence efficacious but brutal, which made it doubly unpopular. In fact, it was this very efficacy that chafed public opinion.

For the past four years, however, a peculiar phenomenon can be seen: gradually nations have been rediscovering the monetary technique. Britain rediscovered it first, followed, during the Korean war, by the United States, and now by France. Austria and the Netherlands had brilliantly applied the technique before, with results far more impressive than those they could achieve through the "national accounts" method. In fact, it was monetary management that enabled these two countries to effect their striking financial recovery.

I am not opposed, however, to national accounts. In these matters one should be cautious, ruling out no possible form of action. At the same time, I feel that under the economic system that still prevails in the West, with its large private sector, monetary management is handier and more effective instrument than direct incomes control by national accounts. As we stand now, men in our countries are not easily ruled by equations. They resist them, and it is difficult to reduce them to passive compliance unless one is prepared to chop off a few heads every now and again. Monetary management, on the other hand, involves neither complex calculations nor subtle theories. It is a tool scaled to man's size, and that is why I think that the world will only come out of the age of inflation by a general return of monetary techniques.

Civilizations are fragile. Price instability, one of their chronic features for half a century, is among the main causes of their vulnerability. Sufficient price stability must be restored in order to save them. No one, of course, is suggesting that the national accounting techniques be discarded; these represent a permanent advance in economics. But their deficiencies and weakness must be compensated for by an efficient monetary policy. An efficient monetary policy is the only means to avoid the deficit—by making its financing impossible. It is the only way to keep freedom from generating chaos.

The liberal civilization in which we believe we are still living can only bear fruit under conditions of stability. If we want to rebuild it we must ensure

that it rests again on the firm monetary basis upon which it was erected. Today, after forty years of inflation, freedom will be saved by the rehabilitation of money.

2.

THE CASE FOR THE GOLD STANDARD

The story I am going to relate covers a long period. It is the life story of the gold standard, now afflicted with so grave an ailment that only time will tell whether the victim will succumb or be left, at the very least, in a state of virtual paralysis.

Mine is a commonplace tale; it begins and ends with a committee of experts. The first committee deliberated at Genoa from October 29, 1445, to June 21, 1447. To my knowledge, it was the first body to perceive the advantages of an international gold standard, in the modern meaning of the term, and to recommend its adoption. The second committee met in April and May, 1922, also in Genoa. Under the guise of attempting to improve the gold standard, this committee virtually destroyed it and laid the groundwork for the policy responsible for the grave disorders we are now suffering from. Moreover, both Genoa committees, though arriving at opposite conclusions, came into being under similar circumstances, both emerging from monetary disorders attendant on a protracted war.

Lecture delivered at L'École des Sciences Politiques
on March 17, 1932.

In 1445 the Hundred Years' War was already more than a century old. It had wreaked a now familiar kind of havoc in the economic field, and had pushed the civilized world into an exchange crisis comparable to the one we experienced at the close of the last world war.

Around 1420 the gold mark, a unit of weight of approximately 250 grams for which the king's mint paid no more than 320 livres, was being quoted by money-changers at 2,817 livres, representing a depreciation of 90 per cent for French money. In 1418 the silver mark was quoted at 90 livres, while the mint's buying price was only about 9 livres.

As in our time, the effects of this monetary disarray soon became oppressive. At the first opportunity, provided by a letup in the war, Charles VII devoted himself, as the chroniclers say, "to the state of: his finances." His primary concern was to check the lack of confidence in money. Toward that end Jacques Coeur, treasurer to the king, resorted to a series of measures bearing a remarkable likeness to those which were to be adopted in France five centuries later: the prohibition of exchange transactions by unlicensed dealers and the fixing of a scale of fees for such transactions; a ban on the export of gold and silver specie; the imposition of fines on notaries who stipulated payments in gold and silver marks, that is, in bullion rather than in livres; the intensive exploitation of France's silver mines; and an attempt to achieve a balanced budget by rigorous and methodical management. Even the balance of payments attracted the attention of the king's treasurer, who concerned himself with "the revival of navigation and of sea-going commerce

which have long ceased due to the tribulations of the kingdom." At the same time, the edicts of June 26 and October 12, 1421, restored the *gros*, whose value had been 20 "tournois-deniers," to the legal rate of 5 (subsequently 2) "parisis-deniers." But all these efforts did not succeed in alleviating the financial distress. A variety of monetary adjustments—which might be termed devaluations—were devised, as usually happens in such troubled times.

Genoa was a great trading and maritime republic in 1445. Its commerce was gravely unsettled by the disturbances—which beset almost all the money marts—resulting from the fluctuation and weakening of foreign exchange, and from the debasement of its own currency. Because of these disturbances, the Genoese government had recourse to what has since become a familiar expedient: they summoned a committee of experts and asked it to propose remedies.

The committee convened on October 29, 1445. It consisted of the officials of the mint and the trustees of the Bank of St. George, which was chartered after 1444 for managing the public debt and making loans to the government. These experts labored for two years, but failed to come to an agreement. Thus on December 14, 1446, a report was published in which the majority and minority set forth their views¹ The minority report was signed by Gaspare Gentile and Luciano Grimaldi. Drawing upon the example of Bruges, where payments had been made

¹ This history of the Genoa Committee is based on the work of La Ronciere, *La Découverte de l'Afrique au Moyen Age*, Vol. III (Cairo, 1924).

since 1434 in equal parts of gold and silver, it proposed not a bimetallic but a tripartite standard, recommending that future monetary transactions be made one-third in gold, one-third in silver, and one-third in the depreciated currencies of the countries involved in the transaction. The majority report signed by Benedetto Centurione, trustee of the Bank of St. George, on the other hand, recommended the adoption of the gold standard pure and simple. A few words on the personality of the signatory should throw some light on this report.

The house of Centurione, described by Jean d'Auton in his chronicles of Louis XII as "one of the great houses of the nobility and the wealthy people of Genoa," was one of the leading houses of international commerce. It had branches in all the important commercial centers, each one usually managed by one of the Centurione brothers. Thus Nicolo and Giovanni were in Majorca, Raffaello was at Bruges, and Paolo at Lisbon. In 1522, nearly a century after the committee, the activities of the house were enlarged even more by the opening of new trading centers in Antwerp, entrusted to Agostino Centurione, and in the Indies, managed by Matteo Centurione. The Centuriones were engaged mainly in the sugar trade, and Christopher Columbus was undoubtedly one of their travelling salesmen. But they were not averse to finance, and, as we shall see, they were quite capable of coupling civic virtue with the fostering of their private interests.

The head of the house seems to have been Benedetto Centurione, who was quite aware of the

fact that for half a century a large number of trading countries had adopted the gold standard. One after the other, Egypt, Syria, Yemen, Hedjaz, and some parts of the Greek world had adopted the Venetian gold ducat or sequin because of its unchanging weight—or as we would put it today, its stability. With this in mind, Centurione proposed to stabilize Genoese currency on the basis of the gold florin of 44 sols. His report reads: “The banks will be obliged to pay in florins, exchange will take place in florins; in this way gold will not leave the country and, in time, by driving out bad money, it will constitute the wealth of the people.”

This was the opinion that prevailed with the 1445 Genoa committee, and under a regulation issued on June 21, 1447, bankers were required to make payments in gold and to deposit one hundred gold pieces as security for fines payable in the event of infraction of the rule. The same regulation provided that on September 1, 1447—and not later than January 1, 1448, in the case of the more distant centers—all drafts on Genoa were to be made out in the new currency, which thus became a great international currency, in the modern sense of the term.

This story would be very edifying if Benedetto Centurione had been solely concerned with bestowing upon the world an instrument of progress. I strongly suspect, however, that he hoped there would be benefits from his advice other than those accruing from the stabilization of the currency. The gold standard went into effect in June, and before the year was out the house of Centurione dispatched

a mission to the Sudan to find the gold-fields whose gold dust was then to be shipped to Europe via Touat. Headed by Antonio Malfante, the mission wandered about the Sahara for fourteen years in an unsuccessful search for the precious metal. Upon his return Malfante reported: "In the fourteen years I spent in the black men's countries I never heard nor saw anyone who had seen the gold or knew where it was for certain. It must therefore be presumed that it comes from a distant land."

Although the House of Centurione had no luck in its prospecting, its leader's recommendations were to have tremendous repercussions, and to endow the world with the most marvellous instrument of international co-operation in its history—the gold standard. The system was to function perfectly well until it was shattered—also at Genoa—by the second committee of experts, which in April and May, 1922, contrived to demolish the work' of the house of Centurione.

Before explaining how the later committee managed to warp this precious instrument of equilibrium and prosperity, let me describe how it functioned before 1914. Try to picture the economic universe which is covered by a particular currency—the franc, for example. You must visualize myriad individuals incessantly on the move, seeking to satisfy the infinite diversity of the desires that animate them. They are all, like countless molecules in the glass jar, producing, selling, exchanging, consuming, colliding against one another in their unsynchronized individual trajectories, and largely independent of one another. Ponder this for a moment: a

36 THE AGE OF INFLATION

non-smoker who one morning decides to buy a package of cigarettes does not stop to ask himself whether some planter in Algeria or in Maryland will add to his crop to satisfy his new want. Don't forget that when you purchase a phonograph or a radio, some manufacturer must have anticipated your wish at a time when it had not even taken shape in your mind.

But let us turn from the individual side and consider the economic universe in its entirety, as it appears before our eyes. If we examine first the pre-war period, we see that, everywhere, what any individual wanted was to be found approximately in the quantity and in the place he wanted to find it. Enterprises seeking loans always found the capital they needed, regardless of the uncertainty of their prospects. In all occupations, however hazardous or drearissime, there was a sufficient supply of manpower to ensure normal production. Lastly, very nearly the entire labor force was employed, and never at any time had there been permanent unemployment. To be sure, there were slumps from time to time—every eight or ten years. But these were of brief duration, seldom lasting more than a year, and after each economic activity resumed its upward trend.

Well, do you, after honest consideration, think it conceivable that this fortunate state of affairs was due to chance? Is it conceivable, for example, that a fortuitous coincidence can explain the fact that the quantity of mustard produced was always, and at any specific moment, approximately equal to the quantity consumed, and that this harmony between

production and consumption prevailed for the innumerable articles required to satisfy our wants? It is obvious that so unlikely an equilibrium could not have been the child of chance, and the very fact of its existence proves that there must have been a suitable mechanism, which made it function and which kept it constantly in working order.

It was then the consensus of economists, reflected in their views and teaching, that this mechanism was and could be nothing but the price mechanism. To illustrate this mechanism, let us suppose that in a given year the wheat buyers allocate 500,000 francs for their purchases, and that there are 1,000 tons of wheat for sale. The price of wheat will then be 500 francs per ton. If in the following year 2,000 tons of wheat are placed on the market and if the means of the buyers have not changed, the price of wheat will fall to 250 francs per ton. It could not be otherwise, as the price will continue to fall until all the wheat on the market has been sold.

There can be no doubt about the effectiveness of this absolute and irresistible mechanism since it does not stop working until the effect it tries to bring about has been achieved. And it is undeniable that at any given moment it is the price mechanism which guides individual activities, balances production and consumption, distributes and apportions, and makes it possible for our world to endure.

It is not only within a given country that this price mechanism is essential, but also between different currency areas—where the balance was maintained in the pre-war period by the operation of the gold standard. In this sphere, the quasi-permanent

harmony between external debts and claims must seem even more unlikely than the internal equilibrium of domestic economies. Have you ever given any thought to how the balance of payments works, as in the case of France? We can visualize balance of payments better on an individual level: every Frenchman who eats a bar of chocolate, drinks a glass of port, or wears a suit made of British cloth increases the debit side of his country's balance of payments, while every person outside of France who drinks a glass of Bordeaux or champagne, or buys French securities, adds to France's credit. In this way, all over the world a host of unrelated individuals, unaware of one another's actions, participate in the total number of transactions whose balance constitutes the French balance of payments. Differences between assets and liabilities can only be settled by the transfer of gold. As a matter of fact, before war, foreign debts and claims were balanced without the interposition of any central agency; they were kept in proportion everywhere, at all times, with a fine precision, and gold transfers, never continuous, were held at very moderate levels.

Indeed, recent developments have so strikingly confirmed the pre-war views of economist that any doubt as to their validity is unthinkable for those who do not deliberately disregard the lesson of events. Remember the transfer controversy of 1928? Some people maintained that, thanks to the operation of the gold standard, balance of payments always adapted itself to transfer requirements—in so far as the budget was kept balanced internal—and that it would be disregarding all the teach-

ings of the past to insist on adjusting actual transfers to so-called possibilities of transfer, which could only be based on prior foreign payments.

Facts speak louder than words. Germany's trade balance showed a deficit as long as she was borrowing abroad. But in two separate years, 1926 and 1930, Germany could not or would not obtain the foreign loans that had helped previously to sustain her economy. Well, in these two years and only then—as has been demonstrated in the first report of the Basle experts—Germany's trade balance showed a surplus (800 million reichsmarks in 1926 and 1,500 million in 1930). This could have been predicted from past experience. And this isn't all. In 1931, Germany not only was unable to obtain foreign loans, but she experienced a massive flight of capital. During that year, in a period of unprecedented depression when no one could sell anything anywhere, Germany was able to boast a three billion mark export surplus, more than one and a half times the amount of the Young Plan annuity. Don't you find this extraordinary? And yet it follows in the exact pattern of the precedents observed in all similar circumstances, particularity in France during the period of capital outflow. Can you contend for a single moment that this infallible operation of the trade balance—so regular that I have yet to discover an exception—can be ascribed to chance? I, for one, can't. If economic balance infallibly weathers any and all conditions, it is due to a permanent mechanism working in its favor. That mechanism is undeniably the exchange-and-price mechanism.

It is not my intent to develop the theory of the gold standard here. What I would like you to understand is that the phenomena tending to keep the balance of payments in equilibrium are bought about essentially by fluctuations of domestic purchasing power. When the means are lacking to purchase the national output at the current prices, these prices must go down, and it is this lowering of prices which stimulates exports or curbs imports.²

Under the gold standard system, however, changes in purchasing power result mainly from gold transfers; but it stands to reason that these transfers will have their normal effect only if they have actually occurred, and if their impact has not been regularly nullified by changes in the opposite direction in the total volume of credit. What should be kept in mind is that, if allowed free play, the system is bound to be effective since the momentum it sets up to bring things back into balance will not cease until equilibrium is actually restored.

The gold standard, therefore, governs all the components of our international transactions with faultless effectiveness. Like the price mechanism, of which it is only a specific aspect, it is a forceful but unobtrusive master, who governs unseen and yet is never disobeyed. Nevertheless, it is too wise to oppose the inclinations of men. It never, for example, prohibits the purchase of foreign securities; if taking all their actions into account, it guides the conduct of men in order to prevent the upsetting of

² If I were to analyze the same phenomenon today, I would establish a distinction between "income effect" and "price effect."

the balance it is supposed to maintain. We should also point out that while guiding men's actions it respects their freedom of choice. They are always at liberty to buy according to their preferences, but the monetary mechanism, in its omnipotence, will raise the price of those items whose purchase is contrary to the general interest, until such time as consumers decide of their own free will to stop buying them. The gold standard thus resembles an absolute but enlightened monarch; he does not destroy man's freedom, but employs it for his own ends. I shall try to clarify these ends by looking into the meaning and purpose of the various monetary phenomena.

Everything I have just said has tended to prove that price or exchange variations at the domestic as well as the international level contribute to achieve a balance, either between production and consumption or between foreign debts and claims. But in the field of economics the term "balance" conceals the concreteness of the subject matter involved. The survival of the system is actually predicated on a balance between production and consumption. If consumption outstrips production, stocks will dwindle to a point where demand cannot be coped with. Famine and chaos will ensue. On the other hand, if production exceeds consumption there will be a steady increase of stockpiles, also ending eventually in chaos and ruin.

The consequences of imbalance are even more striking in the international sphere: when liabilities exceed claims, the gold reserve dwindles and the solvency of the central bank is threatened. Recent

history has provided us with many examples of such a process, outstanding among them being that of Britain in the months preceding the suspension of the gold standard. If, on the other hand, foreign claims exceed liabilities, gold accumulates and gradually replaces income-producing assets in the issuing agency's balance sheet. The very existence of the central bank is imperiled.

Thus what the price mechanism in general and the gold standard in particular tend to maintain is nothing less than the perennality of the economic system. Once they cease to function, through default or surfeit, the economic system goes under. The price mechanism is but the expression of the tendency of something that exists to perpetuate itself, the necessary condition for its existence and endurance. It would seem to be the primary function of those in charge of a living institution to ensure its continued existence, for death puts an end even to the best of policies, and is the antithesis of progress. The first duty of a government acting in the public interest is to secure the survival of the nation for which it is responsible, and the first duty of the governor of a central bank is to oppose with all the means at his disposal those forces which tend to destroy his institution.

Seen in this light, however, the public interest is diametrically opposed to virtually all private interests, which almost always tend to bring about the bankruptcy of the institutions that serve them, jeopardizing their capacity for survival. The private interest of taxpayers, in relationship to the government, for example, is to pay as little as possible,

set the public treasury on the road to bankruptcy and ruin. The interest of civil servants is to obtain the highest possible pay, which is another way of bankrupting the public treasury. The interest of all users of public services is to pay the lowest possible rates, while the interests of those engaged in production is to obtain the highest possible remuneration. All these forces converge upon one common objective: to put the institution to death by exhausting its resources.

This trend is even more obvious where a central bank is concerned. Here, the lifeblood of the enterprise is its metallic reserves. The day these are exhausted the bank has no choice but to close its doors or to evade its main obligation, the convertibility of the currency for which it is responsible through the imposition of "fiat money." Now, in a period of growing monetary needs when the demand for private loans is great, it is in the private interest to obtain loans at the lowest possible rate, or, to put it differently, to resist as long as possible the raising of the bank rate which would tend to preserve the metallic reserves, averting bankruptcy. Contrariwise, when money is plentiful and borrowers scarce, it is in the lenders' interest to hold off as long as possible the forces which tend, through the lowering of money rates, to ease up the economic depression and to avert the gradual transformation into metal of all the income-producing assets of the central bank.

The truth is that the public interest is not, as is widely believed, the sum of private interests, but its opposite. Consequently, the real political problem

consists in finding a system whereby the general interest can prevail over the aggregate of individual wills. There was such a system before the war, and bankruptcy was its decisive instrument. Any community which tried to resist needed adjustments of prices or wages was doomed to self-destruction because it would exhaust its resources; and the same fate could be expected by a central bank which would not adapt its monetary policy to the fluctuations of its balances. The ever-present threat of bankruptcy subjected all persons, even the most unwilling, to the harsh law of prices, and made short shrift of those who, through inability or dissipation, had not managed to subordinate their own interests or those of their associates to the higher interests of the community to which they belonged.

Bankruptcy is not merely a moral device or a way to achieve equity; it is primarily and especially the condition for the efficiency of the price mechanism, of the economic system which is usually called capitalism. The system would collapse without it, deprived of the sole compulsion which obliges the individual to bring his otherwise unimpeded activities into conformity with the conditions necessary for the survival of the system.

But such a system, as you can easily guess, was to have arrayed against itself the total of individual resistance. And men who have come so far as to dominate nature are very intelligent and efficient. Besides, our political system by definition tends to elevate the sum of individual interests to the status of public interest, and the movement toward repre-

sentation of pressure groups has conferred upon this tendency a significance we have yet to grasp.

For ten years men have endeavored to build, not the kind of world that would last, but the kind they wanted—a world to provide them with maximum satisfaction and a minimum of effort. They have succeeded—the world is becoming more and more as they hoped it would become—except that in its present form, with all the brakes removed, it is heading for certain disaster. In the economic sphere, many measures have been taken to arrest the price mechanism. Measures were first undertaken during the period of rising prices, with price-fixing decrees designed to prevent fluctuations in the price of certain commodities. Their effects were felt at once. The long lines in front of the stores, a feature of all price-ceiling systems, were palpable proof that when a price is fixed at a level even slightly different from the one it would have reached on its own, the equilibrium between supply and demand is irremediably disrupted. The housing situation provides perhaps the most characteristic example. In all countries where rents are fixed by law, it has become impossible to find an apartment; but soon after certain buildings are decontrolled, “apartment for rent” signs are again displayed.

