

**International Liaison Committee on
Co-operative Thrift and Credit**

**Report of the Study Group on
"How to Save the Savings Against Inflation"**

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FOREWORD

One of the recommendations made at the 3rd International Conference on Co-operative Thrift and Credit (London 1974) was that a study group consisting of specialists in the savings and monetary field should be established, to study inflation and its effect on the savings of co-operators, and to examine technical bases for solutions in a co-operative context.

It was decided that membership of the study group should be kept to a minimum: in addition to members of the International Liaison Committee, invitations were sent to the Co-operative Bank (U.K.), Bank für Gemeinwirtschaft (Fed. Rep. of Germany), Banque de France, INGEB, the World Bank (European Branch) and others to nominate an expert each.

The meeting was held at the Centre de Formation du Crédit Mutuel Français (French Mutual Credit Training Centre), Bischberg (near Strasbourg) on 20th and 31st October 1974.

Participants were asked to prepare background papers to form a basis for discussion, and to express their views individually.

I would like to take this opportunity to thank Mr. Braun for his excellent chairmanship of the study group and the Confédération Nationale du Crédit Mutuel for their hospitality, Mr. Lacour the chairman of the International Liaison Committee on Thrift and Credit and the members of the study group for all their hard work before and during the meeting.

It is hoped that the background papers, together with the conclusions reached by the study group, will be of help to co-operative thrift and credit specialists, and to all those looking for a way to save savings against inflation.

H OHMI

Joint-Secretary of the International Liaison Committee on Co-operative Thrift and Credit

PRELIMINARY REPORT - THE POSITION TODAY

INTRODUCTORY REPORT

It is not the purpose of the present report to make an exhaustive analysis of all the problems inflation raises for the saver, nor of all the solutions that have been envisaged for the solving of these problems. All it intends to do is to recall certain data, considered to be important, on the present situation, and to point out some of the measures already taken in certain countries or simply proposed by experts, with a view to remedying this situation.

I - THE SAVER CONFRONTED WITH INFLATION

Inflation today : a worldwide phenomenon

Inflation, which manifests itself by a rise in the general level of prices, is not a new phenomenon, but its consequences reveal themselves in all their gravity when it ceases to be a "creeping" inflation and becomes a "two-figure inflation" as it did already on a worldwide basis in 1950-1951 or as is the case at the present time.

It is a fact that the annual rate of the rise in prices in all O.E.C.D. countries which, on the average, remained below 3% up to 1960, and which was around 3.7% through the 1961-1971 decade, has now gone up to 12.5% for the 12-month period from May 1973 to April 1974 - (see table 1).

Table 1 - Rises in the consumption prices indices from one year to another, in percentages (source: O.E.C.E.)

Years	United States						O.E.C.D. Countries			
	Germany	Belgium	France	Italy	Japan	Netherlands	United Kingdom	Canada	Countries	
Average 1961 - 71	3,0	3,4	-	4,2	5,9	4,8	4,6	2,8	3,7	
1971	5,3	4,4	5,5	4,8	6,1	7,6	9,4	2,9	-	
1972	5,5	5,5	5,9	5,7	4,5	7,8	7,1	4,8	4,7	
1973	6,9	7,0	7,3	10,8	11,7	7,9	9,2	7,6	7,7	
May '73 - April '74	7,1	10,4	13,2	16,2	24,9	8,9	15,2	11,3*	12,5	

* -12-month period ending July 74

The causes of today's inflationist crisis most often advanced are of the international kind: monetary disorders, recent food-stuffs scarcities, the rise in the price of energy and raw materials in general.

In certain countries, this imported inflation has become aggravated by various internal factors.

2. The "small saver" is injured by inflation

Inflation provokes distortions in the distribution of incomes primarily penalizing those who hold fixed incomes. However, it seems that, in recent years, wage earners have in general been able to avoid any loss of purchasing power through the rise in prices (see Table 2).

Table 2 : Rates of increase in the wages on non-agricultural workers from one year to another (source: I.L.O.)

Country	1971	1972	1973
Germany	11,9	8,8	9
Belgium	12,1	14,3	15,1
United States	6,5	6,4	6
France	10,9	12,1	19,1
Italy	11,9	9,2	21,8
Japan	14,3	15,7	54,1
Canada	9	7,9	9

The holders of large savings, who more often have the benefit of good information on the various investment possibilities, have been able to avoid the penalizing effects of inflation, to a great extent at least. They have had the opportunity to direct their savings towards investments carrying high rates of interest, towards real estate investments, or so-called "sheltered" securities, or then again towards speculation on all sorts of products (gold, raw materials

As opposed to holders of large savings, and as a result of lack of information or, more simply, of the small amount of their savings diminish as the rate of inflation rises, as the rate of interest given on them is a very poor compensation (See Table 3).

Table 3 : Rates of interest paid on savings by the public
(source : O.E.C.D.)

Country	May 1972	May 1973	May 1974	Observations
Germany	3,75-4,25	4,25-4,75	5,25-5,75	Savings deposits with legal advance notice of withdrawal (without premium).
Belgium	4,00	4,00 (1)	5,25 (2)	Deposits on ordinary CGER savings passbooks
United States	4,30	4,40	4,80	Savings deposits
France	4,25	4,25	6,00	Savings Bank 1st passbook
Italy	4,51	4,65	5,75	Savings deposit
Japan	3,36	3,60	4,32	Ordinary postal savings accounts
Netherlands	4,00	4,00	5,00	Ordinary Savings Bank accounts
United Kingdom	3,50	4,00	4,00	Ordinary accounts with the Trustee Savings Banks and the National Savings Bank
Canada	-	4,50 (3)	8,75	Savings accounts with chartered banks.

(1) Brought up to 4.25% in June 1973, 4.75% in September 1973, and 5% in January 1974.

(2) Brought up to 5.75% in June 1974.

(3) Brought up to 5.25% in June 1973, 5.75% in July, 6.25% in August, 6.75% in September, 7.25% in January 1974, and 8.25% in April 1974.

II - THE PROTECTION OF THE PUBLIC'S SAVINGS

Today, there are two possible attitudes towards public savings.

- The first consists in considering inflation as an inevitable misfortune and in adapting oneself to it. In this case, it appears that the setting up of any system for the efficacious protection of public savings is almost indispensable. One of the usually considered systems is interval indexation.

Those who support the indexation of savings claim that, in addition to protecting savings, this system would moreover enable investments to be better selected (by encouraging long-term investments), over sumptuary investment expenses to be reduced and, as a result, overall demand to be diminished an element which helps in the fight against inflation.

On the other hand, it is often observed that, through its repercussions, indexation risks provoking an acceleration in inflation and introducing rigidities into the economy.

Finally, such an attitude can provoke difficulties from the external standpoint (in particular, need for floating or frequently adjustable exchange rates).

- The second possible attitude towards inflation consists in taking up the fight against the rise in prices, which implies the adoption of efficacious measures of political economy. However, a certain period of time always passes between the moment when prices begin to rise abnormally rapidly, the moment when people become aware of this phenomenon and, finally, the moment when the measures taken against inflation prove to efficacious. It becomes quite clear that some protection or other of savings is necessary during this period of reaction. Moreover, one of the classical means of fighting inflation is the encouragement of savings, and especially of long-term savings, which normally put a weight on consumption and thus in overall demand.

Within the scope of these two possible attitudes when confronted with inflation, a few experiments for the encouragement and protection of savings have been put into application in certain countries.

In practice, usually, the two attitudes are simultaneous. On the one hand the fight against inflation is taken up with all the strength one can. But on the other hand insofar as, in spite of every effort, inflation is still extant, it is necessary to accommodate to it in mitigating its most important disadvantages.

Further, various concrete proposals have recently been put forward by the experts who have taken up these problems. These experiments and proposals form the subjects of the reports attached hereto.