Nevertheless, the general tendency has been more to resist the lowering than the raising of prices. In Britain, the rates established for unemployment compensation virtually froze wages, while the price level fell by 50 per cent. In Germany, unemployment compensation was supplemented by a system

of compulsory arbitration of labor disputes, a policy which impelled the Reich to fix all prices in the German economy.

At the same time, the extension of the network of trusts and cartels throughout the world, as well as the various plans for limiting production (the Stevenson Plan for rubber, the Sugar Plan, the Diamond Plan), have tended to stabilize prices, curbing a downward movement brought on by the steep fall in the general price level. I don't believe that this development is very significant, because so long as the cartels do not enjoy a *de jure* monopoly, they are faced with a latent competition which will eliminate them when they too flagrantly disregard the conditions that would normally have existed. This is how the Stevenson Plan and several other such schemes collapsed. There is a movement, in some countries, however, in favor of legalizing price monopolies. If such a movement takes hold, the decisions of the cartels would become absolute, and all possibility of price self-adjustment would vanish.

Next comes the policy of stabilization of agricultural prices, for which the Farm Board used to be the main vehicle in the United States. The Farm Board, it is true, shared the fate of the Stevenson Plan, but only after its prolonged resistance to the downswing of agricultural prices.

Tariffs have also been employed to control prices. But here a distinction must be made between custom duties and quotas. By protecting certain products which otherwise could not withstand competition, customs duties tend to depress the standard

of living and intensify price fluctuations, consequently increasing the gold transfers needed to restore economic equilibrium; they are not, however, an obstacle to the establishment of such equilibrium. Quotas, in contrast, create an insuperable barrier to the movement of goods; therefore, if they should be more widely used it would become impossible to achieve an economic balance, and even to settle international obligations later. There is no more deadly device against the price mechanism than the quota system, and its general use would blow up the capitalist system as a whole.

There are, as can be seen, many areas in the economic field where attempts have been made to impede the free movement of prices. Yet these efforts have not always been crowned with success, and consequently the policy of price-freezing, because of its partial application, has given rise only to partial disaster. The same cannot be said for the monetary sphere, where matters are much further advanced. In some—countries measures which I will go into in detail—have been taken whereby not only the discount rate has been effectively denied its indispensable free play, but the central banks have even been given the power of regulating market conditions at will. Here the system has been applied to the full, and here it has produced its full effect, in the form of monetary crises and other serious disturbances for which satisfactory solutions have yet to be worked out.

The charter of this new monetary policy was drafted at Genoa in 1922. It was the work of the Financial Commission and comprises, for our pur-

poses, three important recommendations concerning (a) the stabilization of the general price level, (b) the widespread adoption of the "gold-exchange standard"—a conception so peculiarly Anglo-Saxon that there still is no French expression for it, and (c) the practice of cooperation among the central banks of issue. In resolution 11, paragraph 7, the experts considered that "credit [should] be regulated, not only with a view to maintaining the currencies at par with one another, but also with a view to preventing undue fluctuations in the purchasing power of gold."

This recommendation has been followed. It seems first of all to have prompted the policy of "sterilization" of gold practiced in the United States after the war. In truth, it is difficult to get an exact idea of the extent to which gold was systematically sterilized. I believe that the supporters of that policy are somewhat inclined to overstress its deliberateness. Nevertheless, there can be no doubt that the operation of the Federal Banking System was partially, if not entirely governed by it. Essentially, the idea was to prevent the gold which poured into the United States in the post-war period from affecting the credit market, and to keep it from building up a "credit superstructure". This policy seems to have had some effect. But the sterilization of gold stifled precisely those reactions which, under the normal operation of the gold standard, would have tended to check the inflow of the metal. Thus gold was, in fact, allowed to accumulate indefinitely in the United States, causing a maldistribution for

which the system suffering from it is now being reproached.

In Britain, the implementation of the Genoese recommendations has been carried even further. Since the war, Britain has practiced a high cost-price policy by using all kinds of expedients, but especially by freezing wages in a period of decline in the general price level. The result has been the loss of a substantial number of foreign markets, hitherto a regular source of large export returns, which Britain then loaned to the world, adding further to its prestige and profit. We have here a striking example of the result of an abrupt modification of the terms of economic equilibrium. Had the gold standard been given free rein, it would have established a new balance and safeguarded the British currency. Deprived of a portion of the foreign exchange gained from exports, British balance of payments would have been placed in the red. Gold would have left Britain, hence a reduction of liquid assets on the domestic market and, all other conditions being equal, a tendency to dearer money on the London market than on foreign markets. This rise of money rates would have discouraged borrowers on the London market, and a shift to foreign markets would have taken place. This would have been a blow to the city's prosperity, but it would have stabilized British balance of payments, putting an end to the gold outflow and protecting holdings of the Bank of England.

But bowing to facts is not characteristic in a period of managed economy. The unavoidable con-

sequences of the wages policy Britain had freely adopted were considered to be "undue." It was believed that in line with the Genoa Conference recommendations a suitable credit policy could stave off these consequences. By and large, the effect of this suitable policy was to counteract systematically the impact of the outflow of gold. Whenever gold left the country, the Bank of England made up for the reduced liquidity by purchasing government bonds. This was known as an open market policy, and its results could have been foreseen. England averted a tightening of money rates which would have seriously impaired London's prosperity. In 1930, the amount of foreign loans granted on the London money market was almost as high as in 1928, although the amount of resources available for foreign investment, according to Board of Trade statistics, had diminished by roughly £100,000,000. By keeping up the level of those loans, however, the Bank of England also banished the sole factor that might have stemmed the outflow of gold. In fact, the bank made it possible for the outflow to continue indefinitely, and deliberately fostered the factors that tended to drain the metallic backing of the British currency. Here again the policy of managed credit jammed the mechanism which normally would have kept the monetary system functioning. The ensuing disasters were, as it turned out, decidedly the outgrowth of this policy.

There is also a second area in which the Genoa Conference has greatly altered our monetary traditions. In resolution 9, it recommended the adoption of an international convention embodying "some

means of economizing the use of gold by maintaining reserves in the form of foreign balances," that is, the "gold-exchange standard." What distinguishes the gold-exchange standard is the fact that it empowers central banks to include in their monetary reserves not only gold and bills made out in the national currencies, but also foreign exchange assets convertible into gold and maintained in their country of origin. In other words, the currency issue of any country adhering to the gold-exchange standard may be backed not only by gold and assets in national currency, but also by assets in dollars or sterling.

This recommendation was methodically implemented by the Financial Committee of the League of Nations, which set up the system in many countries, such as Austria, Hungary, Greece, Bulgaria, Esthonia, and Danzig. France officially refused to follow suit when it embarked on its monetary reform in 1928, but in a moment of weakness she yielded to representations from Britain, and agreed to maintain certain amounts of dollars and sterling among the assets of the Bank of France, if not in the actual legal reserve.

The great advantage for Britain of the gold-exchange standard was that for many years her true position was not apparent. Throughout the post-war period, Britain was able to invest capital in all Central European countries without any actual transfers, since no sooner had sterling entered the economies of the borrowing countries than it was deposited on the London money market. Thus like a comic opera soldier, it kept popping up again

and again, enabling the British to go on granting foreign loans even though the flow of foreign exchange that had previously made these loans possible had petered out.

Nevertheless, this system has had immense drawbacks in the monetary sphere. In the first place, it has blunted the responsiveness and effectiveness of the gold-standard mechanism. For example, while capital leaving the United States for a country adhering to the gold-exchange standard increases the resources available on that country's market, there is no corresponding contraction on the United States market since it is still left on deposit on that market, where it can continue to serve as a basis of credit as it had done before the transfer. But that isn't all. The gold-exchange standard dissociates the movement of credit from the movement of gold. For instance, in 1927 and 1928 it was possible for capital previously exported to the United States to return en masse to continental Europe without the metallic reserves of the United States being affected in any way. Thus the gold-exchange standard has not merely loosened the ties between gold and credit it has severed them entirely. At the same time it has contributed to the prolonging and accentuating of the abnormal distribution of gold since it has made it possible for capital to flow without bringing the gold in its wake.

The gold-exchange standard has also turned out to be a formidable inflationary device. Capital returning to Europe from the United States has still remained available in the United States. It has simply been duplicated, and thus the American

market in a position to buy in Europe and in the United States at the same time. In this way the gold-exchange standard was one of the main causes of the great speculative boom that lasted until September, 1929, because it postponed the time when the gold standard system could have exercised its braking action.

Finally, in Resolution 3 the Genoa Conference declared that "measures of currency reform will be facilitated if the practice of continuous cooperation among central banks of issue... can be developed. Such cooperation... would provide opportunities of coordinating their [credit] policy without hampering the freedom of the several banks." This policy of cooperation was also implemented, central banks—and sometimes treasuries—granting each other extensive credits, usually in order to postpone the necessary discount measures. This policy had particularly harmful effects when it was practiced between the Federal Reserve Bank of New York and the Bank of England. To accommodate the Bank of England and to spare it the necessary but distasteful task of raising its rate, the Federal Reserve System agreed to maintain artificially low interest rates, particularly during the year 1927. This was not the least of the causes of the credit inflation which characterized the upward phase of the economic cycle and led to the speculative period which ended in 1929.

Thus the recommendations of the Genoa experts tended to remove the brakes with which the gold-standard system held in check the vagaries of men. They left the form of the system untouched, but

eliminated the regulators which made it endure. Thanks to the Genoa wizards, the revelry was no longer inhibited by bothersome restrictions. Our unfettered machine could now dash gloriously down the long, long inflationary slope until the possibilities for fresh expansion were exhausted. Then it was necessary to start climbing back up the slope.

The difference between the 1929-1933 crisis and all those which preceded it lies in the scope of the conflicting trends. This is readily explained by the loosening of those ties which had previously maintained the economic structures in approximate balance. For ten years we had done everything in our power to undermine that equilibrium. The more we had been carried forward in the flow, the further we were pushed back in the ebb.

But that isn't the only new feature of the depression period which is still with us. In the past when, every eight or ten years, the prosperity phase gave way to a recession which restored the market to near equilibrium, a drop in prices preceded it and rapidly led to a fall in costs. The adjustment was made in a relatively brief period, and a new start could be made toward another period of prosperity. In the last ten years, however, we have concentrated on freezing prices. In those areas where this effort has been entirely successful—as in wages in Britain—adjustment is no longer possible; any decline in sales prices merely results in added unemployment. In other areas we have not been able to freeze prices completely; we have only slowed down their movements. Where formerly it had been supple and malleable, economic matter has now be-

come unresponsive; its adaptation to changing conditions over which we have no control is now a long, drawn-out process; recessions drag on instead of running their course in a few months, since they cannot come to an end until the adjustments they tend to bring about are made.

The economic universe we have created has become almost completely rigid. As a consequence, the only outlet for the forces tending to bring about the needed adjustments is through currency depreciation. It alone can touch off the required price changes throughout the economy. In the case of Britain, the freezing of wages made depreciation an unavoidable step. The world we have made is one in which any reversal in the price movement, any recession comparable to those which occurred before the war will unleash an epidemic of currency depreciations, with all the attendant political, social, and moral disorders. In this connection, the spectacle presented by most of the Central European countries, where a tragic struggle between money and prices is in progress, is symptomatic. The only question is which of the two will be the first to give way. Up to now, a currency has been kept from collapsing only through the renunciation of its use as a means of international settlements.

Under such circumstances, what an appalling lie it is to say that the gold standard is no longer capable of fulfilling its function, and that it should be replaced by a new system. On the contrary, it is precisely in those spheres where its functioning has been blocked that grave difficulties have occurred, as we have seen. To avoid the recurrence of these

difficulties, it would suffice—as I hope I have demonstrated—to restore the price mechanism to its former omnipotent position. The only way to keep unavoidable price movements and their distressing consequences at a minimum is to interfere as little as possible with the operation of the price mechanism.

The work of the Genoa Conference has been completed by a committee which supplied it with the needed doctrinal basis. Named after its chairman, it was known as the Macmillan Committee, and met in London in 1930 and 1931. The importance of the Macmillan Report cannot be over-emphasized. With extraordinary clarity it summarizes all the tendencies of our time. For those who study it in years to come, it will represent one of our most characteristic monuments—and probably one of the main landmarks on the disaster course we have set for ourselves. It would take too long to review the contents of the report in detail, and I shall limit my comments to the general statement which appears in its introduction (pp. 4-5):

If there is one characteristic of our times, more conspicuous than another, it is the recent growth among us of a spirit of self-consciousness...In the case of our financial as well as our political and social institutions, we may well have reached the stage when an era of conscious and deliberate management must succeed the era of spontaneous evolution... . . . We are indeed at the parting of the ways and the future depends on whether we choose the right way.

I am not in agreement with this conclusion. I have tried to show you that our choice has already been made, and that we are committed for ten years

—under the irresistible pressure of private interests—to conscious management. I have also attempted to show that the mishaps which occurred whenever a new system was instituted were a bad omen for the future. I have no doubt whatever that in continuing on our present course we are heading for severe disturbances which will greatly imperil the future of human civilization.

To be sure, many theorists of the new persuasion are ready to concede that the practice of freezing one or several prices without at the same time regulating production and consumption is bound to result in imbalance and disorder. They feel that in order to avoid serious disturbances price controls should be accompanied by careful planning whose purpose would be to achieve in each case, through deliberate adjustments, the requisite balance between supply and demand, since the normal regulation—the price mechanism—would no longer be in operation. Thus the present unsettled state of affairs, is attributed not to overorganization but rather a lack of it, and the way to straighten out the situation is seen to be to extend and generalize the system of managed economy.

At least this view has the merit of being logical. No doubt, it is possible in theory to conceive a system in which conscious management would ensure the equilibrium of all economic forces. Such a system would have the very great advantage of permitting us to remake the world to suit our preferences, and to ensure the implementation of what would be deemed to be the right solutions. But just think of the conditions which would have to be met for

such a world to endure! In the first place, consumption cannot for very long remain appreciably greater than production. Some central body, therefore, would have to determine the kind and quantity of goods and services that each individual might consume. Furthermore, it would be necessary to fix both in kind and in quantity everyone's contribution to production, so as to maintain continually, for the innumerable existing commodities, the necessary balance between output and consumption. Clearly, in order to preserve so complex an economic balance—which can be automatically achieved simply by allowing the free play of the price mechanism—the new state would require a statistical services capable of providing at all times accurate and comprehensive data on goods and services produced and consumed, and of organizing down to the last detail the nation-wide distribution of the planned output. Moreover, the effective functioning of the central agency would require it to be invested with an absolute authority, which would be indispensable if economic balance were to be maintained by such devious and painstaking devices.

While such an organization may be theoretically possible, no human agency can realistically be expected to cope with an economic situation involving a group larger than the average household. For in the family unit the price mechanism does not apply. Here, the father—accurately and constantly informed of the needs of each member of the family, and at the same time fully aware of his resources and, therefore, of the total value of the commodities available to his commonwealth—decides to what

extent individual needs may be satisfied. Likewise, his up-to-the-minute knowledge of the productive capacity of the members of his group enables him to apportion the tasks, and the fruits of the joint effort will be pooled and put to the best use in the common interest. At this level, "management" is fairly simple. The head of the family is armed with all the necessary facts, and his undisputed natural leadership ensures that his well-grounded decisions will be respected. It follows, therefore, that the communist system is best suited to the nature and the size of the universe over which the family head rules.

But in an extremely diversified economy—a common feature of all advanced nations—and in large communities such a system cannot possibly establish the kind of complex equilibrium which the price mechanism achieves with such precision. The early Russian experience, that of a genuine communist regime where money ceased to exist because it no longer had any role to play, confirms these views completely. Under the pressure of events, the communist government was obliged to limit the practical scope of its doctrine to a few simple organisms, whose activity could be guided through elaborate statistical research and the exercise of absolute power. Everywhere else the Soviets had to restore money as the medium of distribution and reinvest it with the task, originally assumed by the government, of achieving the economic balance without which the country could not survive.³

The problem of the managed economy is like

³ Cf. Stalin's theory of "control by the ruble."

the problem of the wave of the sea. We have identified the forces that cause them, we apprehend the conditions which must be met for a solution of the problem and we can even reduce it to an equation—but its actual solution is hopelessly beyond our capacities. Even more to the point is the fact that in the field of astronomy the problem of the three heavenly bodies is hardly solved. In the case of greater star formation we must resort to rough formulas whose imperfect solutions requires the most painstaking calculation. And yet in the heavens all the planets, all the suns, all the stars find their assigned courses without hesitation, and make child's play of the solution of the equation of a thousand unknowns which our minds cannot begin to grasp.⁴

After all, we must not forget that we are only human. Much greater means than we possess would be required for the solution of the problem of managed economy, and the fact that nature solves it daily before our eyes does not mean that we poor, bumbling logicians are capable of emulating her by mastering so much unpredictable data.

It is on this note of modesty that I conclude. Before our eyes is the havoc created by our overweening conceit and the blindness of our much-too-learned committees of experts. To persist in this course is to court certain catastrophe. I am convinced that under the present circumstances our first duty is to try to put some common sense into the thoroughly muddled thinking of men today. I am con-

⁴This was, of course, written before the era of electronic computers.

vinced that if we do not succeed in this, our civilization must end.

At the beginning of this account I evoked the memory of the fifteenth century. Let us return to same epoch. Not far from Genoa, in Florence, Girolamo Savonarola uttered his dire warnings from the pulpit of Santa Maria dei Fiori: "Beware, Florence," he cried, "now also the axe is laid unto the root of the trees." Around us, several trees have already fallen. Tomorrow, if we are not on our guard, there will be nothing but devastation in our forest. And we will have only ourselves to blame.

3. THE GOLD FRANC NEXT?

A German economist called Wageman, who was somewhat prominent under Hitler, said, in a book published during the war, that “the most important scientific work of the French in the monetary field was Zola’s great novel *Money*.”

Notwithstanding the fact that, being the modest author of “Theory of Monetary Phenomena,” I feel personally somewhat slighted, I shall demonstrate that I bear no hard feelings by replying to Wageman that it was Germany which gave the world its greatest money theorist—Goethe. He was, to be sure, no economist, yet it was he who in *Faust* (Part II) clearly demonstrated that inflation was and could only be an invention of the devil.

Disguised temporarily as the king’s jester, Mephistopheles prompts the Lord Chancellor to say:

Here and behold this leaflet rich in fate
That turns our woes to prosperous estate:
“To whom It may concern, this note of hand
Is worth a thousand ducats on demand,
The pledge whereof and guarantee is found
In treasure buried in the Emperor’s ground.”

Speech in the Committee for Action and Economic Expansion, March 27, 1952.

He then fully sets forth the theories of exchange media and fully employment:

None has the power to stay the flying chits,
they run as quick as lightning on their way,
And money-booths kept open night and day,
When every single note is honored duly
With gold and silver—though with discount truly. [*an
early example of monetary deprecation*]

From there it flows to wine-shops, butchers, bakers,
with half the world as glutton merry-makers,
The other bent on flaunting fashion-showing,
The clothiers cutting-out, the tailors sewing . [*full em-
ployment*]

“His Majesty!”—toasts flow and cellar clatters . . .
[*the political advantages of inflation*].

But in his commentary on the festivities, the Herald foresees an unhappy outcome:

Now see the charming mob all grabbing rush,
They almost maul the donor in the crush.
The gems he flicks around as in a dream,
And snatchers fill the hall in greedy stream.
But lo, a trick quite new to me:
The thing each seizes eagerly
Rewards him with a scurvy pay,
The gift dissolves and floats away.
The pearls are loosened from their band,
And beetles scurry round his hand.
And round his head they buzz about.
With solid goods before their eyes,
Some grab, and catch frail butterflies.
The rascal offers wealth untold,
But gives the glitter, not the gold.¹

¹Excerpts form Philip Wayne's translation of Goe-the Faust (Part II)(Baltimore: Penguin Books, Inc., 1959).

Nothing is missing: the technical formula, the political advantages, the social consequences. The poet was indubitably more clear-sighted than are most economists; he understood and clearly demonstrated that inflation was the work of the devil because it respected appearances but destroyed reality.

Inflation presents higher incomes to the wage earners, but no sooner does it give them a taste of the promised standard of living than it cunningly whittles it down by raising prices, as though deliberately to heighten the regrets of its victims for the short-lived prosperity. Could there be a more diabolic device for arousing a sense of frustration?

I would be especially fallacious to regard this decrease in buying power as episodic and incidental; it is the very essence of the inflationary process. The inflation which follows a deficit does not create wealth. The lowering of purchasing power of all those whose earnings do not keep pace with the rising prices is the means chosen to free the excess wealth which the deficit allowed its beneficiaries to obtain.

Inflation is the blindest of all fiscal techniques, for it leaves to the whim of adjustment lags the task of apportioning the levy it has exacted. Thus, totally lacking in fairness, it lays before the devil a rich source of social discontent.

IS THE ESCALATOR A REMEDY?

The wage escalator has, it is true, been offered as a remedy, to afford protection from the move-

ment of prices. As such, it seems both fair and desirable. But to the degree that it hastens the alignment of wages to prices, it adds momentum to inflation. Thus has Satan created a fearful dilemma for those of us who are shocked by the levy of inflation: either to discard an equitable solution or quicken the Satanic process of installing the devil in our midst. Can't you hear the sardonic and triumphant laughter of the Adversary, who will not leave the world in peace?

To this impact on incomes is added a parallel impact on money claims. Mounting prices debase the real value of annuities, insurance policies, pensions and rent. Good intentions become a mockery, sacrifices to achieve security in later years are thwarted, saving is penalized, and squandering rewarded. Once again, only Mephistopheles could devise so insidious a technique to deride the "upright citizen" and to swell the ranks of his improvident and frivolous band. To be sure, the small coterie of real estate owners and those whose earnings keep pace with rising prices are sheltered from the scourge of inflation. Those whose debts are payable in, say, francs benefit from the inflation even as their creditors suffer from it.

Inflation thus divides men into three categories: those who suffer from it (the most numerous), those whom it does not affect, and those who, benefit from it. The resentment felt by the first category is aggravated by the indifference of the second and the contentment of the third. Inflation is even more potent than Marxist ideology in creating class divisions. The mood of frustration

it arouses among a large majority of the people, among those who should have been the best-protected, engenders a force for revolution and subversion of the social order.

The microcosm known as man might have been influenced by the gradual tendency to introduce greater justice and charity into human relations, but that was not to be. Justice had to be undermined and charity eliminated, and distrust and hatred put in their place. Satan was on hand with his contribution—inflation. Henceforth, only those who manage to have their wages constantly adjusted to ever-mounting prices will succeed in protecting their standard of living. Loyalty to the pressure lobby rather than devotion to work will become the price of security and well-being. Thus the devil need no longer fear that a morality of work will bind man to his everyday task. From his hiding place behind the screen of inflation, he can roar with contempt as he teaches the workers that the way to get the most is by working as little or as poorly as possible.

INFLATION IMPEDES INVESTMENT

Inflation destroys not only the present but also the future, whose sources it dries up. Whatever lasts may be called investment, the denial of immediate consumption for the sake of consumption later on. Investment is the precondition of social progress. To encourage and facilitate it, God implanted in the hearts of men the desire to ensure their future and that of their descendants. Foresight leads to thrift, which in turn fosters savings.

A community which saves more than it uses or destroys can look forward to ever more prosperous tomorrows.

The growth of a general state of well-being might have put an end to the complaints of men, to their envy and their hatred, but the devil had an eye for this danger as well. Through inflation, he craftily taught the thrifty that they were today giving up a prize which tomorrow would be worth only the shadow of a shadow. The lesson has been learned. A man who has experienced inflation consumes all his reserves right away. The markets are emptied of capital. Money rates reach such heights that no honest business can pay them. No long-term project—no construction of dwellings, hospitals, or schools, no water supply system or electric power network—is feasible any longer if the service it provides is expected to be self-supporting.

Meanwhile, to fan the flames which are consuming man's future, the devil, by devising ingenious and seemingly scientific theories as well as by opportune forms of destruction, amused himself by whetting men's appetite for investment. In this way, he made more desirable the very things he prevented men from having. Investment without savings placed an additional burden on man's budget, and by thus throwing it hopelessly out of balance fed the fires of inflation. At the same time inflation kept the firemen from extinguishing the flames. No budget can be balanced in a system where any rise in taxes or charges causes further rises which in turn create further deficits. The problem of balancing the budget can only be

tackled and solved in a situation where prices are stable.

AN INFLATIONARY DEMOCRACY IS A
SHAM DEMOCRACY

Inflation does more than complicate the work of parliaments; it makes them a laughing-stock and discredits them. You have only to watch these prominent politicians spending days and nights haggling with the government over a few points increase in the tax rate while at that very time inflation is imposing an immeasurably heavier levy on large sections of the population—upon those which, being most vulnerable, require and deserve the most attentive concern. Under inflation, the adoption of the budget is nothing but a sinister and absurd farce. An inflationary democracy is a sham democracy.

The ravages of Satanic inflation are not, however, confined to the domestic sphere. On the international plane, our troubled times have stirred up a yearning for peace in the hearts of men. A mighty effort has been made across the frontiers to bring the peoples of the world closer together, if not to if unite them. The United Nations, the European union, and the Schuman Plan held out the hope of reconciliation. But once again, Satan stepped in. Developing at an unequal pace in the countries it affects, inflation irremediably upsets the equilibrium of the balance of payments. Those whose exchange reserves had been exhausted had no other recourse, regardless of their desires, but to curtail their foreign liabilities. Thus freedom of international com-

munications, "liberalization" of trade, and the single market of the Schuman Plan all were thwarted. Inflation had frustrated the efforts to bring together on earth all men of good will, and to bestow on them the gift of peace.

ONLY HITLER SUCCEEDED IN COMING
TO TERMS WITH INFLATION

In reality, only one man succeeded in coming to terms with inflation—Hitler. He understood that inflation destroys the ties that bind men's desires to reality and, in so doing, transforms their freedom into a terrible menace to the social order. To save the social order, he sacrificed freedom. By subjecting individual conduct to strict control, he restrained people from utilizing that part of their purchasing power which exceeded the value of purchasable wealth. In this way he was able to distribute generously the means of buying goods which did not exist. He turned this lie into a system of government.

In his system, however, men, manipulated from without as the machine is manipulated by the mechanic, had ceased to be human beings. We must say with all gravity that whoever tolerates inflation but rejects disorder is a protagonist of dictatorship. Western civilization was founded on freedom, but is doomed to disappear unless it manages to break out of the inflationary whirlpool where it is sinking relentlessly before our very eyes. The problem of the West today, and particularly that of France and Britain, is essentially the problem of inflation.

Is it possible under existing conditions to put an end to inflation in France? To try and cure an illness we must first know what it is, and an important change has occurred in the diagnosis of inflation. In the past, economists believed its main feature to be an increase in the quantity of money in circulation; today, they attribute it to an excess of total demand over the total value of supply. But the two definitions are equivalent, for demand cannot easily be separated from supply. If I had left my home this morning with 5,000 francs in my pocket, and wanted to return in the evening with the same amount of cash, I could only have bought as much as I sold, that is, I could demand no more than I could supply. When the same situation prevails for the persons and institutions that make up a community, total demand at any given period will be identical with the total value of supply. This would also apply if a political entity such as the government, in order to be able to demand more than it supplied, contrived, through taxes or loans, to force other entities to demand less than they supply.

In each of these instances, total demand remains identical with the total value of supply. The general price level is stable and there is no inflation. Total demand can exceed the total value of supply in a community only if deficits are present which are not offset by equivalent surpluses, so that debtors are able to employ fictitious assets to supplement the resources needed to cover the fraction of their demand which exceeds their supply.² The deficit will

²I am not dwelling here on what will happen when additional cash holdings become "desired." In that case,

have two type of consequences: as regards income, it will create a purchasing power with no counterpart in purchasable wealth; as regards money, it will create new money up to the amount of the deficit.

There can, therefore, be no increase in incomes without the creation of money. An excess of purchasing power and an increase in the quantity of money in circulation are only two sides indissolubly linked, of one and the same reality—the deficit.

THE TWO ROADS TO AN ANTI-INFLATIONARY POLICY

The dual chain of causation issuing from the deficit offers two concurrent roads to any anti-inflationary policy: control of purchasing power to adjust, directly and systematically, its volume to the total value of purchasable wealth; and control over the creation of money to prevent the settlement of deficits and thereby to stop, by means of bankruptcy, the activities which engender them.

An idea of the importance of the first method may be gained merely by calling to mind the mass of purchasing power which is fixed a priori in modern society without any direct reference to the value of purchasable wealth.

In the first place, so far as income is concerned, most of the salaries and wages of civil servants or workers in nationalized enterprises are governed by considerations of equity or by social pressures,

the increase of money in circulation will not lead to inflation as the increase in cash holdings indicates a willingness to defer consumption to some later time.

but they have no direct relationship with the output which they are meant to compensate for. It is a frequent occurrence, therefore, that the total volume of wages paid exceeds the total value of public services placed on the market, this total value being determined by the level of taxes or duties which constitute, so to speak, their sale price.

From this point of view, the situation of private enterprise is strongly similar to that of public enterprise when wages are fixed by the government. This situation has been only partially altered by the return to collective bargaining. In so far as the variations of wages in private industry are actually determined by the variations of the guaranteed minimum wage, they are not directly hinged on the value of wealth produced. The process of wage escalation will become even more arithmetical as the sliding scale begins to encompass—as is quite probable—the entire range of wages.³ Thus the wage recipients will be granted incomes which bear no direct relation to the wealth they produce. The amount of the wages, fostered by all the forms of pressure, emotional and materialistic, will usually be greater than the value of the wealth.

In the past several years, however, arbitrariness and indifference to the market have been even more conspicuous in the case of investment than in the case of personal incomes.

THE INVESTMENT PROBLEM

In former times, investment implied that the

³This was written at a time when the system of the wage escalator had just been or was about to be adopted.

necessary funds had to be obtained beforehand by means of a loan. The loan transferred from the lender to borrower a demand potential corresponding to the amount of the loan. The lender was supplying without demanding, so that the borrower might satisfy a demand without any corresponding supply; thus the equilibrium of the market remained undisturbed.

But the nationalization of large sectors of the economy and the request for a broad investment policy in the name of the public interest have led to the practice of actually budgeting the amount of investments and of deciding their execution without any regard to the amount of savings available to finance them. Thus the tie has been severed between purchasing power transferred to the recipients of investment credits and the value of the wealth produced but not claimed by those who have been saving.

To be sure, at the time that purchasing power was divorced from the volume of purchasable wealth an effort was made to obtain an over-all equalization of these two factors. In France, this concern was reflected in the "national budget" prepared by the Commission des Comptes de la Nation, and in Britain and the United States by the National Income and Expenditure Estimates. However, the helplessness of such accounting records is only too apparent in the face of two realities, the volume of production and the volume of income, which are essentially political in nature since they are based upon the labor of men and determine their standard of living.

The severing of all ties between purchasing power and purchasable wealth automatically generates deficits. In the sphere of income, the government must then directly or indirectly assume liabilities which exceed the revenues it receives from taxes, or the sums which can be obtained from loans. This obliges it to order the central bank to discount claims on non-existent revenues, fictitious claims whose monetization puts in circulation the cash surpluses which are the monetary counterpart of the deficit.

In the case of investment commitments, however, the method of financing is even more subtle, for here medium or long-term securities are offered in an attempt to lure reluctant savings. To be made discountable, such securities are underwritten by the government under various guises, such as *Crédit National* or *Crédit Foncier*, and can thus be monetized by the central bank.

THE FORMER CONSTRAINTS OF MONETARY CONVERTIBILITY

Such methods of financing clearly illustrate, in reverse, the features of the now abandoned procedure which ensured an equilibrium between purchasing power and purchasable wealth, not by directly equalizing the amounts but by precluding the financing of any potential deficit. Such was the procedure imposed, both *de jure* and *de facto*, but more *de facto* than *de jure*, by the constraints of monetary convertibility.

Under this system the central bank was required, on demand and at sight, to pay in the international

medium of exchange—gold under the gold standard, gold or foreign currency under the gold-exchange standard—the amounts needed to redeem its bank notes and to pay off any outstanding balances on current or deposit accounts. It would have run a serious risk of insolvency if it had to any great extent accepted for discounting anything but short-term bills or assets that could if necessary, be resold on the market at their discounted value.

Thus not only the provisions of its charter but even more the inexorable facts of life compelled the bank to refuse to discount fictitious claims, that were apt to jeopardize the maintenance of monetary convertibility. This refusal by the central bank prevented all other banks from monetizing those bills which it would not have accepted for rediscount should the discounters have been in need of liquidity. The constraints of monetary convertibility thus precluded deficit financing for purposes of investment, and compelled investors to limit their ventures to the extent that loans were obtainable.

As the government, convertibility obliged the central bank and through it all other banks to discount only treasury notes reimbursable otherwise than by renewal, that is, bonds representing an anticipation of actual fiscal returns or of potential savings. The government was thus required to maintain a balanced budget, or to resort to the suspension of convertibility.

It may be argued that, in itself, convertibility does not constitute an insurmountable barrier to inflation, since war or even preparations for war lead to the suspension of its operations. In the

realm of human affairs, of course, there are no fool-proof devices, but merely adequate precautionary measures. Experience seems to prove, however, that under a system of monetary inconvertibility the wish to avert inflation and the awareness of its adverse consequences are not effective bulwarks against the onslaught of the interests and specious arguments which press for a deficit. The "veto" of the financial and monetary authorities based on an abstract knowledge of the causal factors of inflation is almost always overridden by the assent of the political authorities based on an immediate and concrete knowledge of the benefits to be derived from spending. To be sure, under a system of monetary inconvertibility the avoidance of a deficit does not appear to be absolutely impossible, but rather to depend upon a rational choice between the advantages and drawbacks of a number of possible alternative decisions. Such a choice, however, will nearly always be made in favour of the expected and hoped for solution, the one that makes the rulers feel that they are performing a philanthropic or constructive deed, which enhances their popularity and prestige and may be detrimental only to the currency.

The system of inconvertibility has made a profound change in the operation of our economic systems and, without our being aware of it, has brought about a sweeping social revolution. *Purchasing power has been transformed from effect into cause*, and henceforth it will determine the value of the purchasable wealth instead of being determined by it.

INCONVERTIBLE CURRENCY EXPOSES THE
NATION TO THE RISK OF LIVING
BEYOND ITS MEANS

Inconvertibility illuminates a common and significant feature of today's world: on almost the same day and in the same terms, it was noted, both in a letter from the governor of the Bank of France to the head of the government, and in the British White Book of March 10, 1952, that France and Britain "were living beyond their means." This is no mere accident. Both France and Britain are living beyond their means, because when a currency is inconvertible the government is neither expected nor, indeed, is it able to finance the deficit or to maintain purchasing power—incomes or investment—on a level with purchasable wealth. Because men are what they are, inflation will continue so long as the franc and the pound remain inconvertible.

In a system of convertibility, however, the authorities entrusted with the defense of that system are bound to be uncompromising in their opposition to any accommodation with the deficit. The central bank can, of course, discount paper corresponding to a deficit, but only if it is simultaneously freed from the rigours of convertibility.

This puts the problem sharply. We can no longer merely balance up the pluses and the minuses, but must openly declare that the advantages of the deficit outweigh the inconveniences of the degradation of the currency.

Experience shows, however, that except when the very existence of the country is at stake, opposition

to the deficit is greatly strengthened by the awareness of the disastrous consequences it entails.

CLOSING THE DOOR ON THE DEFICIT

The problem of convertibility bears a strong resemblance to the problem which parents with small children have with a door. If they want to keep a child from going outside, they can tell him that he will catch cold if he does so. They can appeal to his sense of duty, or warn him that he will be severely punished if he disobeys. These methods may be useful, but the only really effective methods of making the child obey is to shut the door. To sure, even a closed door can be forced open, but the child will then be confronted with a clear choice involving a definite risk. In most cases, he will not run the risk.

Similarly, in most cases convertibility will shut the door on inflation. It alone can force the financial authorities into unconditional opposition to the deficit. It alone can safeguard democracy against the monetary lie.

No social gain is jeopardized by monetary convertibility. To be sure, some critics claim that a convertible currency is incompatible with the policy of welfare and social stability, which they are determined not to abandon. But let there be no misunderstanding on this point. Monetary convertibility does not prohibit even the most generous redistribution of income; it does, however, avoid the hidden, unjust, and immoral levies which are the hallmark of inflation. Nor does monetary convertibility prohibit a broad investment policy; it merely

compels its financing by taxes or by loans. Monetary convertibility is no barrier to a policy of economic stability, the guardian of full employment. It was only the caricature of true convertibility which, through the generalization of the gold-exchange standard, gave rise to the painful excesses which marked the crisis of 1929. A prudently managed system of convertible currency would avoid the seriously unbalanced efforts of inflation; and limit its distortions; it would re-establish in the world the possibility of economic forecasting and social foresight.

No social gains are, therefore, jeopardized by convertibility. On the contrary, by restoring order it enables the nations to pursue a conscious and effective social policy. Anyone concerned with man's plight, anyone refusing to countenance the unfair levies and disorders of inflation, cannot but favour the restoration of a convertible currency.

The question, then is what means are required for the restoration of monetary convertibility in a country ruined by inflation? The answer is two-fold: (1) the central bank must have on hand a foreign exchange or gold reserve sufficient to redeem whatever claims are presented to it; and (2) these claims must be kept within bounds by guarding against a permanent treasury or balance-of-payments deficit. In other words, the restoration of convertibility will be possible only if the reserves of the central bank are reconstituted and equilib-

rium is restored to the balance of payments, on the one hand, and to treasury receipts and expenditures, on the other.

I have personally been associated with three projects for financial reform, all of them designed to re-establish monetary convertibility. The first project was in 1926, when I was a young and unassuming *chargé de mission* in the Poincaré Cabinet; the second and third were in 1927 when, as a member of a mission of the Financial Committee of the League of Nations, I was sent to Greece and Bulgaria. The policies applied in these three quite dissimilar cases raised the same kind of problems: (1) the search for a monetary level that would make it possible to stabilize the balance of payments and the budget with a minimum of disturbances; (2) the establishment of a strict financial equilibrium; and (3) the reconstitution of adequate reserves for the central bank.

I shall now attempt to show how these three problems could be solved in France in the concrete conditions that prevail in our country today.

THE QUEST FOR A FRANC RATE THAT WILL ENSURE STABILITY

I might point out that it was precisely for the purpose of discovering the optimum stabilization rate that I was appointed to the staff of the minister of finance. His instructions to me were to provide him with the full range of criteria needed for a decision, but particularly to highlight those originating on the wage level. The guiding idea was to single out the exchange rate which would entail no

reduction in wages because of the price in francs it would set for foreign good. The difficulties experienced by the English from 1925 to 1930 in attempting to maintain a rate which would have preserved foreign markets for British goods only by an unachievable reduction of wages demonstrated the wisdom of this last criterion.⁴

What we must determine in France today is the franc rate at which French goods, given their cost of production and the present wage level, can hold and regain the markets needed to keep the balance of payments in equilibrium. It is possible that the present rate is appropriate, but I still think that a thorough study should be made.

BALANCING THE BUDGET

Financial equilibrium implies and requires the covering of all government commitments with tax receipts or loans.

In this connection it may be pointed out that despite the extraordinary burdens of reconstructions and rearmament, despite the war in Indochina, despite the fact that the French National Railways are run at a loss, and despite deficit in social security funds, the regular French budget, not counting investment commitments, has been kept in balance or at least near balance through the normal and habitual sources of receipts. The ex-

⁴ The memorandum submitted in 1926 to the finance minister was published in the *Revue d'économie politique* under the title "A point in history—The Poincaré Stabilization Level" (Paris Librairie du Rucueil Sirey, 1959).

penditures resulting from the deficits of the railways and the social services will, nevertheless, have to be eliminated. The condition of the French budget is therefore, satisfactory except for the tax burden it implies.