Systems For the Encouragement of Savings Now in Force and which do not call for indexation

GERMANY

a) Old systems for the encouragement of savings:

i) Savings deposits with premiums ; persons who sign a savings contract (minimum commitment of 60 DM per year) in a single payment (6-year contract), or in staggered payments (spread over 6 years to which one year's waiting is added) are given the advantage of a premium, the rate of which depends on the family situation of the recipient:

This goes from 20% for single persons
up to a 30% rate for a married couple with
at least five children

Thus yields vary between 12.7% and 15.5% in the case of payments spread over the years.

In addition, the premium is increased by 40% when the taxable income does not exceed a certain amount for the year preceding the signing of the contract.

A ceiling is placed on the premium, depending on the recipient's family responsibilities. It is paid out by the administrative office of finances to the credit trustee institution.

ii) Building savings : the savers commit themselves by contract to renouncing the free availability of their assets (paying these into the bank in one single payment or in staggered payments) for 7 years. The unblocking of these savings before the deadline is possible if the funds are used for expenditure on real estate.

The sums saved carry an interest of 3% and give the saver the right to a loan at an interest rate of 5% and equal to 150% of the savings made.

In addition, the office of finances pays a premium of 25% or 35%, depending on the family situation of the recipients (and increased by 30% for the benefit of persons whose net taxable income was below a certain amount).

From 1950 to 1969, the sum total of premiums paid is said to have reached DM 16.4 Milliard, that is, 9.2 Milliard for building savings and 7.2 for deposits.

iii) Finally, the 624 DM law confers the advantage of special treatment (Premiums and fiscal advantages) on certain voluntary payments granted by employers to wage-earners in addition to their normal wages, to enable the latter to build up a patrimony.

b) New advantages offered to savers

i) Faced with the flight savings deposit savers to forward deposits, bankers had the idea of giving a premium on savings deposits invested for a certain period.

ii) New types of investments have made their appearance recently:

"Certificats de croissance" (growth certificates) for a duration of 5 to 6 years but which can be refunded at any moment. The rate of interest rises from 7% per year (1st year) to 12% (6th year).

Savings bonds for a duration of 5 years with interest (9%) added in advance (12% real interest).

Savings debentures are debentures to bearer for a duration of 7 to 9 years. They are thus more fungibly quoted than savings bonds.

II FRANCE

The Caisses de Crédit Mutuel and the Savings Bank "A" savings books are exempted from income tax. Withdrawals are possible at any time and without notice in advance. As from the 1st January 1969, a "fidelity" premium of 0.5% was added to the interest of 4% when the deposits over a full year exceeded the withdrawals.

A super-premium was temporarily added when the average balance of new deposits between 1st September 1969 and 31st May 1970 exceeded the average balance registered between 1st January 1969 and 31st August 1969. On 1st July 1970, the fidelity premium was suspended and the rate of interest was brought up to 6%.

Finally; on 12th June 1974, the interest rate was raised by 0.5% and the fidelity premium was reinstated at the rate of 1.5%, applicable only to the growth of deposits from one quarter to another.

The Caisses de Crédit Mutuel and the Savings Bank "B" Savings books, as well as savings books of banks operating in accordance with the principles as the "A" savings books, do not have the benefit of exemption from taxation. Further, bank savings books carry an interest rate 0.75% lower than that given to holders of Caisses de Crédit Mutuel and Savings bank books.

The "Plans d'Epargne Logement" (Housing Savings Plans) require that the saver make a minimum payment of 500 F followed by periodic payments (at least 1200 F per year) for 4 years. These savings confer a right to an interest of 4% (3.5% before June 1974) and, on expiration of the 4 years, to a premium paid by the State and which is equal to the total sum of interest required. Neither the interests nor the premium are subject to income tax.

In addition, on expiration of the contract, the saver has a right to a loan for the purchase or building of a principal residence, or for the improvement of his housing. This loan carries an interest which is deductible from the fiscal income at the rate of remuneration of the savings accumulated, increased by 1.50% approximately, and its total sum is calculated in such a manner that the amount of interest to be paid does not exceed the sum total of interest acquired by more than two and a half times.

Considering the amount of the premium paid by the State, which brings the interest rate on the savings up to about 7% and above all the level of the

rate of interest on the loan, this formula is relatively advantageous, and it has had a certain success.

I JAPAN

So as to encourage savings by married couples, two measures have been taken:

- a) Six month deposits made during the period of distribution of premiums (these are very high, and usually paid twice a year) are remunerated at the interest rate prevailing at the moment increased by 1%.
- b) The six month deposit certificates have been issued at an interest rate of 3% lower than that of ordinary certificates of the same duration. The first-mentioned certificates give the holder the right to participate in a lottery of which the first prize is 10 million yen.

Receptivity of the preferential treatment for the six months time deposits at the time of bonus seasons has been remarkable, but that of the lottery-number bearing six months time deposits is getting lower just after the popular initial sales.

THE UNITED KINGDOM

- a) Ordinary savings deposits yield an interest of 4% up to £40 of interest, and this is not taxable. Withdrawals without previous notice are possible up to the amount of £20.
- b) Investment deposits in the National Savings Bank bring in a taxable interest of 9%. Withdrawals are possible with one month's previous notice.
- c) The "Save As You Earn" (SAYE) system consists in remunerating monthly deposits of £1 to £20 paid in over a period of 5 years by a non-taxable premium of 23% (yield of around 4.5%). If the saving is left in the account for two years more, the premium is doubled (yield : 5.75%)
- d) The British Saving Bonds carry an interest of 10.1%, payable twice a year and taxable. Refund can be made with one month's previous notice, prior to the normal term of 5 years. When the end of the 5 year term comes, a premium of 3% is added to the nominal interest.
- e) Savings Certificates carry progressive interest rates ranging from 6% for the 1st year up to 7.5% at the end of 4 years.

CANADA

The Federal Government has proposed that, within the scope of the next budget, income on savings shall be exempt from taxation up to the limit of the first \$1,000.

SYSTEMS FOR THE PROTECTION OF SAVINGS WHICH REQUIRE INDEXATION

Most of the savings indexation systems put into application since the last World War have been ephemeral and have only touched the debentures market: such was the case in France, Austria, Sweden and Iceland.

However, a few experiments do hold our attention by the generalisation of the indexation to savings accounts they involve.

I BRAZIL

Since 1967, bank deposit rates have the advantage of indexation clauses which are referred to an index of wholesale prices. The payments which are representative of the indexation are exempted from taxation.

II FINLAND

The first issue of debentures indexed at 100% on the index of wholesale prices dates from 1945. From 1950 on, indexation became generalised on the financial market and was extended to certain insurance contracts, and then, in 1955, to certain categories of forward deposits. The duration of these deposits was fixed at 12 months and that of their minimum amount to 300 marks US\$ 130). The accounts thus indexed carried a nominal rate of interest 1.5% lower than that given on non-indexed deposits, and the compensation provided for the rise in the cost of living index was 50%.

From 1963 onwards, the Commercial Banks and Savings Banks offered a guarantee of 100% on forward deposits. Since 1964, indexed deposits are, in addition, fully exempt from income and property taxation, for capital, the interests and compensatory payments.

In 1967, the proportion of indexed accounts as compared with the total of forward accounts reached 35% and the debentures indexed represented 85% of the certificates in circulation.

In the autumn of 1967, following on the devaluation of the currency, the risk of an inflationary spiral developing as a result of the interplay of indexation and the rise in prices of imported products, led the Government, in agreement with its social partners, to prohibit indexation clauses, in principle, for the future.

III ISRAEL

The indexation of fixed income securities (debentures, and then deposits and insurance contracts) became gradually generalised between 1948 and 1962. The reference index at the outset was the rate of exchange of the Israelian pound with the United States Dollar.

From 1964 to 1968, the indexation clauses were abandoned for long-term government funds, and a system of fixed annual "inflation premiums" was set up in their place.

IV THE UNITED KINGDOM

One Credit institution, Western Credit, issued as an experiment in 1973 three year bonds carrying an interest indexed with a basic annual rate of 9.5%.