If there is a treasury deficit, it is because investment commitments are not covered by savings. Hence it is especially pertinent that the first aim of a system designed to assure monetary stability will be the rapid restoration of borrowing power which will thus enable us to cover an increasing part of our economic investments with savings. Indebtedness is sometimes open to criticism because of the interest and amortization charges it entails, but it will not greatly inconvenience us very much longer. Indeed, in terms of buying power the servicing of the French public debt has been reduced to less than a fourth of what it was in 1938, and less than half of what it was in 1913.

For these two reasons, the problem of financial equilibrium appears to me appreciably less difficult to resolve than is generally believed. It will be easily and quickly resolved within the framework of a general plan. Its solution will even release—and quite rapidly—a surplus of resources that will provide the needed elasticity for an indispensable and thoroughgoing fiscal reform.

RECONSTITUTION OF THE RESERVES OF THE CENTRAL BANK.

The reconstitution of the reserves of the central bank was effected in France in 1926, through the massive repatriation of capital induced by the psy-

chological impact of the Poincaré program. In the absence of such repatriation in the case of Greece and Bulgaria, to which I have referred, loans were floated on the great international money marts. The loans were made possible by the restoration of credit that had resulted from the application of the recommendations of the Financial Committee of the League of Nations. In the case of Austria, however, the loan had to be underwritten by Great Britain, France and some other powers.

Thus it may be that the implementation of a coherent program of financial reform in France today would bring quantities of gold out of hiding. This would greatly facilitate the reconstitution of the reserves of the Bank of France. Nor is it unthinkable that the generous effort of the United States might also contribute to reconstituting these reserves.

It should be noted in this connection that the greater the area covered by a policy of convertibility, the more striking will be its beneficial efforts. Thus even a small part of the sums allocated by the United States for European aid would have enabled the central banks of all the "Atlantic," countries to reconstitute their holdings. Such a development, occurring within the framework of a general policy of financial reform, would have made possible a lasting liberalization of trade, the establishment of the extended market of the Schuman Plan, and even the formation of a European market. Without a common monetary basis, however, all these enterprises would be only childish fantasies. If the United States should decide to support and assist

the policy of restoring monetary convertibility, this support would greatly facilitate its realization, and thus would contribute, more than anything else, to promote the move for European and Atlantic solidarity that this policy seems to want.

For all these reasons I believe it possible, and not even very difficult, to re-establish the convertibility of our currency under existing conditions.

THE RULE OF GOLD MUST BE ACCEPTED
IF WESTERN CIVILIZATION IS TO SURVIVE

It remains to be seen whether the nations will agree to such a measure, for the argument is often made that people will never again submit to the yoke of gold.

The only privilege gained by men in throwing off the rule of gold is the creation of a demand for which there is no supply. By quarrelling over the possession of the limited supply of goods that are available, they unleash all the furies of inflation. Among the casualties of this chaos over long periods have been those classes which should have been the most shielded, a social structure born of long centuries of toil and thrift, national unity, the sense of individual and family responsibility, and the hope of utilizing investment to build a better future and to provide the people with all the benefits of technical progress.

We have already witnessed how inflation and the struggle against its consequences have been responsible for the loss of personal freedom over long periods of time. Tomorrow, if the deficit remains unchecked, our concept of the human person will

founder in the downfall of what we still call western civilization.

In 1932, I concluded a lecture, "The Case for the Gold Standard,"⁵ by repeating the grim warning that Girolamo Savonarola cried out from the pulpit of Santa Maria dei Fiori: "Beware, Florence, now the axe is laid unto the root of the trees." Since that time, many trees in our forest have already been felled. It is too late to safeguard; we must now rebuild. I have demonstrated that reconstruction can be the salvation of man only if it has the sound basis of monetary convertibility. I have demonstrated that we can establish that basis if we really want to.

Tomorrow, to save man, we will give him a real currency.

⁵ See Chapter 2.

4.

PROOF "A CONTRARIO"— THE RESURRECTION OF GERMANY

Western Germany exists and endures. A few years ago, however, nothing seemed less likely to endure. "The destruction and chaos in Germany is inconceivable for anyone who has not seen it," a qualified observer wrote early in 1948.¹

Those who did see it remember that, from 1945 to 1948, Western Germany, her factories idle, her stores empty, lay prostrate in defeat. The same stagnation was registered in her economic index in the most widely varied fields. In April, 1948, an expert could still say: "Economic disorganization appears to be continuing and tends to continue indefinitely. No symptom of revival is to be observed. The organism is so sick that it no longer responds even to the sickness."

At the close of the second quarter of 1948, however, there was a sudden change. All the graphs were skyrocketing. Agricultural and industrial productions came to life at the same time. Homes be-

First published in the *Revue des deux mondes* (June 15, 1953).

¹Wilhelm Röpke, *Revue économique et sociale de Lausanne* (July, 1948).

gan to rise from the ruins, and reconstruction soon set a pace that left neighbouring countries gasping. German exports increased sixfold from 1948 to 1952. The national income in non-monetary terms increased by 40 per cent between 1948 and 1950.

As the black market faded away, shop windows began to burst with the widest variety of goods, smoke started to belch forth from the factory chimneys, and the roads became clogged with trucks. Everywhere the clatter of construction replaced the stillness of the ruins.

The suddenness of Germany's recovery was even more striking than its scope. It was not spread out over months or even weeks, but has a specific date, June 21, 1948, the day the currency reform decreed by the commanders-in-chief of the three Western zones went into effect. "Only those who were on the spot can bear witness to the literally instantaneous effect it had upon the reappearance of merchandise and customers in the stores."² Overnight the shops were filled, and the factories began to work again.

The day before, Germans were wandering aimlessly about the towns in search of a few extra rations; the day after they were completely absorbed in their production. The day before, apathy was mirrored in the faces of a despairing people; the day after, there was the eager look of a nation confident of its future. There can be no doubt on this score: "The decisive recovery of the German economy dates from the enactment of the currency re-

² André Piettre, *L'Allemagne* (February-March, 1953).

form.”³ It acted as the summons to “arise and walk”; it resuscitated the corpse of Germany.

The June 21 reform was the outcome of studies conducted in the three Western occupation zones. Among the many preparatory drafts, three plans were particularly noteworthy: a French plan drafted by M. Mitzakis, the German Homburg Plan, and an American plan prepared by Joseph M. Dodge.

Dodge must be credited with inspiring and animating the program finally selected; he was then head of the financial administration in the American occupation zone, and is now director of the United States Bureau of the Budget. The Dodge Plan is a complex work, but in general it follows a technique of “siphoning off” excess cash holdings, similar to those techniques applied after the liberation in Belgium, Norway, the Netherlands and Austria.

The economic and financial situation in Germany prior to June 21, 1948, was the culmination of a lengthy period of “suppressed inflation.” For almost fifteen years, Germany had covered her financial deficit by creating paper money and relying upon exceptionally severe control measures to keep prices from rising, as well as upon extended rationing to curb the use of the excess purchasing power created by the deficit. All Germans were plentifully supplied with cash balances, which they were kept from spending only by the draconian penalties—including the death sentence—which enforced rationing.

³André Piettre, *L'Economie allemande contemporaine* (Paris: Librairie Médicis, n.d.), p. 207.

The Dodge Plan was designed to do away with these surplus cash holdings, so that they would not have their usual effect on the level of prices when controls were relaxed.⁴

Indeed, making due allowance for measures intended to favour those with small monetary holdings, the quantity of money in circulation was reduced, by cancelling bank notes and bank balances, by about 93.5 per cent; on the morrow of the reform, the Germans on an average held no more than 6.5 per cent of their previous holdings. At the same time, money claims and transferable debts underwent a decline of 90 per cent of their nominal value. As for the public debt—that of the national and local governments, of the railroads, and of the postal service—it was virtually annulled, thanks to the total suspension of debt service.

On the other hand, wages, salaries, life annuities, and pensions remained untouched. Additional equalization measures were contemplated, with the object of spreading the sacrifices imposed upon those with money holding to the owners of real estate. Up to now, however, these measures have not been enforced.

The major results of the June 21 reform were

⁴It would be an egregious error to expect such techniques to serve as a cure for inflation in countries where inflation has not been “suppressed” by strict rationing and price control. In France, inflation has had a continuing effect upon prices since the liberation. Here the problem of inflation is in the province of the budgetary art, and not of the technique of withdrawing excess cash holdings, which would be purposeless and ineffective.

owing to the monetary contraction it effected. The disappearance of cash surpluses immediately altered the lot of most Germans. Previously they had had a supply of purchasing power which only a quasi-universal rationing kept them from utilizing. Afterwards, the cash holdings allowed them were reduced to what was considered the minimum level.

In the first situation, they could buy without selling; there was demand without supply. In the second, they could only buy in proportion to what they sold; demand followed upon supply. This is the change which ushered in a veritable economic and moral revolution for an entire people.

In the economic sphere, as soon as demand is matched with an equivalent value of supply, market equilibrium is re-established overnight. As total demand can then no longer diverge appreciably from the total value of supply, the general price level ceases to be subject to significant fluctuation. If one price rises, another falls proportionately, because expansion in one section of the market must produce an equivalent contraction in another. In this way the over-all equilibrium, which was sought in vain through rationing, is achieved without any kind of intervention.

International transactions are particularly affected by this supply and demand relationship. If a buyer who is also a seller wants to use some of the proceeds of his sales abroad, the total internal demand is correspondingly diminished. As a result, wealth equivalent to actual imports is left available for exports. These increase in direct proportion to im-

ports. The equilibrium of the balance of payments is likewise spontaneously established.

The impossibility of buying without selling completely alters individual behavior. Yesterday, a family could only be provided with sustenance by discovering ways to evade rationing and price control. A good deal of productive energy went into this search for goods. Today one must produce in order to buy. Everyone knows that his sustenance or prosperity depends directly on what he produces. Thus the head of a family suddenly rediscovers all the incentives for returning to his field or his workshop, and all the incentives for wanting to be as productive as possible.

The closing of the gap between total demand and the total value of supply makes price-fixing and rationing superfluous. Prices can be decontrolled overnight, and individuals are given the opportunity to use their purchasing power as they please.

With the removal of controls, prices become subject to the operation of the market mechanism. The gap between controlled prices and black market prices vanishes. The compulsory sale of food-stuffs at ridiculously low prices—utterly absurd in a country wracked by famine—disappears. “A woman’s hat is no longer worth more than several tons of wheat.”⁵ Housing is no longer provided virtually for nothing in a country where 40 per cent of the cities have been destroyed.

Thus the endeavors of producers cease being assiduously directed toward the least useful activi-

⁵ Röpke, *op. cit.*, p.216.

ties. Their very desire of deriving the maximum output from their capabilities and tools of production automatically guides them to produce what is most wanted. The real value of the national income, and thus the mass of goods on hand for the welfare of the nation, increases immeasurably.

Morally, the transformation is no less significant. Yesterday, gain came through cheating; today it must come through production. Yesterday, to remain honest you had to forego the wealth that society gave you the means to acquire. The narrow door barely opened on a tiny corner of the immense roomful of possibilities. To follow the path of righteousness, it was necessary to close one's eyes and shut one's ear to the temptations held out by the enormous accumulations of cash.

Today, everything that is possible is also lawful. The honest citizen freely selects his path within the limits of his purchasing power. With a full sense of dignity, every producer and consumer can weigh all the opportunities held out to him by the market, and then without sham scruples or wrestling with his conscience decide which of his desires he will act upon. Currency reform has restored honesty to the scale of human values. The miracle in all its aspects, therefore; was but the handiwork of reason.

Currency reform re-established order in Germany because it led to and facilitated the rebuilding of the mechanisms that produce order: (a) it eliminated all possibility of demand without supply; (b) it provided the producers with incentives to produce, and guided their endeavors along the lines

of maximum utility; (c) it gave less cause for mendacity and swindling.

It may be argued, however, that the policy of planning had precisely the same aims: through rationing, to regulate the proportions of supply and demand in every sphere; through the organization of production, to attain the maximum in output and utility; and through the imposition of extremely severe sanctions, to compel respect for the laws and regulations governing planning. And yet the price mechanism achieved in a few hours what planning—although reinforced with unprecedented powers—had failed to achieve in several years.

The contrast between the ineffectiveness of planning and the effectiveness of prices in the almost identical conditions which prevailed in Germany before and after the currency reform places that reform in the class of veritable controlled laboratory experiment, and furnishes lessons that are important in the present state of political affairs. Both planning and prices are only regulatory mechanisms. The first is designed to further the kind of social order preferred by the planning authorities; the second furnishes a social order which offers the holders of purchasing power the maximum satisfaction, depending on their personal abilities. But the manner in which these two mechanisms work in shaping society are quite different.

Planning relies on coercion to make men want the things they ought to want, so that the economic and social structure conforms to what the authors of the plan want it to be. But that isn't all. Because planning makes it possible to exert a direct influence

on the behavior of individuals, it is unconcerned with the conditions that stimulate desires or temptations, which men must then be kept from yielding to. It is in this way that planning allows the budgetary deficit to create purchasing power whose utilization is then prohibited by rationing. It is in this way that, by fixing the prices for essential commodities, it systematically depresses profits in the fields it wants to foster, while black market prices stimulate the output of goods the planners consider unessential. It is in this way, too, that by severing, through exchange control, the ties that bind the level of domestic prices and the level of foreign prices, it causes imports to become profitable and exports unprofitable, just when a favourable trade balance is most wanted. In the final analysis, planning is bound to compel men, by directly acting upon their wills, to do the opposite of what they are impelled to do by reason of the conditions fostered by planning.

By contrast, the elimination of undesired cash holdings compels the producers to offer on the market the equivalent of what they intend to demand. Given all the conditions determining production, including the capabilities and individual tastes of the producers, the price mechanism stimulates them to produce the goods which are most wanted. This same price mechanism, along with the factors which limit purchasing power, stimulates and obliges the producers to sell abroad the equivalent value of the goods they wish to import. Thus the price mechanism creates a situation in which everyone is brought, of his own free will, to want what he

ought to want if the economy, in its equilibrium, is to be what the holders of purchasing power expect it to be.

The contrast between the two systems thus appears in full force. In planning, the individual is ordered from without, in the way the machine is ordered by the mechanic. In the price system he may follow his innermost desires, with no other limitations than those set by the prevailing range of prices.

Two extreme types of society are thus placed in juxtaposition: the gloomy regiment obeying orders against its will, and the enthusiastic community where everyone does freely and voluntarily what he is naturally inclined to do. Anyone who has recollections of life in the barracks will have no trouble understanding why the former system begets dreary poverty and the latter enthusiastic prosperity, despite the fact that the buoyant economy brought into being by currency reform is built on the same foundation as the stagnant economy which went before.

In view of the role which structural considerations play at the present time in the economic thinking of Western Europe, this observation is of cardinal importance. Most economists today acknowledge and teach that the transformations which have occurred in the structure of modern states—the substitution of an economy of large units for the atomized economy of the nineteenth century, the high degree of unionization among both workers and employers and the possibilities of conscious organization resulting from it—have all deprived the

price mechanism of most of its effectiveness. They see in this change the need to replace the no-longer-effective guiding force of prices with organization through planning.

I urge these economists to ponder the German experience. The men and things which made up Germany did not change on June 21-22, 1948. All that changed was the nature of the process by which Germany became capable of adapting herself to a new kind of structure.

Before: authoritarian planning carried to its furthest limits. After: the restoration of the price mechanism in the conscious discipline of a market economy. The conclusion is unavoidable: the rigidity of the German economy—unquestionable prior to currency reform—was due in only a very limited degree to the economic structure; its origin was, for the most part, institutional.

By decontrolling prices, by eliminating certain *de facto* and *de jure* institutions which tended to freeze prices, by making money meaningful again and by throttling inflation, the German economy, under the then-prevailing conditions, was reinvested with that amazing flexibility which it has demonstrated in adapting itself to the great structural changes which had been inflicted on it by defeat, geographic mutilation, and the displacement of population.

The rigidity prior to currency reform was, therefore, not structural in nature; it was the effect of institutions which had blocked the price mechanism and tried to replace it by extensive planning, not very effective under the conditions.

It is possible and even probable that within the Soviet framework—given the powers with which the government is invested and the means at its disposal to subordinate the interest of the individual to those of society under any circumstances—planning may give the economy a greater flexibility that would be provided by the price mechanism.

But the situation is diametrically opposite in all other countries. In view of the limits which respect for personal liberty imposes on the planning authority, planning has prove to be a poor instrument for bringing about any radical or rapid structural change, whereas the price mechanism—as the German experience has shown—has been able to do this quite expeditiously. The rigidity of our Western economies, therefore, is far more institutional than structural. And the economists who affirm that the new world must be a managed world because its structural rigidity puts it beyond the guiding influences of prices are like André Gide's Nathanael who "to find his way following a light he held in his own hands."

The German experience will probably convince sincere observers of the force and effectiveness—under the present conditions in Western Europe—of a mechanism based as much on the automatic adjustment of purchasing power to the value of purchasable goods, as upon unregulated prices. Many of them, however, will reply: "We want no part of this mechanism even if it does work. In our view it tends to establish an iniquitous distribution

of wealth. We do not agree to turn over the task of shaping the social structure to a blind mechanism." These people favor planning, not as a safeguard against an alleged ineffectiveness of the price mechanism, but as an instrument for improving the lot of the social classes who would not receive under a system of unregulated prices what they consider an adequate share of the national income. However, in relation to this argument, too, the German experience furnishes important lessons which must not be overlooked.

Since currency reform, the standard of living of the German workers has risen, in non-monetary terms, by more than 40 per cent. Their purchasing power in foodstuffs is 17 per cent higher than it was in 1938. These gains have been made under the least propitious political conditions. It is obvious that they can only be accounted for by an appreciable increase in the volume of production, and by a better adjustment of goods to the wants they are intended to meet.

The planners usually forget that the output of any given productive apparatus is apt to vary considerably, and depends in large measure—even in mechanized industry—not only upon the industry and strength of purpose of the workers but also on the degree of coordination among the numberless tasks which go to make up production, that is, on the support of each task to the labor of all. The German example demonstrates that with the substitution of the guiding influence of prices for the compulsions of planning, a better organization of production alone was sufficient to lead to an im-

provement in living standards beyond the reach of the previous system.

Moreover, the re-establishment of the price mechanism freed the German worker from the shackles which the authoritarian organization of production had to impose. It gave him back the freedom to choose a trade and an employer within that trade, as well as the freedom—so long denied to him—of terminating the labor contract at any time.

Of course, the price system safeguards the worker from the most appalling of perils, unemployment, only in so far as it creates a great demand for labor. But up to now, there has been no lack of such a demand in Western Germany. Thanks to that demand, Germany has been able to absorb most of her 10 million refugees. To measure the social import of this fact, try to imagine what the effect would have been in a stagnant economy of the population influx that Germany has experienced. There can, therefore, be no possible room to doubt that the restoration of flexibility to the economy through the re-establishment of the price mechanism has not only set Western Germany back on an even keel, but has greatly alleviated the sufferings of her people.

A system of unregulated prices, moreover, does not in any way exclude measures designed to modify the distribution of purchasing power or the structure of production that it tends to bring into being. So far as the distribution of purchasing power is concerned the market economy allows for the latitude of redistribution implied by the power to withdraw

from some the wealth that is intended for others. Such a procedure has a direct impact on the social structure, and it has been extensively applied in Germany.

Similarly, in the sphere of production, the government is able through a great variety of subsidies to favor those industries which it deems most important to the social interest. Germany has in this way been very successful in stimulating building activities, which have been one of the principal means of restoring prosperity to the devastated economy of the German cities.

Once again, I invoke testimony of the eyewitnesses who were in Western Germany before and after the monetary reform. The disappearance of the queues at the stores, the availability of food and lodging, the right to have an occupation of one's choosing and to move about at will, and the rekindling of hope in a despairing people are just so many social benefits which the "pre-money" economy could plan on paper but was unable to realize. Although the market economy has not given German families everything they had wished for, it has given them much more than the previous system was able to, and much more, also, than could have been reasonably anticipated.

What is most remarkable in the German renaissance, however, is not that a market economy could be made to work, but that it could have been instituted and deliberately fostered in the political circumstances which prevailed after the Second

World War. German policy subsequent to the introduction of currency reform was distinguished by the fact that it was not introduced surreptitiously, by back door maneuvers, but was openly promulgated.

Germany was unique in Europe, I believe, in daring to proclaim that it intended to establish order through the medium of the price mechanism. To avoid confusion, the new regime was named *Sozialmarktwirtschaft*, social market economy.

The "Düsseldorf Directives" of July 15, 1949, laid down the general principles in the program of the *Christlich-Demokratische Union* (C.D.U) that were to guide government policy after the currency reform.

These principles define "the social market economy as a socially orientated form of the industrial economy in which the efforts of free persons are fitted into an order which produces a maximum degree of economic benefit and social justice for everybody."

This order is achieved through freedom and respect for contracts, which, in a social market economy, take the form of genuine competition and independent monopoly control. Genuine competition exists where the conditions of competition are such that, given equal chances and fair conditions of competition, the best efforts are rewarded. *The co-operation among all concerned is guided by genuine market prices.*

Social market economy is firmly opposed to the system of planned economy Social market economy is also opposed to the strictly "free economy" of liberal origin. In order to avoid a return to the strictly "free economy," an independent monopoly control is necessary to ensure competition

Social market economy approves, however, of a planning influence being exerted on the economy through a comprehensive economic policy based on a flexible adaptation to market conditions . . .

Competition and monopoly control, as the basis of the economic and social order towards which we are striving, and the influence exerted on economic development through the monetary and investment policy . . . will ensure a continued upward movement of the economy . . .

These principles for an economic policy are closely bound up with the "principles for a social policy," listed further on. The latter prescribe "a new social order based on social justice, socially responsible freedom and true human dignity." They declare that "human labor is not a commodity but . . . the basis of the physical and spiritual development of man."

Then follows a detailed exposition of the methods by which the social aims of the market economy are to be pursued, in such matters as the role of labor unions and professional organizations within the framework of the state, business organization, and housing policy.

The Düsseldorf Directives provide an insight into the practical expression of beliefs that have made possible, lasting, and both morally acceptable to and accepted by the electorate a social order based on the actions of free men and governed by the price mechanism within the framework of existing laws and regulations.

To be sure, freedom presumes a right of self-determination, but the free man determines his

conduct in accordance with how he assesses the consequences of his actions. These actions can be influenced without impinging on his freedom either by changing his nature or the consequences to him of his eventual decisions.

By "conditioning" human nature, religious education and moral training alter the scale of values—and therefore the conduct—of the free man, external circumstances remaining unchanged. In the same way, laws and regulations, by creating penalties and in some cases reward for certain acts, transform the consequences of such acts for the door. Thus laws and regulations determine the acts which a free man freely decides to undertake.

In business, too, there is a corresponding penalty or reward for each economic act: a penalty in the case of a purchase—the paying of the price; a reward in the case of a sale—the receipt of the price. The price mechanism, by taking into account the means and tastes of all the participants in the market, sets punishments and rewards at a point which will stimulate individual actions that keep the economy in balance and make for the maximum output that is possible in the society served by the apparatus of production.

Thus a society of free men is not an unregulated society, but one in which the government intervenes, either conditioning human nature or imposing penalties or rewards calculated to encourage men to engage voluntarily in those actions which are beneficial to the commonweal. For such a society to endure, a government intervention of both kinds should: (a) awaken in the strong the desire

to respect the freedom of those weaker than themselves; (b) encourage those who would not of their own volition concern themselves with the weak and the handicapped to perform, directly or indirectly, the charitable acts which are needed if a great number of men are not to be deprived of the possibility of being free or the desire to remain free; (c) promote those public services which would never be provided if the only incentive were the benefits to the servers; (d) create a situation in which prices, the mainspring of economic action in a free system, conform to the necessities of the public interest, and not to what special interests, private or corporate, would like them to be.

Even this rough outline indicates that the government of a society of free men has need of a good deal of government intervention, probably only slightly less than would be required to govern a society based on coercion. It is obvious that a serious error is made by those who rely upon *laissez faire* alone to usher in the liberal society. Freedom is never a gift of nature. It can only be the hard-won acquisition of a complex of institutions, designed first to guard it against mortal dangers, and then to make it acceptable, even to those who feel themselves threatened by it. Modern liberals concerned with efficient performance have dubbed their program "neoliberal," so as to distinguish their doctrine from the system of studied do-nothingism which was wrongly identified in the past with classical liberalism.

Neoliberalism makes no claims to orthodoxy. It arises from a deliberate choice based on a knowledge

of the facts and the interpretation of experience. It pursues no absolutes but, keeping in mind the realities of human nature and the means at the disposal of the government, tries to ascertain the policy which will bring into being the least objectionable of the social orders within man's purview. The German miracle as it exists in real life is the offspring of the neoliberal doctrine, explicitly formulated and put into practice.

Pascal declares that "it is not possible to have a reasonable belief against miracles." Is it any more possible not to have a reasonable belief in a doctrine which, singlehandedly and against all the combined forces of geography and history, has produced the most improbable of miracles?

SOUND MONEY
IS THE ONLY ROAD
TO THE NEW EUROPE

You want a new Europe and so do I. However, precisely because I desire this as much as you do, I feel I must tell you that the elimination of quotas and the lowering of tariffs will not be enough to accomplish it. To remove or lower the trade barriers between countries, that are planning to unite is certainly a spectacular feat, but one that will have little value if it is not part of a general program of financial and monetary reform. Without such a program the structure built one day will have to be demolished the next, and amidst the rubble the barriers unwisely torn down will have to be put up again.

It was not out of malice or any special attachment to the theories of self-sufficiency that all the governments of Europe drastically curtailed the right to spend money and to travel in other countries. They just knew that their citizens, if not restrained in their relations with other countries, would incur payment obligations that could never be met. If people are to be allowed to make their own decisions, especially in the choice of countries where they

spend their income, these decisions must not be such that they tend to unsettle the international balance of payments.

The decisions individuals make are the expression of their preferences which in turn, are determined by their environment. Of course, these decisions are in no way affected by the position of the balance of payments. Unless some relationship is established between the aggregate balance of a country's foreign debts and claims and those individual decisions of the country's inhabitants which are apt to affect international debts or claims, then it is unlikely that the people will act in a way that will be conducive to an equilibrium in the balance of payments.

There is something inherent in the workings of the monetary mechanisms, where variations in the exchange rates of foreign currencies in a system of flexible exchange rates, or over-all variations in purchasing power in a system of monetary convertibility, induce people to act in ways that are in harmony with the demands for equilibrium in the balance of payments. If, for example, there is a deficit in the balance of payments, the rates of foreign exchange, in the absence of exchange controls, will rise. Foreign goods will become dearer on the domestic market, whereas domestic goods will become cheaper on foreign markets; thus everyone will be induced to act, of his own free will, in ways that will eliminate the balance of payments deficit.

Since, on the other hand, variations in the exchange rates lead to serious social disorders, they may be tolerated only for brief transitional periods

when, after some deep-seated disturbance, a new level of balance must be sought out by the method of trial and error. A more permanent substitute has thus been found in the system of monetary convertibility, which keeps the exchange rates within narrow limits. Under this system a deficit, by causing the debtor country to incur payment obligations towards other countries, leads to a shrinkage of purchasing power. The volume of income thus becomes sufficient for the entire output of the debtor country to be bought at market prices by the inhabitants of that country. For want of buyers, a portion of this output equal in value to the amount of the deficit becomes available for export. When, in the creditor country, the surplus on the balance of payments is settled by the debtor country, the aforementioned process operates in reverse and produces a surplus of purchasing power which in turn enables the export surplus of the debtor country to be absorbed. If the resources made available in the debtor country are not of a kind which the creditor country is prepared to absorb, lower prices in the debtor country and higher prices in the creditor country will induce such shifts in production as are necessary to set up trade flows that will re-establish equilibrium in the balance of payments. Since the stabilizing influence becomes increasingly pronounced up to the time when the result towards which it tends had been achieved, it cannot fail to be effective. The machinery of monetary convertibility thus induces individuals to perform of their own free will, those acts which they must perform if

international equilibrium, and hence the solvency of nations, is to be ensured.

Under such a system, people can be given a completely free choice of the countries where they spend their income. Their free decisions, even though arrived at independently in each case, cannot bring about any international imbalance. If a monetary system of this kind were in effect in the countries of Western Europe, it would be possible to eliminate quotas and tariffs between them, and consequently "to launch the New Europe" with the full assurance that Europe would then be viable, regardless of what decisions the Europeans would make of their own free will.

The system under which international settlements are at present effected in Western Europe is, seemingly, the system of monetary convertibility, but it has, unfortunately, been so modified that it no longer has the effectiveness advantages which could be expected from it. The principle cause of this modification is the excess of government spending over government receipts in most of the countries of Western Europe. If the system of monetary convertibility operated as it should, a balance of payments deficit would tend to adjust itself automatically, because it would lead to a contraction of purchasing power in the debtor country equal to that deficit. If, however, the shrinkage of domestic purchasing power brought on by a balance of payments deficit is accompanied by an expansion of purchasing power of even greater dimensions in consequence of an excess of government spending

over government receipts, the result will be an increase rather than a reduction in purchasing power. This, in turn, will cause domestic demand to outstrip the value, the market prices, of domestic output, and hence will discourage exports and stimulate imports. This excess of spending over receipts in some of the countries of Western Europe thus tends to produce a deficit in their balance of payments, and to create those "shortages" of dollars or Belgian francs which are characteristic of the present international situation. To fail to impose restrictions on purchases and spending in foreign countries while such government deficits persist is to court serious trouble. Trade restrictions cannot be removed safely until a sound monetary system has been restored among the countries concerned.

At the present time, the monetary system in most of the countries of Western Europe is nothing more than a disabled mechanism, devoid of any regulating action. The restoration of sound currency, capable, as in the past, of serving as the guardian of the international economic order is the main prerequisite for any policy designed to form the New Europe.

The method by which the monetary system of Western Europe can be made sound again is well known. It was applied and put to the test by the Financial Committee of the League of Nations on various occasions between 1920 and 1930, under the auspices of the Bank of England, and it gave conclusive results. It consists of a three point program of action: (1) to balance government income and receipts; (2) to rehabilitate the economy; and

(3) to reconstitute the reserves of the central bank and determine the parity at which convertibility will be established.

In the present situation there is, however, an entirely new element. In the past, every effort at reform was necessarily very slow because, in each case, the resources needed for reconstituting monetary reserves could only be obtained through loans on the great international money marts. A situation unique in history has been created for a limited time by the generosity of the United States, which, in the Marshall Plan, has forged an instrument through which all reserves of the central banks could be reconstituted simultaneously, and almost overnight. This could be accomplished simply enough if a considerable part of the resources of the plan were used to set up a currency stabilization fund, instead of being spent on all kinds of goods and services, which, while certainly capable of improving conditions temporarily in the recipient countries, are not likely to bring them permanent stability.

A currency stabilization fund would not, of course, be sufficient in itself to guarantee that convertibility would endure. This could only be accomplished if the fund was part of a general program of reform. As both the crowning point and endorsement of such a program, the fund would quickly lead to the restoration of conditions that would prevent the removal of trade restrictions from seriously disrupting the balance of payments of the countries affected.

Some people may fear that in a program so com-

pletely geared to monetary requirements there will be no place for the generous social policy to which they are attached and which they regard as the foremost feature of a united Europe. No one is more convinced than I that our economic institutions must be subordinate to the needs of justice and the moral order. But I am equally convinced that, in comparison with a coercively planned society, a society governed by the price mechanism can produce equal or even greater social benefit, for it leaves open a wide range of possibilities for effective action and lends itself to any kind of income distribution or to structural changes that may be considered desirable. A society based on the price mechanism can be generous if the people want it that way. But the largesse it promises it is able to deliver in an orderly fashion, instead of chasing a phantom prosperity amidst inflation and deficits. If tomorrow, therefore, there is to be a united, free, and prosperous Europe that will be stable and enduring, our first step must be to restore, among all the countries that wish to be united, the free play of monetary mechanisms.

Man's freedom has not been bestowed upon him by nature. Freedom is possible only under a system which induces men to perform of their own free will those acts that are in the public interest. To want freedom without wanting the conditions that make it possible is to ask to be keenly disappointed. Without monetary order, freedom can only engender disorder. Sound money is, truly, the only road to the New Europe.

THE MONEY PROBLEM OF THE WEST

The West is for us the land of freedom. The Strasbourg lore has it that the Kehl Bridge, during the French Revolution, displayed a huge sign which read: *The French Republic, One and Indivisible—Here Begins the Land of Freedom*. The land of freedom is the land where men freely choose what they want to do, where they want to live, and how they want to use their means—where, in other words, they decide what contribution they want to make to the supply and demand of the market place, and thereby to the supply and demand of the country as a whole

It requires no great imagination to realize that if the manifold currents of supply and demand in each section of the market place were not co-ordinated, and if the over-all demand was apt at any time to get seriously out of line with the over-all supply, the land of freedom would also be the land of disorder. But it does not have to be so. The liberal economic order is no less precise and no less strict the planned order. For long periods of time, and despite the freedom of individuals to make

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their own choices, prices remained stable, markets were well adjusted, and from country to country the balance of payments was as it should be—in balance.

I shall deal here in particular with the achievement of equilibrium in the balance of payments. The number and diversity of the individual decisions that combine to give form to a balance of payments make it easy to realize how great the odds are against achieving any real equilibrium. If these decisions are free, in the way that they have been free in our country since import quotas were abolished, equilibrium cannot be the result of chance. It can exist only if there is an appropriate mechanism to bring about. This mechanism can take various forms, according to whether the monetary system is based on inconvertible money with fluctuating rates of exchange or on convertible money with stable exchange rates.

A system of the latter type was that of the metallic currencies, as these existed before the last war—that is, currencies freely convertible into gold bullion at fixed rates. Under that system, the balance of payments was kept in proper shape as a direct result of the transfers in purchasing power that were brought on by any imbalance in a country's obligations towards other countries. When the balance was unfavourable, the gold or foreign exchange that had to be purchased to make up the deficit caused the purchasing power in the debtor country to contract by a corresponding amount. The over-all purchasing power, represented by the aggregate income, in that country consequently became less than the

total value of its output. This, in turn, released for export sufficient wealth to restore the equilibrium of the balance of payments, and in due course stimulated price movements which made such wealth attractive to foreign buyers.

Of course, this process was more complicated than the foregoing brief analysis seems to imply. But regardless of how complicated it was, its driving force was the mechanism I have just described.

This system operated efficiently for an entire century, up to the very eve of the First World War. It caused prices to remain remarkably stable, despite a major expansion in production; it provided a means of keeping foreign obligations in balance; and, as a consequence of all this, it was the keystone of monetary stability in all the countries that submitted to its discipline.

After the war, the countries of the West were so convinced that the gold standard was indispensable to their economic stability that they decided to reinstate it without delay, regardless of the difficulties involved. In 1920, however, the gold price index was 246, against 110 in 1913. The volume of money in circulation had increased to the same extent. Because, whether for reasons of fact or in law, the amount of gold reserves needed to maintain convertibility is in direct proportion to the amount of money in circulation, which is backed up by these reserves, it was evident that not enough gold would be available for purposes of convertibility unless the price of gold was changed.

It was for this reason that the monetary conference which met at Genoa in 1922 recommended

in resolution 9 the conclusion of an international convention; that would “embody some means of economizing the use of gold by maintaining reserves in the form of foreign balances.” As a result of this recommendation, the system designated merely as the “gold-exchange standard” replaced the old gold standard after the First World War in France and Germany, and all the other countries whose currencies had been restored by the Financial Committee of the League of Nations. It collapsed during the Depression, but rose again from its ashes after the Second World War.

According to the principles of this system, a central bank is authorized to create money not only against instruments of indebtedness in domestic currency or against gold, but also against other currencies payable in gold (after the First World War against pounds sterling and dollars, and after the Second World War mainly against dollars.¹

Hence when, as a result of the balance-of-payments deficits of the United States, the central banks of the Western countries—especially the Bundesbank, the Bank of Italy, the Bank of Japan and, although to a lesser extent, the Bank of France—came into the possession of dollars or claims payable in dollars, they did not demand the gold to which their dollars entitled them, but instead left some or all of these dollars on deposit in the United States, where they were generally lent out to American borrowers. The central banks looked upon this

¹ Within the sterling zone, the pound sterling was governed by a special regime similar to that of the dollar.

new system with particular favor because it enabled them to substitute income-producing assets for entirely non-productive gold bullion and specie.

The international monetary system thus came to resemble a group of children playing marbles who agree that after each game the losers will get back the marbles they have put up. To the extent that the central bank of the creditor country gives back to the debtor country, in the form of a loan, the foreign exchange that it has received in the settlement of its debts, the debtor country can rest assured that, for the duration of the loan, the balance-of-payments deficit will not entail any international settlements. The monetary consequences of the deficit will simply be wiped out.

A great revolution has accordingly been wrought by the gold-exchange standard, and the result has been to give to those countries whose currencies have international prestige the marvellous secret of a "deficit without tears," whereby they can give without receiving, lend without borrowing, and buy without paying. The discovery of this secret has also had a profound psychological effect on the people benefiting from a boomerang currency, for the domestic consequences which under the gold standard would result from a balance-of-payments deficit have been lessened or eliminated.

The gold-exchange standard has thus brought about conditions which are favourable to the great change in international traditions that has been initiated by the generous policy of giving. By leaving to the giver the joy of giving and to the recipient the joy of receiving, it has had only one result—the

monetary situation which was described by President Kennedy in one of his first messages. The effects of this situation must now be examined.

THE EFFECTS OF THE GOLD-EXCHANGE STANDARD

The replacement of the gold standard by the gold-exchange standard has had three main results: 1. Under the gold standard a balance-of-payments deficit had the effect, through the transfers required for its settlement, of reducing the purchasing power—or one might better say the face value of income—in the country incurring the deficit. Under the gold-exchange standard, on the other hand, the total volume of purchasing power is in no way affected by balance-of-payments deficits, regardless of how large they are. Hence in so far as the total purchasing power of the debtor country is concerned, the gold-exchange standard creates a situation identical to that which would exist if there was no deficit.

The total volume of domestic purchasing power is, of course, affected in other ways—more particularly by the credit policy. It is at any given time the culmination of a great number of more or less independent factors. Domestic inflation, for example, can counteract and even reverse the shrinkage of purchasing power that is a consequence, under the system of the gold standard, of a deficit in the balance of payments. Granting that other influences play their part, there is still no denying that even where the volume of income is equated with the volume of national output—that is to say, even in the absence of inflation—the gold-exchange

standard brings about a complete break between the volume of total purchasing power and the position of the balance of payments, and thus sweeps away the corrective influence of a monetary system based on the gold standard.

Since, under the gold-exchange standard, the balance of payments is no longer affected by the international settlements to which it gives rise, the only means, even under the most favorable conditions, for restoring its equilibrium is a systematic credit policy or dictatorial controls over international trade. Experience has amply demonstrated, however, that it is virtually impossible to restore by any kind of systematic and conscientious action the restriction of credit which the gold-exchange standard tends precisely to suppress. As to the high-handed manipulation of the balance of payments by such means as restricting purchases in foreign countries, establishing foreign exchange quotas for tourists, or even prohibiting short-term movements of capital, these efforts, to the best of my knowledge, have always failed.

The layman is sometimes amazed at how decisively a balance-of-payments surplus or deficit is affected by over-all variations in purchasing power. It would not be appropriate here to deal at length with the theory of this phenomenon. Let me just say, as a brief explanation of how it works, that any excess of domestic demand over domestic supply tends to cause the national output to be consumed within the country, whereas the opposite situation—an excess of the supply over demand—will cause a portion of the domestic output to become available for export.

The adjustments in the balance of payments that have taken place in France and Britain during the past ten years have always been the result of a contraction in the volume of income, and never of any direct action by the authorities on the various elements of international trade.