The interests, but not the capital, will rise each year within the limit of a 15% rate, on the basis of inflation measured by the index of retail prices.

Furthermore, two projects announced by Mr. Wilson last August consist:

On the one hand, of replacing the SAYE system now existing by a system operating on the same principle but comprising revaluations in accordance with the retail prices index.

And on the other, of proposing to small retired savers the purchase of debentures at £10, for a minimum of 5 years and indexed, in capital and interests, at the level of retail prices. A premium will be paid to those who keep these bonds to the end of their term but they will be negotiable at any moment.

* * * * *

The results of experiments which have been running for a sufficiently long time to be judged have in general proved to be rather disappointing. Admittedly, it does seem that indexation measures at 100% have proved to be fairly good protection against monetary erosion, but these have so far always been abandoned after a shorter or longer period of time for reasons of general economic policy.

As opposed to this, most of the measures which do not call for indexation have not provided sufficient protection of savers capital against present-day inflation, except in the case of Germany where the rates of yields on savings have always been relatively high and where inflation rates, on the other hand, have remained among the lowest in the world.

Presented By:

**Secretariat of the International Liaison
Committee on Cooperative Thrift and Credit.**

I N F L A T I O N I N C A N A D A

INTRODUCTION

In Canada, as in most other western countries, both the public and political authorities feel that inflation as experienced recently, is the economy's major problem. This feeling seems to flow from the inflationary troubles suffered during recent years and which reveal two main features: the high level of inflation rates as compared with average inflation rates during the sixties and the very high variability of Canadian inflation rates since 1971. It is a fact that inflation has not stopped increasing and even accelerating since that time as shown in the following table:

1971	Rate of <u>Inflation*</u>	Growth of <u>Inflation***</u>	Acceleration of <u>Inflation***</u>
1971	2.9%	-.4	.8
1972	4.8%	1.9	1.5
1973	7.6%	2.8	.9
1974**	10.6%	3.0	.2

* Annual rate of increase of the IPC Index of Prices at Consumption level

** from January to March at the annual rate

*** measured in percentage points

B) THE LEVEL OF INFLATION IN CANADA

The rate of inflation in Canada (measured by IPC) (1) was 11.3% (11.7 in the United States) over the 12-month period ending in July 1974. Canadians are absolutely unused to such a high level of inflation, for the average during the 10 years ending with 1973 had only been 2.9%. The European experience during this same 10-year period was, in general, much more inflationist. Only in the United States was there an inflation rate comparable to that of Canada during this period (3.1).

Even today, the rate of inflation in Canada is not as high as that experienced in most European countries (over 13.4 for EEC members). Nonetheless, the differential in percentage as between these two inflation rates has shrunk considerably during the last few years.

At first sight, one is led to believe that the Canadian authorities, like the American authorities, have chosen to accept an appreciably higher rate of unemployment than that of foreign countries in exchange for a rate of inflation much lower than theirs. For there is no doubt, in fact, that among the industrialised countries, Canada and the United States have the highest

(1) IPC: "Indice des Prix a la Consommation" (Index of Prices at Consumption Level)

unemployment rates (5.1 on the average in Canada, from 1962 to 1973), even taking into account the different methods used by countries for the calculation of their unemployment rates.

B) THE INCREASE IN CANADIAN INFLATION

From 1971 to 1973, the IPC annual increase was a rise from 2.9 to 7.6, which implies an average rate of increase in inflation of about 6.2%. At this rate, Canadian inflation will reach the 20% level in 1975. Admittedly, such an extrapolation has no value as a forecast if it is not supported by economic theory and the plannings of economic policies. It is only given here as an illustration of the manner in which the problem of inflation could be felt by Canadians if they were to form their extrapolation on this basis.

C) THE ACCELERATION OF CANADIAN INFLATION

The acceleration of inflation is not a new phenomenon in North America; several economists considered it to be an essential characteristic of North America from 1960 to 1969. And it is a fact that, during this period, Canadian inflation accelerated by an average of .54 percentage points (.44 in the United States).

However, what is new is that this phenomenon has become generalised in the European economies since 1972.

* * * * *

Within this context, we shall first attempt to explain the causes of the recent Canadian inflation and to compare them with those of the sixties.

After that, we shall evaluate the effects of inflation on the distribution of income and wealth. We shall do all we can to measure the impact of inflation on the savings in the Caisses populaires and in financial intermediaries in general. Finally, as a conclusion, we shall suggest a few measures which, in our opinion, will permit us to fight inflation and to alleviate or reduce its harmful effects on the savings of the Caisses populaires.

We think it pertinent to discuss inflation in Canada and its incidence on the economy by studying it within the scope of a well structured theory. It will indeed be of interest to observe that the absence of a theoretical perspective of the process of inflation can lead to the adoption of unsound economic policies which have no impact whatever on the real causes of inflation. For a start, we shall sketch a simple conceptual framework which will enable us to explain the causes and effects of inflation. After that, we shall see that this simple theoretical framework can easily be applied to Canada's inflation experience. It is obviously more of a risk but much more profitable, in our opinion, to take the economic theory as a basis and to try to explain the causes of inflation, than to keep to a

simple description of the Canadian inflationary experience of recent years. The measures we shall suggest for the protection of savings bank depositors against inflation will thus be founded upon the economic theory we are going to elaborate.

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C H A P T E R I

INFLATION: A DEFINITION

It is generally agreed that the rate of inflation can be defined as a steady rate of increase in the general level of prices or, what comes to the same thing, as the difference between the rate of increase of production in current dollars and the rate of increase of production in constant dollars.

This definition calls for two important observations. Firstly, the utilisation of the term "steady rate of increase" in the definition of inflation is very significant. Its purpose is to make a clear distinction between the fundamental forces which cause a "steady" rise in the level of prices and certain phenomena which affect the short-term level of prices without for all that having an effect on the long-term increase in the level of prices, i. e. inflation. This distinction is all the more important for being, so it seems, often badly understood by the public and by political authorities at the present time. It cannot be denied that, in 1973, certain special factors led to a higher increase in the level of prices than would have been the case without them; as examples, we mention the increase in food prices, the worldwide energy scarcity and the economic boom experienced by most western countries. These factors explain very well why the index of consumption prices rose by 7.6% in 1973 instead of, let us say, 6%. On the other hand, they do not explain why the rate of inflation would have been as high as 6% without them. They cannot explain why the IPC has increased by more than 25% in Canada and the United States between 1968 and 1973. In the text which now follows, we shall concentrate our attention on the fundamental forces which give rise to inflation without for all that neglecting the special factors which caused recent inflation to be higher than would otherwise have been the case.

If we accept the definition of inflation as given above, we also have to reject the theory according to which inflation is caused by the thrusting up of costs by trade unions or monopolies.

The structure of power over the labour and products markets cannot explain a steady rise in the level of prices, for this structure has remained relatively stable in Canada since the last war. Only a change in this power structure could have had some effect on the rise in the level of prices, and even then only a passing effect. In our opinion, the trade unions and monopolies cannot be held

responsible for an inflation of 7.6% in 1973 while they were not held responsible for the inflation of ten years ago. The trade unions and monopolistic concerns are the same in the two cases and their striking force has varied only very slightly within the period mentioned. In actual fact, the structure of economic power affects essentially the structure of prices and wages in the various markets. This brings us to our second point.

The second point we wish to stress is raised by the use of the term "general level of prices". In order to evaluate the consequences of price variations, it is very important to distinguish clearly between a change in relative prices, or what comes to the same thing in the structure of prices - a rise in food prices as compared to prices of other goods, for example - and a rise in the general level of prices, that is, inflation. The fundamental causes of these two phenomena differ very considerably. Changes in relative prices stem from variations in the relative forces of supply and demand in the various economic sectors. Thus changes in the structure of prices enables resources to be allocated more effectively so that the needs of consumers may be satisfied. On the other hand, variations in the general level of prices are of a quite different nature and are caused by fundamentally different phenomena. In fact, the rate of inflation is a measure of the decrease of purchasing power of money. It can thus be expected that inflation is a phenomenon closely linked up with the rate of increase in the stock of currency held by agents.

Thus we must distinguish, conceptually at least, between the part of a rise in prices attributable to a change in the relative price and that caused by a general rise in the level of prices. It is, for instance, misleading to affirm that the rise in prices for services (4.4% per year on average) in Canada from 1962 to 1968 is the source of the increase in the IPC (3.5%) during the same period. The truth is more likely the reverse: it is the rise in the IPC that has led, for the most part, to the rise in the prices of services. If the rise in the IPC had been constant, the rise in the prices of services would only have reached .9% ($4.4\% - 3.5\% = .9\%$).

More generally, studies in which changes in price levels are analyzed on the basis of variations in the prices of various goods, so as to discover the cause or causes of inflation, make the same mistake. The causality works rather in the opposite direction: certain fundamental forces produce inflation, and the spreading of this inflation over the various goods depends on the developments in the supply of, or demand for each of these goods. To be sure, an abrupt change in the supply of, or demand for a commodity affecting its relative price (as was the case for petrol, for instance, in 1973,) can have a momentary repercussion on the rise in price level. It cannot however have a sustained influence on this. Further, it is very likely that inflation will produce changes in relative prices, particularly if it is high and variable. Certain prices respond in a very slow manner (for example, those covered by long-term contracts). These relative changes in prices stemming from inflation produce distortions on the markets of the economy, for they provoke an inefficient reallocation of resources towards sectors where protection against inflation is easier. For

example, in the short term, inflation brings about a reallocation of financial assets for the benefit of physical assets (i. e. houses, durable goods ...) for, in general, these latter offer better protection of the yield from savings than the former. This latter point is an essential one; we shall come back to it when we take up the question of the effects of inflation on savings.

* * * * *

C H A P T E R I I

THE SOURCES OF INFLATION

For the purposes of this account, in this second chapter we shall restrict ourselves to the study of the sources of inflation in a closed economy (1), i. e. without relations with outside countries. We shall then turn our attention to the sources of inflation in a small and open economy like that of Canada. The distinction between a system of fixed rates of exchange and a system of floating rates of exchange will then be an essential one.

A) INFLATION IN A CLOSED ECONOMY

Let us presume an initial situation in which the level of prices is stable and where economic agents expect them to remain stable for a long time. However, stability in the level of prices is bound up with a rise in wages in current dollars. It is a fact that, in a free market economy, competition between firms for the engaging of workers will force real wages, (i. e. wages in terms of purchasing power) to increase at the same rate as the real productivity of the manpower (2). As long as the overall demand for goods and services increases at the same rhythm as potential production, the rate of increase in wages, 3% per year, for example, will be maintained and the level of prices will remain stable. This initial situation is also consistent with a positive rate of unemployment attributable to the structural characteristics of the labour and products markets, for example, mobility costs, costs of obtaining information on vacant posts, the stochastic variability of the supply of, and demand for products, and the structure of minimum wages In Canada, it is estimated that this unemployment rate lies on the average between 4.5% and 5.5%, but it may vary if the above characteristics develop as time goes on.

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- (1) The American economy constitutes a good approximation of this kind of economy since it only exports 6.5% of its GNP (1972)
 - (2) In a case where the rise in real wages would be weaker than that of the additional productivity of the workers, it would be to the advantage of each firm to engage more workers so as to increase profits. The increased demand for workers would force wages up until the rise in wages becomes equivalent to that of productivity.

Now, let us suppose that the political authorities wish to lower the unemployment rate from 4% to 3% by an expansionist monetary policy. In other words, the monetary authorities decide to purchase more government bonds held by the banking system and individuals. The initial effect of this policy would be a lowering of the yield of these bonds, and the result of this would be the provoking, between the economic agents, of pressures for the lowering of all interest rates on financial assets in general. In addition, the consecutive rise in bank cash reserves will permit the banking system to increase its assets. A certain part of these assets will serve to increase the surplus reserves of these banks, but it is to be expected that the banks will utilise the major part of this increase in reserves to make loans and to purchase bonds on more favourable terms, thus adding to the pressures for the lowering of interest rates. Presuming that the rates of yields from existing physical assets remain initially unchanged, a lowering of interest rates on financial assets will induce an increased demand for all physical capital, including the fixed capital (machines, equipments, industrial buildings) of firms, the inventories, the residences, and the durable goods possessed by consumers.

Thus, the increase in the rate of growth of the volume of money promotes increased demand on the products market and, consequently on the labour market. This results in a rise in prices and in wages. However, on the short term, the rise in prices will be greater than that of wages. This is because the workers, having negotiated their wages without having foreseen a rise in the level of prices, will be victims of a drop in the purchasing power of their wages, even if wages in current dollars rise. For example, if wages rise by 4% while inflation is at 5%, real wages drop by 1%. This decrease in real wages which has not been anticipated by the workers is a stimulus to employers to engage more workers. Thus, unemployment will decrease as a result of the rise in the level of prices. Hence, in the short term, there is an inverse relation between inflation and unemployment in every economy.

This, however, only describes the initial phase in the process of inflation: this expansion phase (or pressure on demand phase) will necessarily be followed by a contraction phase (or upthrust of costs phase). For the workers cannot be deceived indefinitely. In due course they will ask for a premium equal to the initial inflation so as to protect themselves against the latter. By this very fact they will start up an additional inflation of prices as a result of this "upthrust of costs". Consequently, each time there is a new round of negotiations by the workers for the purpose of indexing their wages at the cost of living level, there will be a new inflation in prices and wages. This creates what is known as an "inflationist spiral". However, this spiral does not generate an unending inflation. The latter will continue to grow, but at a lower and lower rate up to the time when real wages converge towards the long-term rise in productivity, (i. e. 3%).

For as long as there is a divergence between these two variables, there will always be an excess demand for workers.

During this contraction phase, the convergence of the rise in real wages with the rate of growth in productivity will reverse the process which provoked a drop in unemployment during the initial phase. Over the long-term, the rate of unemployment will come back to 4%. From then on, the rate of inflation reached will be anticipated perfectly by the workers and the latter will be fully protected against inflation. Over a long period, the monetary policy will have an effect upon the inflation rate of prices and wages without having an influence on the rate of unemployment and real wages. Over the long-term, therefore, the rate of inflation essentially depends on the rate of increase of money. If the Central Bank decides to increase this rate by 4%, the long-term rate-of-inflation growth will be 4% without having an effect on unemployment. Only an acceleration of a rate of growth of the volume of money, producing an acceleration in the rate of inflation, will permit the economy to "purchase" an unemployment rate lower than 4%. For the fact is that it is only on this condition that the rate of inflation will be always greater than the inflation rate anticipated by the workers.

This, however, presupposes that the workers do not anticipate the acceleration in the rate of inflation, and that they are the dupes every time. Sooner or later, even this acceleration will come to be anticipated. When this moment is reached, even an acceleration of the inflation will not be able to lower the unemployment rate below 3%. Over the long term, there will not be a negative relation between inflation and unemployment.

To sum up, according to the inflation theory elaborated above, the two principal factors in the determination of the rate of inflation are the rate of growth in the volume of money and the inflationist anticipations of economic agents. Over the short term, a change in this rate of growth has an effect on employment, production and inflation, but over the long term, it only has an effect on inflation, once the anticipations of individuals have been adjusted to the inflation reached.

The American studies by Professor Milton Friedman of the Chicago University seem to indicate that a change in the growth rate of the volume of money is followed, generally speaking 6 to 9 months later, by a change in the total expenditure of the economy on goods and services. The greater part of the change in expenditure derives from a rise in production, rather than from a rise in inflation. This corresponds to the expansion phase. However, 12 to 18 months later, the change in the rate of growth of money only has an effect on inflation. This corresponds to the contraction phase. It is important to note that these periods of time express an average relation, which is not necessarily stable, between the monetary policy and inflation. It is clear that the workers' rapidity in anticipating the inflation has a lowering influence on these periods.