2. Under the gold-exchange standard, any deficit in the balance of payments of a country whose currency is returned to its point of origin—that is, to the United States and, within the sterling zone, to Britain—by the central banks receiving it leads to a veritable duplication, on a world scale, of the basis of credit, subject, of course, to the other factors affecting the assets of the central banks. The process by which this occurs is as follows.

The currency transferred in settlement of the deficit is purchased, against the creation of money, by the banking system of the creditor country. The cash resources thus brought into being are remitted to the debtor country's creditors. At the same time, the currency against which the creditor country created new money is reinvested in the debtor country; everything, in fact, proceeds quite normally, just as if the currency never left the debtor country in the first place.

By thus being transfused into the credit system of the creditor country while remaining in the credit system of the debtor country, the currency representing the deficit is in fact doubled, subject, of course, to the other factors affecting the volume of credit.

This process by which the gold-exchange standard is substituted for the gold standard, would have

little effect on total purchasing power in a period when the various balances of payments were more or less in equilibrium, but it becomes a powerful stimulant to inflation as soon as international capital begins to move from country to country.

The analysis above was graphically and tragically illustrated by the events which proceeded and followed the recession of 1929. The financial rehabilitation of Germany through the Dawes Plan in 1924, and of France through the reforms carried out by Poincaré in 1927, brought on a massive influx of foreign capital into these two countries. Both of them, however, were operating under the gold-exchange standard, and it was the duplication of credit so characteristic of this system that caused the 1929 boom to assume such vast proportions.

There was a similar extraordinary expansion of liquid assets in 1958, 1959, and 1960, as an aftermath of the movement of capital from the United States to Germany and France. In this case the results were and continue to be an abnormal rise in stock prices on world exchanges, marked overemployment, and a strong upward trend in prices.

The conclusion to be drawn from all this is that in a period when capital is flowing from countries with a key currency to countries whose currencies are not so privileged, the economic climate can be expansionist in the latter countries without being recessionary in the former. The leaders carry along the others, where there is nothing to check the boom, and the result is that as long as the migration of capital persists, all the countries affected by the gold-exchange standard are caught up in a powerful

surge of expansion. This may be reflected in the economy or in the stock markets, and is clearly inflationary.

The foregoing remarks are in nowise incompatible with those theories which regard wage rises not accompanied by increased productivity as the origin of the inflationary process, and which set demand-pull inflation over against cost-push inflation. Although it is often difficult in such matters to distinguish cause from effect, there can be no doubt that the constant rise in over-all purchasing power both encourages and justifies the demands for higher wages, and at the same time eliminates the obstacles to their fulfilment.

3. The most serious consequences of the gold-exchange standard is, however to be found in the inherently unsound credit structure which it spawns. President Kennedy's message pointed out that the \$17.5 billion in gold held by the United States at the end of 1960 served to cover both the \$20 billion of short-term foreign holdings and demand claims on dollars and the \$11.5 billion requested by the present laws and regulations to cover the domestic currency in circulation in the United States. Now, I am not in any way implying that the existing gold stock is inadequate to ensure the stability of United States currency in present circumstances. Besides, President Kennedy has said that the amount of gold required as backing for the currency in domestic circulation could be reduced if the existing regulations concerning the guaranty of the domestic currency were changed, and he has, in fact, proposed that this be done. Further support for the dollar is, moreover, available in the form of

a variety of as yet untapped assets, such as large drawing margins at the International Monetary Fund and extensive foreign holding.

The proceeding remarks do not, therefore, cast any aspersions on the the value of the dollar. They merely point to the inevitable conclusion that the application of the gold-exchange standard in a period of large-scale capital movements has saddled a considerable portion of the United States gold stock with an exceedingly high double mortgage. If a substantial part of the foreign holdings of claims on dollars were cashed for gold, the credit structure of the United States would be seriously threatened. This, of course, will not happen, but the simple fact that it could inevitably calls to mind that the depression of 1929 was a "great depression" because of the collapse of the house of cards that had been built on the gold-exchange standard.

In 1960, roughly the same set of circumstances was again present, and unless proper precautions are taken, the same cause could have the same effects. Consequently, the situation brought about by the doubling of the credit pyramid that has been built up on the world gold stock must be corrected while there is still time.

THE REMEDIES

The system of the gold-exchange standard, which had been in operation in many countries for a long time, can be dismantled only if two problems are solved: (a) The substitution of a system that will not foster or maintain the deficit of those countries whose currencies are considered by the central banks receiving them to be the equivalent of gold;

(b) The elimination of the unstable and dangerously vulnerable situation resulting from the duplication of the credit structure erected on the gold stock of those same countries.

1. Under the system to be set up in the future, there must be no possibility of the creditor countries receiving in settlement of their debts a purchasing power never lost by the debtor countries. No central bank must, therefore, be able to lend a foreign creditor the currency against which it has already created purchasing power within its own monetary system.²

As the gold standard, even when limited to external payments, differs from the gold-exchange standard in preventing the central banks from creating money except against gold or against claims on the national currency, it would fully meet the requirement mentioned above.

Some other system of multilateral clearing might also be satisfactory, on condition that the proceeds from the settlement of deficits not be made again available to the debtor country in the form, for example, of short-term loans on that country's money market. Under a system of this kind, however, the immobilization of such proceeds, being voluntary and burdensome, would always be precarious and hence uncertain, whereas under the gold standard this would be an unconditional and inevitable re-

² In any detailed treatment of the subject, this statement would have to be tempered by certain reservations.

sult of the workings of the system. The European Payments Union gave an example of a gradual approach to a system based on the gold standard by the progressive "hardening" of its clearing procedures, that is to say, by the increased percentage of gold that had to be paid under the clearing agreements which it sponsored.

2. There is, unfortunately, only one way to eliminate the risks which fifteen years of the gold-exchange standard have left to the West, and that is to redeem in gold the greater part of the dollar holdings that have been accumulated by the various central banks. Only by doing this will it be possible to avoid the risk of a slump or a sudden deflation inherent in the duplication of the credit structure built on the gold reserve of the United States. The principal disadvantage here would be the sudden depletion of the gold reserve of the Federal Reserve System that would result from the redemption operations.

The situation is not so serious, however, as it might appear. President Kennedy himself referred in his message to the resources that are or could be made available if the dollar holdings had to be redeemed in gold. Unless, moreover, the gold-exchange standard had to be abandoned hastily as the result of a panic—and that is precisely what must be avoided—the dismantling process could be prop-organized so as to take place gradually.

3. To eliminate the duplication inherent in the gold-exchange standard would, however, reduce the liquidities of the central banks as whole by the amount of their dollar holdings. This, in turn, might

bring them below the minimum levels required for the transaction of current international business. Such an eventuality could not be tolerated, and various proposals have been advanced to cope with it.

The best-known of these is the one advanced by Professor Robert Triffin of Yale, for concentrating the currency reserves of the central banks in the International Monetary Fund, where they would in effect become an international currency. As a means of remedying any liquidity shortage, the IMF would also be empowered to create and issue its own money, to an extent determined by an international authority in relation to the need for expansion. Depending upon the results of further study, Professor Triffin believes that this new money might be issued in such volume as would increase the aggregate stocks of gold reserves and currencies held by central banks by 3 to 5 per cent per annum.

This plan, which is very similar to that put forward by Lord Keynes in 1943,³ is worthy of attention because, through the concentration of cash resources that it would bring about, it would considerably reduce the liquidity requirements of the central banks. However, it also involves certain complications, since the new money that would be created would be only partially convertible and might in certain circumstances be destined to become a forced currency. Furthermore, the authority empowered to issue this money would, by reason

³ "Proposals by British Experts for an International Clearing Union."

of this power, be able in effect to impose levies on the economy of the member states.

The main reason why the Keynes plan was rejected in 1943 was fear of inflation. The reasons which caused it to be discarded still seem valid today, and apply with equal force to various other plans based on the same principles.

The refusal to accept an inflationary solution has led some commentators to advocate a higher price for gold as a means of increasing the face value of gold reserves. They point out that this price has remained immutably fixed at its 1933 level of thirty-five dollars an ounce, even though dollar prices are just about twice what they were then. A higher dollar price for gold, and thus also a higher price for gold in all the other currencies whose rates are based on the dollar, would, without any doubt, increase the face value of gold reserves, and thereby make it easier to eliminate the false cash balances that have resulted from the workings of the gold-exchange standard.

It would be imprudent, however, on the basis of calculations alone, to hazard an estimate of how much higher the price of gold should be, or even to assert that a rise in the gold price is unavoidable. In the first place, a much smaller volume of liquid assets would be needed if new methods of settlement were evolved through an expansion and improvement of the existing clearing machinery. In the second place, it is incorrect to assert that gold production is not greatly affected both by the price assigned to gold and by the movements in the general price level.

4. It is clear from all that has been said above that the elimination of the gold-exchange standard, although necessary, does present some difficult political and monetary problems which require considerable study and discussion. In such discussion it would have to be borne in mind that these problems are not exclusively or even essentially American. There is no possibility of solving them except by radically modifying the present system for the settlement of deficits in international trade, hence also the procedures of all the central banks. Although the gold-exchange standard is chiefly to blame for the balance-of-payments deficit of the United States, this system was not initiated by the United States but by the international monetary conference which met at Genoa in 1922, and at which the United States was not represented.

What has been done by an international conference cannot be undone except by another international conference; but in any event, it must be undone quickly. A monetary crisis would endanger the financial rehabilitation that has at last been completed in all the countries of the West. It could bring on a serious recession that would have every prospect of becoming a "great depression."

No matter what happens, the problem of the gold-exchange standard will be solved soon—either in the press of emergency or with quiet deliberation. We cannot allow it to be solved otherwise than with deliberation, which means that government action is necessary and urgent. If the action comes in time, it will spare the people of the West the disorder and suffering of a new world crisis.

APPENDIX

It seems appropriate, by way of illustrating the views set forth in this book, to reproduce here the text of the *Report on the Financial Situation of France*, on the basis of which the French financial reform was carried out late in 1958.

The report was prepared by a commission headed by Mr. Rueff, who wrote most of it himself. It was submitted to the minister of finance, Mr. Antoine Pinay, for recommendation to General de Gaulle.

The original report included a number of *ad hoc* recommendations, which are not reproduced here because they deal too specifically with conditions in France. It is worth noting, however, that virtually all those recommendations were adopted by the government of General de Gaulle. They formed the substance of the executive orders of December 27, 1958, by means of which the reform of the French finances was carried out with complete success, and in a remarkably short time.

REPORT ON THE FINANCIAL CONDITION OF FRANCE

1. APPOINTMENT AND MEMBERSHIP OF THE COMMISSION

On September 30, 1958, Mt. Amtonie Pinay, Minister of Finance and Economic Affairs, held a conference with the following gentlemen in his office:

J.Alexandre, Honorary Chairman of the Board of Governors, Association of Certified Auditors and Accountants

C. Brasart, Presiding Officer, Finance Section, Council of State

C.Gignoux, Member of the Institute

J.Guyot, Managing Partner, Banque Lazard

J.M Jeanneney, Professor, School of Law and Economic Sciences, University of Paris

M. Lorain, President, Société Générale

J Rueff, Inspector-General of Finance, Member of the Institute

J,Saltes, Deputy Governor of the Bank of France

R. de Vitry, President, Compagnie Pékiney

He asked them to report to him on the problem of French finances as a whole and to offer him any pertinent suggestions for exercise of the special

powers granted to the Government by referendum of September 28, 1958.

He invited Mr. Jacques Rueff to coordinate the work of the commission.

The commission met daily, almost without exception, between September 30 and the filing of its report. The members of the Commission asked Mr. Rueff to preside over their deliberations.

With the Minister's concurrence, Mr. G. Devaux, Director to the Budget, and Mr. P.-P. Schwitzer, Director of the Treasury, Participated in all proceedings of the Commission in an advisory capacity.

Mr. Blot, Director General of Revenue, attended all sessions devoted to consideration of fiscal problems.

Messrs. Arasse, Dargenton and Querenet of Mr. Pinay's office were present at numerous meetings.

Mr. Questiaux and Mr. Vienot, Inspectors of Finance assigned by the Bureau of the Budget and the Bureau of the Treasury respectively, acted as Co-Secretaries of the Commission.

The Commission heard Messrs. Aujaleu, Bernheim, Bloch-Laine, Braconnier, Calvert, Clappier, David, J.-R. Debray, Doublet, Doumenc, Franck, Gardent, Gruson, Hirsch, Sadrin, Sauvy, Uri, and Wormser.

The Commission wishes to acknowledge the co-operation extended by the Bureaus of the Budget and of the Treasury, by the Division of Revenue, and by those Directors with whom communications was held in the specialized Ministries. The services of the Co-Secretaries in particular proved invaluable.

132 THE AGE INFLATION
II. PURPOSE OF THE COMMISSION

The Commission, while not seeking a rigid definition of the task assigned to it, has viewed it as essentially one of information and recommendation. It has borne in mind the wish of the Minister of Finance to receive its report substantially prior to the announcement of the Budget. In the brief period of time allowed, it was not possible to contemplate major changes requiring protracted preparation and inquiry. An attempt has been made to present the Minister of Finance with a list of suggestions apt to initiate promptly, through exercise of the special powers, that profound strengthening which French finances require.

III. NATIONAL PROSPECTS AND NEEDS

The history of France has entered upon a new phase. The wave of productivity upon which she has risen will, within a few years, create a young country, facing the future with eagerness, and once more equal to the highest destiny. In an inspired effort of forehandedness—by an unprecedented economic expansion—the country has already prepared the means of its recovery.

But the growth achieved has not yet nearly reached the level called for by the nation's responsibilities.

If it were desired merely to maintain the existing level of development for an increased population, it would be necessary to invest immense sums in schools, in infrastructural development, in construction of housing and in job opportunities.

Yet to do no more than this would be to remain hopelessly inadequate to the task. To accomplish the task would mean, in the course of the coming years,

To develop the Sahara;

To raise the standard of living of the peoples that have lately reaffirmed their loyalty to and confidence in France;

To modernize the national defense;

To develop and convert power installations so as to retain the benefits of technological progress;

To continue modernization and growth of productive plant in the spheres of agriculture, industry and commerce;

To improve facilities for scientific research;

To expand medical and hospital services;

To foster the advance of social welfare by all suitable means.

At the same time, France is under a basic imperative to remedy, without delay, the housing crisis that is undermining her social structure, freezing the distribution of labor in a manner highly injurious to industrial progress, inflicting cruel and unjust suffering on wide sections of the population and turning them into confirmed enemies of the social order.

For many years to come, all France's problems will be problems of investment. France will not be taking full advantage of the opportunity that offers unless these are successfully solved, not in a spirit of apathy and decadence, but with the liberality

called for by the task to be accomplished and by the great rewards to be won.

IV. THE PLAGUE OF FRENCH FINANCES; INFLATION

Close upon her liberation, France heard the voices of her destiny. Even while binding up the wounds inflicted by the Second World War and establishing a farsighted policy towards increasing the population, she achieved a development that was to set an unprecedented pace of post-war expansion. The investments that the situation called for were planned and in large measure effected.

Except for brief and infrequent respites, however, it has not been possible to find the resources required for this effort by drawing directly upon income. The excess of expenditure over receipts has been reflected in many items of deficit, public or private, which have nearly always ended up in the Treasury.

The quasi-permanent crisis of French public finance since the liberation is only the outward sign of this unbalance. Yet the aspect of finances over-lies, and often masks, a deeper and more serious economic unbalance. To say that the expenditures of the Treasury exceed the sum of the resources it commands by taxation or by loan means that the income it creates by defraying the public expenses enables the recipients to command a larger share of the national product than would correspond to the diminution of demand through payment of taxes and subscription of loans.

The deficit, by adding its own amount to total demand, makes possible a demand for goods that do not exist.

The excess of total demand over the total value of the national product computed at market prices may operate at home or abroad.

At home, it causes expansion if there is under-employment, raises prices if there is not, and usually both, at least unless the factors of production are being utilized to the very maximum.

Abroad, the excess of purchasing power causes a deficit in the balance of payments, thus exhausting reserves of foreign exchange.

In fact, rising prices and a drain on foreign exchange reserves are inseparably connected. It could be shown that if either were to occur alone, it would tend to bring about the other. The experience of all foreign countries and the events observed in France under all circumstances warrant the statement that declining exchange reserves, like rising prices, are only manifestations of one and the same phenomenon—the presence of an imbalance between purchasing power and value of the wealth purchasable.

France has felt the irresistible force of this process. We have seen that, however cunningly devised, no administrative measures tending to encourage exports have been able to restore a balance of payments vitiated by inflation. We have found that expansion, desirable as it is, when born of inflation necessarily meets a check in the want of outside means of payment, and then leaves no choice ex-

cept the restraint of imports, with consequent unemployment, or the humiliation of seeking fresh foreign aid.

At the same time, the inflationary process, because it affects various price categories unevenly, causes serious and often irremediable dislocations in the apparatus of production. It encourages the production of items whose prices will adapt quickly to swollen purchasing power, and by the same token discourages that of goods and services whose prices, because of circumstance or regulation, follow fluctuations in income slowly or not at all.

The clearest example of this is housing. The lag in rentals causes an excess of demand and a deficiency of supply, generating a cumulative crisis, the more so since any rent increases are more than offset by the depreciation of the currency in the meantime.

A similar state of affairs, though less severe, is to be seen in many other fields, especially those with fixed or controlled prices. This emphasizes the difficulty, if not impossibility, of escaping from inflation through inflation.

On the social plane, inflation, notwithstanding all precautions taken to mitigate its effects, gives rise to unconscionable inequities. By its very nature, the inflationary process is a mechanism of drawing upon those incomes which—like those of pensioners—do not follow the general level of prices, or which—like those of wage earners—do so only at a distance. All the purchasing power born of inflation is taken out of those groups in society. And whereas taxation is hedged about with exemptions and graduated

rates, tending to shift the burden according to the ability to pay, the inflationary exaction is blind, striking chiefly those who ought to be protected. Whenever it is great, it rouses deep and justifiable resentment in the social classes victimized by it. If there are no means of defending their standard of living but political protest and pressure.

Also, experience teaches that excess purchasing power can be neutralized by extensive rationing, price control and import quotas—practices typical of Dr Schacht's policy and the Hitlerian economic system. By keeping large blocks of purchasing power out of the market, they can only end in such major surgery as the German currency reform, suddenly destroying the reserves of purchasing power that have been kept impotent, to the great detriment of private individuals, or in a rise in prices such as occurred in France after the war, whereby purchasing power temporarily "repressed" gets its way.

So the choice before the Government is simple: either restoration of balance between the expenditures and receipts of the Nation, or unavoidable recourse to methods of rationing and control from above that would necessarily have grave political consequences.

V. THE "IMPASSE" SYSTEM AND INFLATION IN FRANCE

The "impasse"¹ is an attempt to measure the difference between the sum of the Treasury's firm

¹IMPORTANT NOTE: *Impasse*—Amount of money which has to be borrowed every year for the payment of public expenditures, including investment financed

commitments—whether arising from current expenditures or from investment programs—and its firm receipts, taxes, income taxes or repayment of prior advances.

It was during the year 1952 that the *impasse* was introduced into the lore of French finance; the concept, so far as we know, is not in use in other countries.

Originally, the *impasse* reflected what was certainly a praiseworthy aspiration—to bring the sum of commitments that meant firm expenditures by the Treasury close to the sum of resources absolutely sure to be collected within the same period; the difference to be met with the uncertain resources expected from borrowing.

The initiators of the system were unquestionably motivated by a concern for truth, with the aim of keeping the difference between expenditures and assured receipts within the limits of what might reasonably be expected from savings. What they wanted to bring about was that when the amount of the *impasse* exceeded the amount of loan availabilities, the Treasury's unconditional commitments should be revised, either by reduction of public spending or by increase of fiscal revenue.

Unfortunately, such revision raises difficult problems. Though in certain exceptional situations it was accomplished, with no less political courage than technical skill, in most cases the *impasse* manifested itself as a consequence of the demands

by the state. The word *impasse*, as used in the French original has no exact English equivalent. Therefore the French word is used throughout the text.

of an investment policy, and the limitations of a fiscal policy which we were unable or unwilling to make any changes.