An expansionist fiscal policy (for example, a rise in the rate of growth of governmental expenditures), providing it is not financed by an increase in the

volume of money, i. e. if it is financed by taxes and public loans, cannot have a sustained effect on the rate of growth of price levels; especially, it will cause a rise in prices in relation to public property as compared with private property. It will bring about a reallocation of the private sector resources as the income on the latter will have diminished as a result of taxes and the loss of savings for the benefit of the public sector. In time of war, this will mean more cannons and less butter.

However, an increase in governmental expenditures can, as a last resort, explain the rate of inflation in a country. This happens when the government finances a large part of its expenditure by selling bonds to the country's central bank so as to prevent a too great a rise in the interest rates on its bonds. It thus increases the volume of money. This is the explanation of the very high rates of inflation in certain countries of Latin America. For example, over the 1950-1959 period, Uruguay, Bolivia and Brazil experienced the average annual inflation rates of 43%, 41.3% and 35.1% respectively, whereas the annual rate of increase of the volume of money was respectively 40.1%, 41.6% and 38.2%.

This inflation theory has a practical impact on economic stabilization policies:

- 1)* Political authorities must not attempt to force the economy to produce with a very low unemployment rate by adopting an ever increasingly expansionist monetary policy. The target aimed at will not be reached (except over the short term,) and over the long term, this policy will give rise to inflation acceleration problems. The Canadian inflationary experience since 1971 is largely explained by this error.
- 2) It is important that the persistence of a too rapid inflationary period over too long a time be prevented. Once the inflationist anticipations (or psychosis) are incorporated in the economic decisions process, it may be very costly to eliminate them. For example, monetary authorities can succeed in bringing down the inflation rate from 15% to 5% within a relatively short period of time through the application of a very restrictive monetary policy. However, this will result in a drastic rise in short term rates of unemployment (exactly the opposite of the effects of the initial phase of an expansionist policy) even though, at long term, the rates of unemployment will return to their initial level once the inflationist psychosis has been reabsorbed. In a way, there is a choice to be made between more or less unemployment at the present time, and more or less inflation later on.
- 3) Fiscal policy must not be utilised as an instrument for fighting inflation. When it is not financed by an increase in the volume of money, its only long-term effect will be on the allocation of resources between the government and the public.

- 4) A country's central bank must avoid producing abrupt variations in the rate of growth of the volume of money. It must be remembered that this rate underwent an annual average decrease of 35.2% in the United States and Canada during the 1929 to 1933 crisis. Paradoxically, stabilisation policies can by themselves generate economic cycles. Generally, these latter incite the authorities to cause over-abrupt variations in the growth-of-money rates. For the fact is that, at the first sign of success of a restrictive monetary policy against inflation (as in Canada from 1969 to 1971), the resultant short-term unemployment incites the authorities to change arms and to adopt an over-expansionist monetary policy (as in Canada from 1971 to 1973). These too abrupt variations in the growth rate in the volume of money can generate very great economic fluctuations, create uncertainty in the minds of the public and provoke an inefficient allocation of productive resources.

B) INFLATION IN A SMALL AND OPEN ECONOMY

a) Under a system of fixed rates of exchange

For a small "open" country (1) like Canada, the decision to fix its rate of exchange with another country like the United States almost amounts to choosing the same money as the latter. This is true when the financial and trading transactions between the two countries are highly integrated (2). The Canadian monetary policy is then completely dependent on the American monetary policy over the long term, and consequently, the Canadian rate of inflation cannot diverge appreciably from that of the United States over a long period.

If, hypothetically speaking, Canada were to choose to increase the rate of growth of the volume of money so as to restrict unemployment, the initial drop in Canadian interest rates as compared with those of the United States would lead to a net mass departure of American capital from Canada. The fact is that transaction costs on the Canadian-American financial markets are very low, and they do not really constitute a barrier permitting a large differential of interest rates without provoking high flux variations of foreign capital. The capital account difficulties of the Canadian balance of payments would force

(1) It should perhaps be remembered that Canada exports and imports between 20% and 25% of its GNP.

(2) This is true of Canada and the USA. For, on the one hand, it is seen that a slight variation in the differential between the Canadian and American interest rates provokes very large variations in the flux of capital on short term of the two countries. This implies that the financial markets of the two countries are closely integrated. On the other hand, we know that 65% to 70% of Canadian exports go to the USA. This implies that the commercial markets are likewise closely integrated.

the Bank of Canada to return to a less expansionist monetary policy at long term. To be sure, the Exchange Fund can support the Canadian dollar over the short term by supplying foreign currencies for the purpose of repurchasing Canadian dollars. The Banque du Canada can also sterilise or neutralise the decrease in the volume of money brought about by the Exchange Fund operations by intervening on the open market. The presence of a stock of foreign currencies in the hands of the Exchange Fund in a way allows the Bank of Canada to "purchase", over a short period, a monetary policy autonomous with the American monetary policy.

However, the stock of foreign currencies will become exhausted as the Exchange Fund continues its policy of support of the Canadian dollar. Consequently, the monetary policy will have to change its direction if the Canadian authorities wish to avoid a serious crisis in the balance of payments. Further, foreign speculation against the Canadian dollar will make itself felt as and when speculators begin to anticipate a possible devaluation of this dollar. This speculative thrust (as in 1968 in Canada), will force the authorities to intervene more rapidly so as to reestablish the initial differential between the Canadian and American interest rates by a monetary policy which has become less expansionist.

Further, the rise in the inflation rate caused by the expansionist monetary policy of the initial period will make Canadian exports less competitive, and imports relatively less costly for the Canadians. The effect of this will be a clear decrease of exports from Canada in goods and services as compared to what they would otherwise have been. This second effect will accentuate the deficit in the Canadian balance of payments and will add to the pressures on the Bank of Canada for the return to a less expansionist monetary policy.

Under a system of fixed exchange rates, the American inflation rate is thus entirely passed on to the Canadian economy in a long period, through the intermediary of the variations in the growth rate of the volume of money. Only the imposing of artificial barriers on capital movements and imports can enable Canada to choose an inflation rate different to that of the United States. For example, a severe control of exchanges and a high tax on incoming and outgoing capital (1) could, in principle, isolate the Canadian monetary policy from that pursued by the Americans. Nevertheless, the possibility of adopting such barriers is very limited; certain among them are prohibited by IMF or GATT international agreements and, moreover, they can provoke reprisals from other countries and consequently result in a considerable restriction of international exchanges. Such a restriction would be a catastrophe for an "open" country like Canada. As expressed by the economist Harry G. Johnson:

(1) An example of this kind of tax is supplied by the American experience. In July 1963, the United States brought in a tax "for the equalisation of interest rates" on capital leaving America for countries abroad.

"The Banque du Canada, under a system of fixed exchange rates, forms the thirteenth American Reserve Board." Actually therefore, Canada cannot choose the inflation rate it desires under such a system; it is obliged to adopt that of the United States.

More generally, the existence of a fixed exchange rates system associated with a growing integration of international markets (the appearance of a Eurodollar market is a striking example) implies that inflation in each of the Western countries must no longer be analysed as an isolated phenomenon. It is becoming increasingly necessary for the problem of inflation to be solved at the international level by means of coordinated economic policies (mainly monetary policies).

b) Under a system of floating exchange rates

The existence of a floating (but not necessarily unstable) exchange rate means that the central bank of a small very open country can be given the possibility of pursuing an autonomous monetary policy and therefore of choosing the inflation rate it wishes to obtain. However, the variations in the rate of exchange essentially depend on the choice of inflation rate the country wishes to attain as compared with a foreign inflation rate. For in fact, to obtain an equilibrium in the balance of payments of a country, it is necessary for prices in this country (in terms of American dollars) to increase at the same rhythm as prices abroad. This is the important restraint imposed on a small open economy such as that of Canada. Under a system of flexible exchange rates, this country can however choose what part of world inflation shall be conveyed to domestic inflation and, consequently, what part will be transmitted indirectly by means of a variation in the exchange rate. For example, if world inflation is 12%, this country will be able to choose an inflation rate of 3%, but only if it accepts a rise of 9% in its exchange rate (which automatically equalises the balance of payments). Thus, the variation in the rate of exchange is a substitute for the variation of the domestic level of prices.

C H A P T E R I I I

CANADIAN INFLATION FROM 1962 to 1974

The Canadian economic experience during this period can be divided into two parts. From May 1962 to May 1970, Canada knew a fixed rate of exchange system whereas, from May 1970 onwards, it adopted a floating rate of exchange system.

A) THE PERIOD FROM 1961 to 1971

We have established above that, under a system of fixed exchange rates,

a small and open country like Canada cannot adopt a long-term autonomous monetary policy, although) at the short term, the existence of a stock of foreign currencies does permit this economy to have a certain margin for manoeuvring (particularly if it desires an inflation rate less than that abroad). Canada lost this slight manoeuvring margin from 1963 to December 1968 since it agreed not to keep more than 2.6 milliard American dollars in its reserve of foreign currencies, in exchange for exemption from the famous American "equalisation of interest" tax. This restraint was in fact effective during the period in question since the level of the Canadian reserves almost always kept close to this maximum.

As a consequence, during the 1963-1968 period, the Canadian monetary policy was almost entirely dependent on the American monetary policy. Following the American example, the annual rate of growth of the volume of money (1) accelerated, going from 6.1% in 1963-64 to 12.8% in 1967-68, and producing an acceleration in the inflation rate from 1.5% to 4.4% during the two same periods. The economic history of this period is very well explained by the theory elaborated above: initially, the rise in the growth rate of money permitted the economy to lower its unemployment rate from 5.5% in 1963 to 3.6% in 1966. This corresponds to the expansion phase. However, this phase was followed by the contraction phase, i.e. by a rise in unemployment associated with a rise in the inflation rate, as the inflation anticipations (and its acceleration) of the economic agents were incorporated in the wage negotiations and in the fixing of prices in general. In 1968, the rate of unemployment returned to 4.8%. With the abolition of the ceiling on Canadian reserves of American dollars, the Canadian monetary policy became very restrictive during the last half of 1969 and the first half of 1970. As a result, the Canadian volume of money in February 1970 was 11% below its February 1969 level. This monetary policy, more restrictive than the American monetary policy, produced a drastic rise in the differential between the Canadian and American rates of interest, causing a net mass entry of foreign capital into Canada.

The Banque du Canada then had the choice between returning to a less restrictive monetary policy and reevaluating its money. It decided in favour of the second policy and, in May 1970, the Government announced that the fixed rate of exchange system was to be abolished. The rate of exchange having become flexible, it rose by about 7% in terms of American dollars.

As was to be expected, this restrictive monetary policy produced a rise in the rate of unemployment (from 4.7% in 1969 to 5.9% in 1970), while the rate of inflation dropped from 4.5% to 3.3% during the same period.

The lesson of this period is clear: a small open country like Canada cannot have an autonomous monetary policy under a fixed exchange rate system. This does not seem to have been properly understood by the authorities of that time.

(1) The volume of money is defined here as the sum total of deposits by the public in chartered banks, and notes and hard cash held by the public (M2).

B) THE 1971 - 1974 PERIOD

First, it is interesting to note that, during the year which followed the freeing of the Canadian rate of exchange, Canadian inflation lessened considerably as compared with foreign inflation. This is perfectly in accordance with our analysis of inflation under a flexible rate of exchange system: the rise in the value of the Canadian dollar has taken the place of a domestic inflation, so that the rise in the price level, measured in American dollars, comes to just about the same rate as that of American inflation.

Compared with the 1969-1970 period, the 1971-1974 period is rather astonishing. Whereas, during the 1969-1970 period, the Banque du Canada chose to pursue an independent monetary policy (an unworkable policy under a fixed rate of exchange system), it chose to reject this policy as from 1971 on when this was possible because of the flexibility of the exchange rate.

In other words, it chose to maintain the parity between the Canadian dollar and the American dollar, by this very choice depriving itself of an autonomous monetary policy and thus of the possibility of having an inflation rate lower than that of the United States. One can, on the whole, qualify this system as a "quasi-fixed" rate of exchange system.

The monetary authorities, faced with the high 1960 unemployment rate, were afraid that the rise in value of the exchange rate would increase unemployment by creating pressures towards the lowering of net exports from Canada. They consequently reversed the policy, so that the volume of money (M2) rose, on the average, by 23% from mid-May 1970 to the first quarter of 1973. The Banque du Canada's objectives were to stimulate the overall demand for, and restrict indirectly the rise in the value of, the Canadian dollar. The accelerated rise in the growth rate of the volume of money generated an expansion phase, and the unemployment rate dropped from 6.4% to 5.6% in 1973. However, certain special factors limited this drop in the unemployment rate. In 1971 and 1972, the Canadian fiscal policy remained restrictive, though less so than in 1970. Further, the setting up, in 1971, of a new system of unemployment insurance, a very generous one for unemployed workers, certainly had an effect on Canadian workers' incentives to go back to work.

In 1972 and 1973, the rise in the level of prices in Canada was aggravated by certain special phenomena. First of all, as a result of the restriction in supplies, caused essentially by the bad harvests in most countries of the globe in 1972, the prices of foodstuffs rose considerably as compared with the prices of other goods. This phenomenon certainly had a short-term effect on the general level of prices.

Secondly, the adoption of certain price controls in the United States in 1972-1973 created artificial pressures on Canadian exports in those fields where there was a surplus American demand.

Thirdly, the October 1973 Arab embargo on petroleum products provoked an artificial scarcity of petroleum energy, resulting in a rise in the production

costs of goods utilising this type of energy. Then, on account of the increased demand for the utilisation of other forms of energy, the initial petrol scarcity was passed on to other energy sources. This phenomenon engendered rises in prices in the primary and secondary sectors (sectors consuming energy in an intensive manner), as compared with the services sector. This most certainly generated a rise in the level of prices in 1973. It has often been asserted that Canada was less affected than the United States by the energy crisis, on account of the West Canadian petrol reserves. We must not, however, lose sight of the fact that trading mechanisms between these two countries almost automatically pass on the relative changes in prices of American products to the Canadian economy. For example, a rise in the prices of raw materials in the United States provokes a rise in the prices of Canadian products utilising these raw materials in their production. In addition, the increases in the relative prices of certain American products provokes an increased demand for the exportation of these products from Canada and, as a consequence, such increases create pressures towards the rise of the relative prices of these products in Canada.

It would, therefore, be naïve to believe that monetary policy and economic agents' inflationist anticipation alone were the sources of the rise in the level of prices during the last two years. It is however, in our opinion, a mistake to believe that alone the special phenomena discussed above are at the origin of inflation and its acceleration in 1972-1973. The fact is that all serious empirical studies of the chronic accelerated inflation phenomenon unanimously consider this phenomenon to be a fundamentally monetary phenomenon. The 1972-1973 acceleration of inflation was, to a great extent, caused by an excessive acceleration in the growth rate of the volume of money. Due to the rapid rise of inflation, the workers were not however able to protect themselves efficaciously, as they were behindhand with their inflationist anticipations as compared with the inflation which actually occurred. Consequently, the expansion phase was a very long one. However, since the beginning of 1974, the Canadian unemployment rate has remained stable at about 5.5%. It would seem that the Canadian (and the American) economy started out on the contraction phase at the beginning of 1974. We can therefore anticipate, for the year 1975, an increase in unemployment without any notable decrease in inflation, for the inflationist psychosis is very solidly incorporated in the behaviours of economic agents, particularly in wage negotiations. This contraction phase will be accentuated by the effects of Canadian and American monetary policies which have become less expansionist since the end of 1973. The annual growth rate (irrespective of season) of the Canadian volume of money has indeed dropped from an average of 29.5% in the first quarter of 1974 to 12.5% in the month of May 1974.