Under these circumstances, the Treasury was yearly forced into an actual wager on the volume and availability of savings, like a bridge player who must gamble on whether a card is held by the opponent on his left.

Now there is nothing more difficult to forecast than the Treasury's capacity to borrow. It depends on fluid factors—economic, such as the state of the crops; psychological, such as the expectations of savers. It is moreover, through the mechanism of "circuit,"² (circular flow) directly affected by credit policy.

The proceeds of the loans actually obtained to meet the *impasse* would determine the outcome of the wager they reflected. If justified by the event, it would ensure regular financing of the Treasury's expenditures; if not justified, it would inexorably push the Treasury into inflation.

The *impasse* system, by virtue of the unconditionally factual nature of its premises, thus implies acceptance of inflation as the proper cushion of the Treasury and as the ultimate means of financing the public expenditure.

The dangers of the *impasse* system are placed in a clear light by the manner—far divergent indeed from the principle—in which it has been applied.

The objective of confining the amount of the

² "Circuit," describes the return of the Treasury of part of the monies created by inflation (mainly by subscription to Treasury bills).

impasse, not within the uncertain limits of possible, but within those of the probable, resulted in causing the Bank of France directly and automatically to finance a fraction of the housing expenditures rendered unconditional by Treasury backing. This mechanism, which involved rediscounting the medium-term paper representing the corresponding loans, served for the financing, outside the *impasse*, of unconditional commitments that would have increased its amount. It had the effect of creating, over and above advances to the State, a source of inflation that yielded 203 billions in 1956 and 159 billions in 1957. The sum total of medium-term paper rediscounted for construction by the Bank of France in this way became 674 billions on October 31, 1958.

We believe that the *impasse* system, however laudable the purposes that prompted its adoption, is dangerous because it leads to reliance on loan receipts, problematical by nature, for the financing of unconditional charges. Through this effect, it greatly weakens respect for financial equilibrium in the mind of government agencies.

We do not at all mean to bar the financing of some part of investments by loan, but as we do wish to bar elasticity through inflation, we think it is essential to establish a budgetary system ensuring and requiring that all unconditional commitments of the Treasury, whether arising from current needs or investment programs, shall be met by the unconditional resources derived from fiscal levies.

Any commitment to expenditure in excess of the amount of fiscal revenue should have the same con-

ditional character as the resources from which it is to be financed.

Certainly no system of budget presentation can in itself prevent deficit if the public power is not firmly resolved against it. Nevertheless, we consider that reform of French finances requires elimination of the risk that the *impasse* system has introduced. In section a) of our Specific Recommendations (Chapter IX), we propose a method that, without abandoning the desirable features of the *impasse* system, should in our opinion restore the insistence upon balance without which no financial structure can endure.

VI. MAGNITUDE OF THE PROBLEM OF FRENCH FINANCES

The problem of French finances is outlined in the table on the opposite page, which assesses the several factors involved in the determination of the *impasse*.

A number of comments may be made on this tabulation.

It appears that the Budget "proper" shows a surplus in 1958 of about 90 billion francs, despite the extraordinary burdens resulting from the situation in Algeria.

Specifically, the budget includes 1444 billions in military and 1352 billions in civil expenditures, 341 billions in economic programs (representing 48 billions in agricultural subsidies and the balance of 293 billions substantially in subsidies to keep certain prices or rates below the level to which inflation

would have brought them), and 781 billions in "other programs," primarily welfare programs.

In the circumstances, the surplus of the Budget "proper" bears witness to France's fiscal achievement. It indicates the unfairness of criticisms abroad that have represented France as a country of financial abandon.

Still, unless remedial action were taken, the situation would deteriorate in 1959. Estimates made by simply applying 1958 expenses plus automatic increases would then indicate, not a budgetary surplus, but a deficit of around 250 billions.

But the Budget "proper" represents only part of the burden upon the State. Section II of the table, entitled "lending operations," shows that the Treasury carries unconditional lending obligations besides. The balance of this section II for 1958 is 535 billions, not including 43 billions for Posts, Telegraphs and Telephone investments. Also, it is to be noted that this total does not include the increase in medium-term paper outstanding in the amount of 100 billions for construction and 50 billions for investments of nationalized enterprises.

The tabulation also shows that for 1959, the anticipated balance of lending operations becomes 722 billions and the amount of the *impasse* 1133 billions, not including 50 billions in PT & T investments nor 50 billions in increased medium-term paper outstanding for national enterprises.

The *impasse* in the past, since the system making use of it was introduced, has been:

668 billions in 1952

652 billions in 1953

664 billions in 1954
 662 billions in 1955
 1004 billions in 1956
 1041 billions in 1957

If these figures are increased by the amount of unconditional investments not included in the *im-passe* as conventionally understood, we obtain totals of 1312 billions in 1956 and 1301 billions in 1957.

Now the fact is that in recent years, the Treasury, despite all endeavors, has never succeeded in obtaining such sums from saving public.

Treasury loans during the past five years are recapitulated in the following table:

SOURCE OF TREASURY RECEIPTS					
	1953	1954	1955	1956	1957
<i>I. Savings Drive</i>					
Loans from the public	23	73	91	403	84
Form Treasury Bonds	94	138	139	107	107
Total I	<u>117</u>	<u>211</u>	<u>230</u>	<u>510</u>	<u>191</u>
<i>II. Sundry Receipts</i> (corresp.)	<u>278</u>	<u>289</u>	<u>338</u>	<u>314</u>	<u>219</u>
<i>III. Monetary Resources</i>					
Treasury Bonds held by bank system	76	63	28	117	11
Postal checking & private deposits	52	85	69	119	43
Advances from the Bank of France	228	— 65	—111	—71	452
Sundry	— 99	81	108	15	125*
Total III	<u>257</u>	<u>164</u>	<u>94</u>	<u>180</u>	<u>631</u>
Total I+II+III (equal to <i>im-passe</i> burden to be financed)	<u>652</u>	<u>664</u>	<u>662</u>	<u>1004</u>	<u>1041</u>

* Including resources deriving from International Monetary Fund.

This table shows that the savings drives never

"IMPASSE", 1958 AND 1959 (billions of francs)

	Item	1958 Finance Act 1	as at October 1958 2	1959 (estimated October 1959) 3
I. The Budget				
A. Expenditures				
Public debt.....		444	445	477
Government agencies and (civil) service.....		1,323	1,352	1,503
Economic programs.....		282	341	434
Other programs.....		768	781	884
War claims.....		165	165	180
Administrative investments & capital grants (civil).....		393	407	443
Military expense.....		1,326	1,444	1,555
Expense on receipts realized (net).....		9	17	17
Total (A).....		4,710	4,952	5,443
B. Receipts				
Fiscal & sundry revenue (excl. loan repayments).....		4,637	4,887	5,032
Receipts of autonomous fund allotted for amortization.....		156	156	156
Total (B).....		4,793	5,043	5,188
Receipts less expenditures (Budget).....		+83	+91	-255

II. Lending Operations of All Kinds

A. Expenditures

Loans by administrative services (B.R.E.) ¹	112	118	111
Nationalization & assimilation loans (F.D.E.S.) ²	233	233	300
Loans to H.L.M. ³	155	175	175
Consolidation of loans to construction.....	54	54	170
Commercial accounts & accounts prepaid (net).....	32	14	54
Total (A).....	586	594	790

B. Receipts

Loan principal repayments.....	59	59	63
Receipts less expenditures (Lending Operations).....	-527	-535	-722
Total Impasse			

Total expenditures.....	5,296	5,540	6,233
Total receipts.....	4,852	5,102	5,256
Net State indebtedness.....	444	444	977
Released to Independent Amortization Fund.....	156	156	156
Impasse	600	600	1,133

III. Public Liabilities Not Counted in "Impasse"

Posts, Tel. & Tel. investments financed by public loans or special credits.....	43	43	50
Investments financed directly, outside of <i>impasse</i> , by Bank of France or other Treasury resources:			
• Special loans to construction.....	100	100	memo
• Loans to nationalized enterprises.....	50	50	50

¹ Budget of Reconstruction and Equipment

² Economic and Social Development Fund

³ Habitations à Loyers Modérés (Low-rental dwellings).

covered more than a fraction of the Treasury's unconditional commitments during these years.

We are thus brought to the conclusion that under present conditions, the capacity of the Treasury to float true loans, financed by savings and not by inflation of credit, is well below 600 billion francs.

The results forecast for the year 1958 confirm this indication. To date of November 1, 1958, the Treasury had secured 293 billion from savings in long-term loans and about 74 billions in form issues of Treasury Bonds.

Government auditors estimate gross family savings at 1242 billions for 1957 and 1545 billions for 1958. But only part of these savings reach the market, the rest being applied to direct real or personal investments.

The State cannot be the only borrower in the market; it must give room to private enterprises and also to national enterprises for such part of their investment as is not financed out of public funds; thus for national enterprises alone, the total of direct issues is estimated at 150 billions in 1959.

The behaviour of savers as to the portion of their income they will spend or invest directly in actual goods depends of course on the attractiveness of the financial opportunities offered them; and in particular on their confidence in these, but most of all on their notion of the monetary situation. The choice is always open between more radio or television sets, more cars, and subscription of securities for purposes of old-age income or to set the children up in life.

There would seem to be no way to determine

accurately the margin of increased savings that would result, through lessened monetary uneasiness, from diminished consumption. However, one need visualise the honor roll of the thrifty in order that, though not limitless, it must be substantial—certainly some hundreds of billions.

Yet this margin of increase is trifling compared to what would follow from the least change in hoarding, whether of gold or foreign currency.

The movements of capital resulting from payment for exports or collection for imports are capable, as experience shows, of wide variations. But it is chiefly from credits accumulated abroad and from the stock of gold held in France that major changes can be hoped for in the resources of the financial market.

No one knows the extent of that stock. It is sometimes put at several thousand tons. It is beyond doubt very great. Investment of a small share of it in French securities would substantially expand possibilities of issue on the market, and would, other things being equal, contribute decisively to the solution of our investment problems.

It was these movements of capital that once made possible the Poincaré “miracle.” We certainly need it more in 1958 than we did in 1927. It is up to us to bring it to pass again.

VII. FINANCIAL REFORM NEED NOT SACRIFICE INVESTMENT TO CURRENCY

Proposed financial reforms—most especially those tending to reduce the *impasse* to the level of finance potentially—always arouse criticism and misgivings

among those who object to "sacrificing investment to currency."

We can reassure them. The program of reform we have drafted is not to sacrifice investment but on the contrary expand it.

In the first place, supposing no change as to the supply of saving on the market, reduction of the burden on the Treasury will to that extent increase the amount of resources available for investment.

But as was shown in the proceeding chapter, the supply of savings on the market—whether deriving from the current savings or from savings previously hoarded—is by no means unchangeable. It is controlled by individual decisions, and especially by the response of savers to the monetary outlook.

The recent activity of the French exchequer and foreign currency reserves is significant in this connection. Without noticeable change in the objective situation, the change in psychological climate has sufficed to transform a difficult position into a state of affairs which is on a path of steady improvement.

This transformation is a repetition of what happened in 1952, in 1938, and on many previous occasions.

If the expectation of inflation creates the conditions for its onset, conversely the expectation of stability creates the conditions for stability.

It may be stated almost with certainty that reproduction of the squeeze to the level of potential financing will promptly bring abundant repatriated capital into the financial market, lower all interest rates—especially long-term rates—significantly, and thereby expand the capacity for public or private credit.

At present, concern for lessening the deficit in public finances takes the form of penurious restriction on the amount of investments undertaken by the Treasury. And yet that amount is never limited sufficiently to arrest the process of progressive deterioration characteristic of inflation; the limitation is sufficient, though, to prevent contemplation of all the increased investments that the present situation requires.

A chasm yawns between the jealously restrained and hotly debated investments we appropriate to plans of modernization or to housing construction programs, and the recovery that would be made possible by restoration of a real money market.

All past experience goes to show that so far from sacrificing investment, an end to inflation would call forth those financial resources essential to the happy accomplishment, without glum negation, without paralyzing distinctions, of the tasks with which circumstances are confronting France.

VIII. PRINCIPLES OF A REFORM STRATEGY

The duty to place France's investment capacity on a level with present exceptional requirements calls for a reform strategy on principles as listed below.

a) *Relieving inflation by saving.* Under the present system, inflation represents all that portion of Treasury expenditure—current expenses and investment expenses—which is covered neither by taxation nor by savings.

If investment is to be increased and inflation stopped, there is no alternative, after current ex-

penses have been reduced to a minimum and fiscal revenues raised to a maximum, but to increase the supply of savings offered to the Treasury as much as possible.

The point is not to return to the policy—too often appealed to—of confidence, but to create the technical conditions apt to favor an ample influx of savings on the market.

b) *Breaking the inflationary cycle.* The French position is summed up in the following statement:

We have inflation because there are not enough savings on the market; and there are not enough savings on the market because there is inflation.

The problem is to get out of this vicious circle.

c) *Establishing a certainty that the inflationary process is over.* This is the essential requirement of any reform program.

The way to meet it is to create a situation of certainty that the public expenditure will in no case exceed the cumulative sum of receipts from taxation and savings.

d) *Substituting elasticity by investment for elasticity by inflation.* Elimination of inflation entails two conditions:

That the whole of the Treasury's unconditional expenditures be met by unconditional receipts;

That the amount of any expenditures not covered by unconditional receipts be at all times geared to receipts realized from savings during the same period.

When these conditions are met, the tap of inflation will have been turned off tight.

Of course, it would be out of the question for

the Minister of Finance not to have the power and responsibility of deciding the nature and extent of appeals for public savings in terms of the condition of the market.

However, we would note that, as set forth in the specific recommendations under IX, section *a*), "conditional" status would remain theoretical and could be lifted at the beginning of the fiscal year as long as the amount of appeals to savings remained within the limits set by application of our recommendations as a whole.

On the other hand, if the amount of expenditures to be met by loan should exceed that of the resources anticipated from savings, conditional status would again become essential as the only effective bar to inflation.

Loans could be floated either directly by the Treasury, or by the actual recipient of the investment credit. In all cases, financing by the Treasury of an investment not included in the unconditional budget would be contingent on the possibility of securing resources in a like amount from savings.

It should be borne well in mind by the Minister of Finance, or by the head of the Government, that under this plan, conditional status does not imply abandonment but on the contrary tends to bring the possible amount of investment to a maximum.

e) Averting the danger of renewed inflation.

The risk involved in a policy towards reduction of expenditures and increase of receipts is that in so far as it entails withdrawal of subsidies, withdrawal of exemptions, or increased taxes, it may result in rising prices.

Such a rise in turn, either through change in the index underlying the basic minimum wage, or through renegotiation of collective bargaining agreements, or generally through interplay of the numerous French index systems, may result in wage or income increases themselves giving rise to new price increases, new deficits, and hence renewed inflation.

The Commission is not unaware of the danger of such a "runaway" process. Failure to estimate it correctly has been the downfall of most of the reforms hitherto attempted.

It is a fact that the measures recommended may result in some price movements that would affect the basic inter-occupational minimum wage level.

The Commission sees this effect as desirable rather than undesirable, since it would mean that the lowest standards of living—those to be regarded as near the subsistence level—were being protected as much as possible from the impact of the remedies proposed.

But a rise in the minimum wage must remain what the law intended that it should be—a safeguard, for social ends, in favor of the lowest-paid workers, and not the entering wedge for a proportionate rise in the entire wage structure.

In the past, the basic minimum wage has often carried the whole scale of remunerations for services with it, employers having nearly always been able to pass on the increased costs incurred to consumers, without advantage to the wage worker.

They were able to do this because, as the price scale was not tied to any fixed point, every increase

in cost resulted in a general price shift, automatically confirmed by the increased monetary circulation it required.

To avoid any risk of this runaway process, the contemplated program must be placed from its inception in a setting of actual monetary convertibility, capable of being promptly superseded by legal convertibility at the same level.

This conclusion requires:

A return to the policy of liberalizing international trade which the shortage in our balance of payments compelled us to discontinue;

Performance, as already enacted, of the obligations arising from the Common Market treaty; Affirmation of convertibility of the currency for commercial purposes within the scope of the "de-control" provisions above mentioned;

A solemn declaration by the Minister of Finance or the head of the Government, stating the Government's determination to restore a pattern of true monetary convertibility as quickly as possible;

Elimination wherever possible, as outside pressures upon prices become re-established, of economic controls; enforcement personnel may well be transferred, or reassigned, to the service of the Division of Revenue.

Incidentally, the Commission finds no cause to forestall possible repercussions of the proposed reforms by any change in the establishment of budgetary credits or evaluation of receipts.

f) Providing and preparing to fight against recession. Since the spring of 1958, the pace of ex-

pansion of the French economy has slackened. In a few areas, in fact, activity has decreased. This development is similar to that which other major western countries have experienced, though somewhat earlier in most cases.

This economic slackening of speed is not to be wondered at. Growth cannot be unremitting, particularly if rapid, because of the adjustments to which a growing production apparatus is necessarily liable. These adjustments, which in collectivist economies take the form of drastic overhauls of five-year plans, express themselves in market economies through alteration of investment programs. The changes ultimately tend towards better utilization of national resources. Unavoidably, they slow down certain activities temporarily. What matters is that the adaptations must not inflict needless damage upon the economy. Productive capacity must not lie idle beyond the point where its prudent utilization becomes possible. Unemployment is not a social scourge merely; any lasting underemployment of the productive apparatus represents a real loss of wealth; for by aggravating fixed expenses, it raises unit costs of production.

But it would be most dangerous, in the present condition of the French economy and in view of the great tasks ahead, to ward off possible recession by a new spree of consumption. If total demand became inadequate, it should be for investment to bring it in line with supply.

And if an enlargement of investments became necessary, the material and psychological facts of the French position, marked by half a century of

inflation, should forbid any supplementary deficit financing to generate purchasing power.

Happily, the recommended policy will expand the volume of possible financing through savings.

Should it appear that some of the resources thus made available were not being used for want of inclination to invest, this threat would be easy to remove. Nationalization and the practice of concerted action between private enterprises and public agencies have given the latter much influence on the volume of investment.

In the sectors of future promise, therefore, there should be immediate planning and detailing of remunerative supplementary investment programs that can be put into prompt execution. Such programs would be financed by any unemployed surplus of savings. The investments thus made, through the resulting distribution of income, would open new outlets for the consumer-goods industries, whose recovery would thus be the fruit of sound policy rather than the seed of fresh imbalances and perturbations of the balance of payments through inflation.

g) Rehabilitating our economic institutions.

Whatever vigilance the present business situation may require, it can detract nothing from the necessity and urgency of a long-term effort to restore the soundness of the economic structure.

This endeavor will expand the productivity of France's economy by purging it of Malthusian devices born of a long history of unbridled protectionism, countless surrenders to special if not private interests, and the consequences of inflation.

The undertaking would be mandatory in any case. The imminent opening of the Common Market renders it pressingly urgent.

It will put an end to the dissipation of productive forces through lingering of obsolete enterprises, deficient utilization of existing plant, and duplication of investment. The action called for must be worked out in terms of the concrete situations, but it cannot be properly taken until these situations have been cleared of distortions due to subsidies, tax privileges, or operation of actual or virtual monopolies.

Efficiency likewise demands elimination of the waste resulting in some fields from poor coordination between the public and private components. The harm done is especially apparent in the field of transportation, through competition between the S.N.C.F.³ and private highway and waterway carriers, as well as in the field of health, through rivalry between public hospitals and the clinics under social security contract or accreditation.

Fiscal reform will be one of the chief means to this rehabilitation.

In order for a fiscal policy to control the causes of inflation, it must be armed with a system of direct levies with a broad base and of a nature to minimize legal evasion and fraud. These levies must not unduly favor certain kinds of enterprise, their rates must be capable of change as required to correct tendencies giving rise to excess or deficiency of private demand.

³Société Nationale des Chemins de fer Français (French National Railways).

Direct taxation should include real base levies as well as graduated personal taxes. With the aim of encouraging the habit of saving, consideration should be given to pairing the graduated over-all income tax, the rates of which would be reduced, with a graduated tax on expenditure, likewise with a feature of allowance for dependents.

At all events, proper measures are needed to permit more precise and more complete assessment of taxables. The most urgent, subject to the findings of further inquiry, would relate to farm and business earnings. They are outlined in Appendix IV.

h) Reforming the administration. The Commission, in the time at its disposal, has not been able to make a detailed study of the operation of the public services. It is nevertheless convinced that there is much room for improvement, in the civil as well as in the military ministries, and that such improvement should pursue three aims: lessened expense, increased administrative efficiency and speed, and simplified relations with the persons affected.

In the past, repeated attempts in this direction have been disappointing. There are certain lessons to be learned from their unsuccess.

Budgetary procedure is not the means by which real economies are affected. It must usually confine itself to taking the expenses of agencies as they are and adding the automatic increments due, for example, to salary increases; budgetary debate is therefore concerned only with new measures as a rule.

It is true that committees have at various times been assigned to draw up plans for reform within

a few months or so. But their work has always been hampered by time limitations, and often their findings have not received due consideration.

Remedial action calls for perseverance, persistence and firmness. It cannot bear an immediate financial return, if only because absorption of surplus staff must take place gradually as vacancies occur.

In view of this fact, we have felt that budgetary realism would admit of no allowance for administrative reform in forecasting 1959 expenditures. But if the housecleaning we recommend is undertaken without delay, it may help greatly in following years to check the hitherto chronic ballooning of public spending and to balance the budget.

Reforms must be studied, planned and carried out on three different levels:

1. The structure of the central authorities should be revised. Their present functions frequently overlap, so that matters wander through office after office before action can be taken by the minister or ministers concerned. The duties of every bureau, division and ministry should be defined. There should be abolition or fusion where duplication is found. It is probably on this level that the quickest economies can be secured, and those to which public opinion will be most responsive.

2. The territorial subdivision of administration should be completely recast. Having undergone no change to speak of since the beginning of the nineteenth century, it reflects none of the profound changes that have occurred in the economic and human geography of this country in the last century and a half. Unavoidable adaptations have

nearly always been made by creating new entities, while omitting to abolish those rendered superfluous. The diversity of administrative, judiciary and military districts has become bewildering to the public.

3. Finally, within each administrative department, these over-all reforms should be supplemented by thoroughly overhauling all details of operation. In particular, there should be a systematic effort to get rid of unnecessary formalities and to master the new possibilities daily afforded by advances in management techniques.

To implement the program sketched above, the Commission suggest the following procedure.

It is believed that the reforms under groups 1 and 2 (ministerial structure and territorial organization) call for action emanating from the Government. They should be worked out by small teams made up of the members of the Council of State, the Court of Audit and control bodies.

As to the reform under group 3 (internal administrative operation), the Commission, following the method that has proved its worth in well-run industrial and business organizations, recommends establishment of an organizational office within each ministry. It would conduct its inquiries in cooperation with the services concerned. It could only gain, we believe, by consulting private specialists, and by including representatives of the financial administration. Above all, however, we would wish that its work be followed closely by a high official empowered by his minister to take necessary action promptly.

The Commission attaches such importance to this reform effort that we believe its coordination should be assigned to a member of the Government.

i) Making social policy effective through orderly finances. The program we are submitting is drastic. We nevertheless do so, in the conviction that there can be no effective social policy in financial disorder. Only a stable currency and sound economic institutions can make possible either an improved standard of living or the redress of inequities and injustices.

To the illusion of liberality in inflation, we prefer a real policy of fairness and well-being in stability. Our program will bring this about, and that is not the least consideration in its favor.

IX. SPECIFIC RECOMMENDATIONS

Implementation of the strategy set forth in the preceding chapter requires numerous reform measures—in law or in fact—which are described below.

a) Presentation and balancing of the budget. The essential point is to re-establish the imperative of balance in French finances.

To this end, the Commission proposes presentation of the budget in two separate divisions.

The first division, entitled "Budget of Public Receipts and Expenditures," will comprise:

Under expenditures, the whole of the current expenses of the State as well as non-income-bearing investments which, by their purpose, share the nature of public expenses and could not be covered by market issues in the absence of State intervention. In application of this principle, credits relating

to "Loans by administrative services (B.R.E.)" and to "Loans to H.L.M." have been transferred to the Budget of Public Expenditures.

Under receipts, the taxes and sundry revenue.

These receipts must at all times suffice to meet the public expenditures above mentioned. As soon as any fiscal deficiency is found, as soon as any additional expenditure is decided upon, new levies or economies must ensue.

The second division, entitled "Budget of Income-Bearing Loans," will comprise under expenditures the loans granted for income-bearing investments authorized by the Treasury.

With respect to these loans, the Treasury acts as intermediary, something like a bank, in a position, when the borrowers cannot conveniently act on the market, to process the credit operations necessary for financing.

In application of this principle, the Budget of Income-Bearing Loans will include "Loans to nationalized and assimilated enterprises (F.D.E.S.)" and "Commercial accounts & accounts prepaid."

But if it is desired to end Financing by the Bank of France through rediscounting of medium-term paper representing loans for which the State assumes responsibility, this must be replaced, on pain of diminishing the corresponding investments to that extent, with Financing through savings instead of through inflation.

For that purpose, we ask that loans to construction granted beginning January 1, 1959, under Act of July 21, 1950, be financed directly by the Treasury.

Outstanding medium-term loans to nationalized enterprises would be ceilinged at the present level. The added resources now expected from expansion of this level would be replaced at need by direct Treasury campaigns.

The credits provided for these purposes in the 1959 Budget of Loans are 170 billions for construction and 50 billions for nationalized enterprises.

No change is to be made in medium-term credits granted to private parties.

A budget tabulation drawn up in accordance with the principles stated above appears under *e*), page 167.

That tabulation shows the amount of resources to be obtained from savings in 1959 will be 445 billion francs. Again, it is to be noted that the financial market will have been supplied to the extent of 156 billion francs by repayments effected by the Independent Amortization Fund. Hence the anticipated net indebtedness of the State for 1959 will be only 289 billion francs.

The Minister of Finance will continue to control the timing and the nature of the corresponding issues, and can in fact reduce or omit certain loans if he believes the market will not yield the necessary resources.

In order that there may be no need for this expedient, it is essential that the Budget of Loans be at all times less than the volume of loan obligations that can be placed on the market. The Commission sees observance of this requirement as the key to financial reform. To omit it would take away all realism from the recommendations as a whole.

It is believed that the figure of 448 billions representing the amount of loans included in the 1959 budget and corresponding to a net indebtedness of 289 billion francs will conform to the requirement stated above, and can safely be covered by appeals to savings. To reach that figure necessitated a reduction of 688 billions in the *impasse* forecast in October 1958, when the Commission began its work, for the fiscal year of 1959.

We proceed to outline the reforms by means of which the 1959 budget is to be balanced.

b) *Reduction of "Economic programs."* Economic programs for 1959 comprise direct or indirect subsidies to agriculture (56 billions) or industry (23 billions), subsidies to foreign trade (57.6 billions), subsidies to lower prices of sundry food products (chocolate, preserves, pastes, rice, milk, in the Paris area, breads, semolina) (29.7 billions), subsidies to lower freight tariffs (196 billions), or coal prices (51 billions), and finally subsidies to construction (50 billions).

The fact of these subsidies is the most ominous feature of French finances, and presents the most difficult problem for any reform program. It shows that in France, many basic prices are below—often very considerably below—cost of production. Chocolate, for example, brings in only 73% of its value from its consumers. The difference is made up out of the common resources of the nation.

Similarly, preserves, pastes, rice, bread, semolina, are in large part paid for by others than the consumer.

This is a serious situation, responsible for a

large share of the deficit and causing dislocations in the economic structure. No reform effort is conceivable without sharp reduction of economic subsidies.

The Commission has reviewed all of these items of subsidies. Its proposals are presented in Appendixes I and II. Their adoption would cut down the deficit by 192 billions.

Incidentally, the Commission recommends revision of certain rate scales to facilitate self-financing of investments by public enterprises. Such revision is considered particularly necessary for the enterprises engaged in rapid growth, such as the *Electricité de France*, and the Posts, Telegraphs and Telephone (cf. Appendix V).

c) *Reduction of "Other programs."* "Other programs," appearing at 768 billions in the 1958 budget, consist of 637 billions in social programs as listed below, to which must be added programs carried out with receipts realized, bringing the total from 637 to 820 billions.

With respect to these disbursements, the Commission recommends detailed changes set forth in Appendix III. Their adoption would reduce the budgetary burden of State social programs by 166 billions.

d) *Fiscal arrangements.* French finance is honey-combed with special exceptions and exemptions. The burgeoning of exemptions results from surrender of the public authorities to pressure from private interest, always in the guise of the public interests.

Restoration of French finance requires subjection

of all private interests to the general rule. If privileges must be allowed to certain categories of citizens, they should be expressly and manifestly granted through subsidies exposed to the hard light of budgetary debate.

However, it would be unwise to regard as exemptions those provisions which, while favouring certain of those affected, are part of the structure deliberately and lawfully intended for the fiscal system. Thus allowance for dependents, often called an exemption, is an integral part of the system of graduated surtax.

Appendix IV lists the exemptions which the Commission recommends be discontinued, together with simplifications, rate adjustments and measures necessary in its opinion to improve returns.

Adoption of these recommendations will diminish the 1959 deficit by 330 billions.

The Commission has not proposed any rise in rates of graduated surtax, as the rise in nominal incomes due to rising prices has the effect, without amendment of schedules and owing to the graduated feature, of automatically increasing the incidence and yield of this levy, which yielded 328 billions for 1957 and will yield about 530 billions for 1959.

e) The 1959 *budget*. In Chapter VI above, we showed the 1958 and 1959 budgets, the latter as anticipated in October 1958 when we began our work, in the form leading to determination of the *impasse*. The *impasse* as anticipated at that date was about 1150 billions.

On page 169 we tabulate the same 1959 budget in

the form we suggest, before and after application of the reforms proposed in the preceding sections.

This table shows that after application of these proposed reforms, the first division of the 1959 Budget (Budget of Public Receipts and Expenditures) will balance, while the second division (Budget of Income-Bearing Loans) will be 448 billions short.

Hence the amount of sums to be borrowed in 1959 (combined balance of 1st and 2nd divisions of the Budget) will be 445 billions.

But in the year 1959 the Independent Amortization Fund will repay prior loans to the extent of 156 billions.

Therefore the net indebtedness required for 1959 will be only 289 billions.

The adjustment that would result from adoption of the reforms proposed in this report would extend and consummate that achieved in 1958.

To see how far we have come, we may compare the year-by-year cumulative amounts of the net State indebtedness and of the increase in outstanding medium-term paper backed up by the State for construction and nationalized enterprises. This amount was 1158 billions in 1957 (1041 billions *impasse* less 129 billions amortization, plus 40 billions PT&T loans plus 144 billions medium-term construction plus 62 billions medium-term nationalized enterprises).

In 1958, the amount will be 637 billions.

Application of the recommendations of this report would reduce it to some 300 billions in 1959.

f) Measures regarding foreign trade. The meas-

SOCIAL PROGRAMS (millions of francs)

	Title IV Part 6	Title IV Part 7	Budgets Append.	Non- Budget	Title VIII	Over-All Total
Regular assistance.....	85,386	..	..	..	..	85,386
Combat veterans.....	285,964	..	..	..	..	285,964
Old-law social security.....	..	50,775	..	..	..	50,775
Social security.....	148,772*	1,072	..	..	..	149,844
Farm social security.....	..	..	149,294	14,300	19,050	182,644
Miscellaneous (preventive).....	..	..	..	..	..	..
• Rate reduction, pensions, unemployment.....	54,514	11,050	..	..	..	65,564
	<u>574,686</u>	<u>62,897</u>	<u>149,294</u>	<u>14,300</u>	<u>19,050</u>	<u>820,127</u>
	687,483					

* Including 140 billion for over-all system.

1959 BUDGET ANTICIPATED OCTOBER 1958 (billions of francs)

<i>I. 1st Division—Budget of Public Receipts and Expenditures</i>			
	Before Application of Proposed Reforms	After	Difference
<i>A. Expenditures</i>			
Public debt.....	477	477	..
Government agencies and (civil) service.....	1,503	1,503	..
Economic programs.....	434	242	192
Other programs.....	834	668	166
War claims.....	180	180	..
Administrative investments and capital grants (civil).....	443	443	..
Loans by administrative services (B.R.E. ¹).....	111	111	..
Loans to H.L.M. ²	175	175	..
Military expense.....	1,555	1,555	..
Expense on receipts realized.....	5	5	..
Total.....	5,717	5,339	378
<i>B. Receipts</i>			
Fiscal and sundry revenue (excluding loan repayments).....	5,092	5,362	270
C. Balance, Public Expenditures Budget.....	-685	+ 3	688

II. 2nd Division—Budget of Income-Bearing Loans

<i>A. Expenditures</i>		
Nationalization and assimilation loans F.D.E.S. ³	300	250
		-50

x financing of resources formerly obtained by direct discounting of medium-term paper to the

Bank of France:

—For nationalized enterprises.....	..	50	+50
—For construction.....	170	170	..
Commercial accounts and accounts prepaid.....	46	46	..
Total.....	516	516	..

B. Receipts

Prior loan principal repayments.....	68	68	..
C. Balance, Income-Bearing Loans Budget.....	-448	-448	..

III. Sums To Be Borrowed

Sum of balances, Public Expenditures and Income-Bearing Loans budgets.....	1,138	445	688
Autonomous amortization fund.....	156	156	..

IV. Net Indebtedness of State.....

977 289 688

Memo:

V. Public Liabilities Not Counted in "Impasse" (cf. table, Chapter VI)

Posts, Telegraph and Telephone investments financed by public loans or special credits.....	50	..	-50
Investments financed directly by Bank of France or other treasury resources:			
—Special loans to construction.....	..	..	..
—Loans to nationalized enterprises.....	50	..	-50

¹ Budget of Reconstruction and Equipment

² Habitations à Loyers Modérés (Low-rental dwellings)

³ Economic and Social Development Fund

ures suggested in this report will not be innocuous to economic equilibrium nor have their full effect on the financial market unless the French economy is restored to contact and communication with the outside world. In fact, we have no choice; honoring our international commitments will entail inexorable imperatives. At the beginning of 1959, these are:

Under the Common Market treaty, a 10% reduction of customs duties and enlargement of quotas, which in each branch of the economy may not be less than 3% of domestic Production;

In accordance with commitments made to the OEEC, return to the level of exchange decontrol in effect prior to the restrictions imposed in 1957.

The Commission views these measures as a minimum which it would be desirable to surpass, especially as regards exchange decontrol. They are expected to exert a wholesome pressure upon prices, indispensable at a time when they will be affected—and that in the opposite direction—by the reforms contemplated.

In the sphere of the tourist trade, re-establishment of an allotment to travellers going abroad is desirable. Its ultimate cost in foreign currency probably would not exceed the indirect burden imposed, for support of the franc, by tourist exportation of French money.

Finally, to maximize the repatriation of capital expected from the proposed policy, the financial transfers through which it must take place should be facilitated. To this end, the Commission recommends maintenance and strengthening of the system enabling French residents to negotiate foreign se-

curities and encouraging foreign capital to invest in the French economy. In particular, an attempt must be made to introduce French securities on foreign stock exchanges and to give non-residents ampler opportunities to trade on the Paris market, specifically the option of exporting French bearer securities.

The importation of capital to be stimulated by these measures will largely offset the repercussions of the above-mentioned exchange decontrol policy on the balance of settlements.

Application of the recommendations embodied in this chapter will constitute a major step towards convertibility.

g) Measures regarding index systems:

1. The S.M.I.G.⁴

The institution of a guaranteed interoccupational minimum wage linked to the 179-commodity index should be retained, as it protects the lowest-paid wage earners from the harsh consequences of a rise in their cost of living.

While the recommendations of this report are being implemented, any change in the system as now in effect should be avoided, especially as to mode of determination and periods of adjustment of the index, since any change might be interpreted as a manoeuvre tending to strip certain groups of workers of the safeguards provided for them just at the time when they would have come into play.

This consideration does not mean that later on,

⁴Salaire Minimum Interprofessionnel Garanti (Guaranteed interoccupational minimum wage).

after thorough study of the technical possibilities, it might not be desirable:

To replace the 179-commodity index, which takes account only of prices quoted in Paris, by a nation-wide index based on prices found throughout France proper. In the present state of affairs, it is anomalous that the price of public transportation in Paris, for example, should have any major effect on determination of the minimum wage in the provinces;

To adopt a method of calculation such that accidental and temporary fluctuations of certain prices, for example as a result of a poor crop, would not have the effect of permanently raising the guaranteed minimum wage. Consideration might be given to a formula which, in computing each monthly average, would exclude the prices of items suffering the widest fluctuations. For it is inappropriate that a permanent rise in the S.M.I.G. should result from one night of frost threatening the year's vintage.

2. The wage structure.

A rise in the S.M.I.G. must be prevented from resulting automatically in a rise of the entire wage structure. For if the national output does not provide the equivalent, in consumer goods, of such a rise, the latter will unbalance foreign trade and, before long, raise domestic prices, canceling out the benefit of the increase in nominal remuneration for those concerned, and recommencing the inflationary cycle.

A provision of public policy should be enacted to nullify any clause of a charter or contract having

the effect of automatically adjusting remuneration in proportion to changes in the S.M.I.G., any cost-of-living index or the general price level. Under such a provision, all wages higher than the S.M.I.G. would be set by negotiations conducted within the scope of the regulations in force, with regard to the financial capacity of the industry or enterprise concerned, as is already the case in most fields.

This measure would in particular alter the terms upon which the wages of miners are arrived at. When it is adopted, inquiry should be made whether the benefits—imaginary in some respects—of automatic variation cannot be replaced by effective safeguards against the hazards of under-employment, particularly acute in the mining industry.

3. Farm target price indexing.

This index system is intended to ensure that the purchasing power of farmers will not be drastically reduced by a rise in the prices of goods and services necessary to agriculture.

Without calling this aim into question, the Commission feels that rural prices and, in the case of products whose prices are set by comparison of market supply and demand, supported floor and ceiling prices, should take more account of the quantities harvested or produced. For this purpose, the Act of May 16, 1957, and Executive Order of September 18, 1957, should be amended to permit greater price flexibility. Widening of the margin of fluctuation would permit a more equitable division between producers and consumers in sharing the

benefits of abundance due to favourable weather conditions or technical advances in agriculture.

As to the target prices themselves, as fixed in 1957 they promise continual rises in francs that might have major repercussions on economic equilibrium. The price of beef, for example, will in 1961 be 25% above its 1957 level. The Commission asks that a study be made of the prerequisites for bringing such prices into line with a lasting economic equilibrium. Inquiry should in particular be directed towards reducing costs of merchandising and towards rationalizing the channels of distribution.

X. CONCLUSION

Our plan will be difficult to carry out. It affects many interests and will arouse vigorous opposition. We nevertheless present it in the conviction that the country must choose between a thoroughgoing reform to restore lasting stability and a resumption of the process of deterioration which, a few months ago, faced France with the irremediable consequences of exhaustion of her foreign exchange reserves.

Almost all of our neighbor countries have solved their finance problem. We will not accept the idea that France alone, in all of Europe, cannot do so.

But the plan we have to offer is an entity. Though some of its features may be modified, it will not lend itself to partial adoption. One does not half-rebuild an edifice that is crumbling. Either we shall in a matter of weeks restore the balance of French finances by strictly limiting public expenditures, come what may, to the amount of fiscal revenue,

and income-bearing public credit to a level below assured resources available from savings, or we shall awaken to the same situation that lately compelled us to go abroad for means of perpetuating a state of affairs incompatible with the dignity of France.

In order for our plan to succeed, it is essential that the country realize there is no acceptable alternative. We ask that the most authoritative spokesmen explain, in the full light of day, the seriousness of the impending dangers and the imperious necessity for immediate and total remedy.

If this is all accepted, all will be well.

If it is not, the country will find its survival once more jeopardized, and face eventualities threatening alike to its greatness, welfare and freedom.

Paris, December 8, 1958.

Signed: Rueff,

Alexandre, Brasart, Gignoux,
Guyot, Jenneney, Lorain,
Saltes, de Vitry.