Admittedly, as soon as the inflationist anticipations catch up, Canada will see a decided drop in the pressures for a rise in the level of prices. It is however to be expected that the fight against inflation will be long, and costly as regards a higher rate of unemployment. The fact is, we have to break an inflationist psychosis which has been developing at an accelerated rate for the past three years.

The Canadian and American recession anticipated for 1974-1975 is a direct consequence of the excessively expansionist monetary policy of recent years. We have waited too long before resolutely attacking the inflation problem. The voluntary income policies as advocated by the Canadian Commission on Incomes and Prices were complete failures, for they did not attack inflation at its sources. One cannot induce workers to demand wage increases only covering an increase of about 2% in productivity when the inflation rate is at 7.6%. If these voluntary action policies did have an effect on inflation, then it was a negative effect. The political profitability of income policies is, as a rule, high: the public often perceives them as concrete gestures by the Government against inflation. Thus, they can have the effect of holding back the adoption of adequate monetary policies. However, at the last federal elections the conservative party led by Mr. Stanfield advocated a prices and incomes control policy. Canadians rejected this policy by electing Mr. Trudeau's liberal party to power. The failure of such a policy in the United States, during phases I and II of the Nixon Plan, was still very fresh in the memory of Canadians.

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C H A P T E R I V

THE EFFECTS OF INFLATION ON THE DISTRIBUTION OF INCOME AND WEALTH

When the price of a product rises, there is a gainer and a loser: the seller and the purchaser. At first sight therefore it is not so evident that a rise in the price level constitutes a net cost to society. It is none the less obvious that it generates a redistribution of income and wealth, especially when it is badly anticipated, and such is the case in Canada since 1971.

Such a rise redistributes the income of individuals who want goods and services at prices fixed in advance to the advantages of those who purchase them. It redistributes the wealth of those who hold assets giving yields fixed in advance to the advantage of those to whom such holders of assets have lent.

Among those who incur losses as a result of non-anticipated (or inadequately anticipated) inflation are the following:

- 1) Old age persons drawing annuities fixed in terms of dollars;
- 2) Persons receiving government payments which are not indexed to the cost of living;

- 3) Workers whose work contracts fix wages in terms of dollars;
- 4) Persons who have lent their savings without anticipating the rise in prices. They will in fact receive dollars with a purchasing power seriously reduced by inflation; ✓
- 5) Those who hold cash. The value of the stock of money depreciates as inflation rises.

Among those who receive gains as a result of inflation are the following:

- 1) The entrepreneurs who have engaged workers whose wages are fixed in terms of dollars;
- 2) Persons who have debts and who pay them back at an interest rate fixed in advance. They in fact pay an interest rate cut down by the amount of the inflation rate;
- 3) The Government, for several reasons:
 - a) by creating money to finance expenses, the Government holders of money who pay the Government, by means of a reduction in the purchasing power of their stock of money. Such is the case in several Latin American countries, where the Government essentially finances itself by printing money;
 - b) if the rhythm of income tax payments is progressive (as is the case in Canada), those who pay the taxes, even when the purchasing power of their incomes remains constant, are forced to pay in a larger part of their incomes in taxes when they change their "marginal rates of taxation", on account of the higher monetary income;
 - c) the payments it has to make have a lower real value.

Without having made a very extensive study of statistics, we can take it that the effects of badly anticipated inflation on the distribution of incomes and wealth among the various income and wealth classes have tended to be those described above. However, the effect of badly anticipated inflation in terms of the various income classes is ambiguous. None the less, an American study (1) shows that, in 1969 in the United States, that part of inflation which had not been anticipated by the economic agents provoked a redistribution of the income and wealth of the poorest and the richest classes (the latter because they save a greater part of their income) to the advantage of the middle income classes. In addition, it redistributed the wealth of the oldest people (because they save more) to the advantage of the youngest (because they borrow more). We would

(1) G. L. Dach: Inflation; Who gains and who loses: Challenge. July 1974

not be surprised to find that a similar redistribution exists in Canada since the recent acceleration of Canadian inflation.

As opposed to badly anticipated inflation, inflation that has been well anticipated has much less marked redistribution effects. The Canadian experience shows that workers' (whether in trade unions or not) incomes are only very slightly affected by inflation (over the long term at least) when such inflation proceeds at a moderate pace. In this case, workers protect themselves almost completely against inflation over the long period. In the course of the 1961-1968 period, no chronic tendency towards a lowering of that part of the national income intended for the remuneration in wages was noted, and that was a period of (moderate) inflation acceleration.

Further, the savers, once they have perfectly anticipated inflation, will demand an inflation premium on the rates of interest of their financial assets, which will entirely compensate them for the loss of purchasing power of their future incomes. Empirically, the Latin American countries suffering from excessive inflation rates also offer very high nominal interest rates. Lastly, if the Government is not malevolent, it will index all its payments to the cost of living. This is, incidentally, the general policy of federal and provincial governments.

On the whole, when it is well anticipated, inflation only produces one important form of income redistribution, i. e. the form which affects the incomes of taxpayers and of holders of money, redistributed to the advantage of the government. However, in Canada since 1973, the Federal Government indexes the basic exemptions of its taxation system, as well as its rates of taxation, to the cost of living. The policy considerably lightens the harmful effect of inflation on taxpayers. But the Province of Québec has refused to index its taxation rates. It is to be hoped that it will soon follow the example of the Canadian Government.

Once taxation rates are perfectly indexed to the cost of living, only the holding of money is taxed by the Government as a result of inflation. This form of taxation, currently used in Latin America, is perhaps not less just than a progressive system of taxation such as is known in Canada. For the stock of money held by rich persons is, generally speaking, on the average higher than that held by poor people.

As we have just seen, the redistributive effects of inflation essentially depend on the extent to which such inflation is anticipated by the economic agents. It also depends - and this is very important in the case of a badly anticipated inflation - on the efficacy with which the various groups in the economy manage to protect themselves. Consequently, the incidence of inflation is closely linked up with the two phases of the monetary policy's transference of the impact. During the expansion phase, wages rise more slowly than prices. Thus, at this time there is a redistribution of income in wages to the advantage of business heads. This phenomenon is clearly seen in Canada since the beginning of the

inflation acceleration in 1971. For, whereas the income of labour as a percentage of the total national income was 75% at the beginning of 1971, it has dropped constantly since that time, reaching 70% in the first quarter of 1974 (1). In the same way, during this phase, the rise in nominal rates of interest (for those who save demand a premium against inflation) is less than that of prices. Thus there is a redistribution of creditors' wealth to the advantage of the debtors. During the contraction phase, the reverse redistribution takes place, as the economic agents proceed to a better anticipation of inflation. When unemployment becomes greater, the workers' share in the national income grows too; this fact was ascertained during the 1969-1971 recession in Canada. We must therefore expect there to be a redistribution of this same kind, from now on and during the next few years, during the contraction phase with its unemployment.

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C H A P T E R V

INFLATION, SAVINGS AND THE THRIFT AND CREDIT COOPERATIVES

A) THE EFFECT OF INFLATION ON THE OVERALL LEVEL OF SAVINGS AND CREDITS IN THE ECONOMY

We have seen that the inflationist process has redistribution effects on incomes and wealth. It is however not certain that the economy's overall savings will go down, or will go up, as an effect of inflation. For example, when inflation has been well anticipated by the community, we have seen that it redistributes the incomes of individuals to the advantage of the government. There will therefore be a rise or a drop in total savings depending on whether the government's tendency to save is higher or lower than that of the private sector. If the government decides to spend all the additional revenues stemming from inflation on the building of schools, hospitals and dams, the economy's total savings will be greater. Inflation in this case generates what may be called "forced savings".

On the other hand, the effects of badly anticipated inflation on overall savings will depend on the tendency level of those who realise a gain by inflation to save on this gain, as compared to the tendency level to save of those who undergo a loss.

The discussion above implicitly presupposes that inflation does not effect national income and that it only has effects in the distribution of income.

However, in a period of high and variable inflation, such inflation produces uncertainty in the capital market, generates bad allocation of savings and thus reduces the economy's total production. An ultimate case of such a process is the phenomenon of hyperinflation (as in Germany, at the end of the First World War). In such cases it is quite clear that inflation will produce a drop in overall savings. In any event, even if the saving tendency of all the economic agents remains constant, the drop in overall production will, due to this very fact, result in a decrease in overall saving.

B) THE EFFECT OF INFLATION ON SAVINGS IN THE QUEBEC CAISSES POPULAIRES

Inflation, when badly anticipated, generally provokes a reallocation of public financial assets savings, such as forward savings in banks and Caisses populaires or savings bonds, to the advantage of other assets such as durable goods (houses, paintings, etc...) and company shares. For whereas the last-mentioned assets give the saver good protection against inflation (over the long term at least), the first-mentioned do not offer this protection against the reduction of the real yield on savings caused by inflation. For example, since the nominal rate of interest on Caisse populaire savings deposits is fixed (at least for the short term) a rise in inflation, if it has not been anticipated, will produce a reduction in the real rates of interest on these assets. Moreover, physical assets give the saver better protection against inflation, if the value of the latter increases at the same rhythm as inflation.

Speaking generally, when inflation is as highly variable as it has been in Canada since 1972, it creates uncertainty among savers. It induces them to hoard assets giving a real yield which would not justify their accumulation in a time when inflation is non-existent. On the whole, it provokes a "dis-intermediation" phenomenon: savers lend less to financial intermediaries (to which the Caisses populaires belong) so that they may themselves invest in the purchase of physical assets or in the purchase of shares. This phenomenon provoked the setting up of policies at Government level, and at the Caisses populaires level, for the preservation of savings:

i) At governmental level

In its last budget, the Federal Government proposed to grant a basic exemption of \$1,000 on all income derived from yields on savings. The explicit purpose of this proposal was the safeguarding of that part of the yield on public savings which had been eaten away by recent inflation. The application of such a proposal will certainly have a positive effect on the rate of increase in savings placed in the Caisses populaires. It is however important to note that the yield on savings rescued by such a basic exemption positively depends on the marginal rate of taxation for persons whose yield from savings is lower than \$1,000. For if a person has a very low income, so that his rate of marginal

taxation is only 10%, the exemption will permit him to obtain a fiscal rate reduction equal to 10% of the recovery of the saving, whereas the fiscal rate reduction will be at 30% for a person whose taxation rate is 30%. While this proposal does have the effect of encouraging savings in the Caisses populaires, it nevertheless discriminates against the low income savers as compared with the others.

ii) At the Caisses populaires level

At the Caisses populaires level, the most important long-term element of strategy to be adopted by these Caisses so as to rescue public saving from the effects of inflation consists in respecting a policy of competitive rates of interest, both for savings and on loans. In other words, the Caisses have submitted to the mechanisms of the market. Put concretely, this means that the Caisses have followed (after some delay however) the rises in interest rates demanded and given by chartered banks on the various categories of their assets and liabilities.

The adoption of market mechanisms has enabled the Caisses populaires to preserve the major part of their growing savings. Let us make a brief study of the way these mechanisms work. First let us suppose that the rates of interest are initially constant. A rise in inflation creates a relative drop in the supply of savings (for the real yield of savings goes down) in the Caisses populaires and in other financial agencies, as well as a relative rise in these same financial agencies' requests for loans (for the rates of interest to be paid by the borrowers are lower in real terms). These two effects will thus generate pressures for a rise in the whole structure of interest rates on the various categories of assets and liabilities of these institutions. These rises in interest rates enable the Caisses to preserve (who create) deposits they would otherwise have lost, for these increases allow those who deposit savings in the Caisses to protect a part of the yield on their assets.

The rapid rise in Canadian interest rates since 1973 is explained by mechanisms of this kind: savers demand a premium against inflation, a premium that lenders are prepared to give them. To be sure, the premium demanded by the savers depends on the rate of inflation they anticipate. Now, the acceleration of the inflation rate in recent years was not perfectly anticipated by the savers (and by the workers). Consequently, the interest rates did not generally grow as rapidly as inflation and as a result, the real yield rates dropped appreciably (until, in certain cases, they became negative), varying on the average between 2% and 4% per year. Paradoxically, whereas rates of interest have never been so high, the yield from savings has never been so low and credit so cheap. This is a temporary situation however; as inflation comes to be better anticipated, market mechanisms will create pressures for the raising of savings interest rates as long as these rates will not have given the saver perfect protection. Over the long term, if inflation is perfectly anticipated, it is to be expected that the difference between the economy's nominal and real rates of interest will be equal to the rates of inflation. The effect of an expansionist monetary policy would thus be to increase and not to diminish nominal rates of interest over the long period, without having a notable influence on

real interest rates. It seems that the Caisses' strategy of adjustment to the market has borne its fruits thanks, in part, to the considerable rise in these interest rates (for example, the rate of interest on stable savings has gone up from 4% in January 1973 to 8.7% in July 1974). It is a fact that, so far, there has not been any considerable flight of savings from the Caisses. While the long-term growth strategy adopted by the Caisses consists in submitting to the market, they have also undertaken to adopt a series of special provisions at short term, so as to solve the profitability and liquidity problems generated by the recent inflation. We shall first study these two problems, and then go on to sketching the solutions brought forward by the Caisses for their solution.

iii) Profitability problems (1)

Whereas the Caisses populaires were very profitable in 1971 and 1972, this tendency became modified in 1973 and at the beginning of 1974. The results of operations by the Caisses populaires ending their financial year in January, February and March 1974 reveal a certain drop in the net income realised. This decrease in net income was ascertained in both absolute dollars and the percentage of liabilities due to members. This is a significant contrast to the position of the Caisses in 1970-1972. For during this latter period, the gross income of the Caisses went up from \$2.95 per \$100 of the liability-deposit in 1970 to \$3.45 per \$100 of liability deposit in 1972, i. e. a very rapid increase. The Caisses populaires have never been so profitable as they were during this period.

Why were the Caisses populaires so profitable during the first two years of the nineteen seventies whereas, recently, they have experienced a decrease in their net income? We know that the initial effect of an expansionist monetary policy (during the expansion phase) is to bring down all nominal interest rates, whereas its effect over the longer term is to make them go up, and to send them up as the savers become aware and anticipate inflation. That is what happened in Canada: from 1970 to April 1973, interest rates dropped and then did not cease to rise from that time on. Now, the net income of the Caisses varies in the reverse direction to that of nominal interest rates. In a period when interest rates are falling, the Caisses' income rises, whereas it falls in a period when interest rates are rising. This is explained by the structure of assets and liabilities categories of the Caisses. On the average, the assets categories are more deferred than the liabilities categories. The slightest rise of interest rates on the market instantly becomes expressed in liabilities costs (in particular, the costs of savings with operations and stable savings), whereas the yield of productive assets reacts slowly when there is a rise in the interest rate.

In fact, if an investment is made at an interest rate fixed for the whole duration of the investment (like bonds or acknowledgements of debts) or for partial duration thereof (mortgages) and the term of these assets is longer than that of the liabilities, the yield of the productive assets only starts a rise

(1) Federation de Quebec des Caisses populaires Desjardins, Report on the Liquidity and Profitability of the Caisses populaires Desjardins, Research and Development, July, 1974

after a certain delay. There is thus a squeeze on the Caisses' gross income when interest rates rise and when their rise has not been anticipated by the Caisses. The contrary movement occurs when there is a drop in interest rates.

Today's analysis of the economic situation leads us to believe that interest rates will continue to rise over the short term because of:

- a) The economic agencies' rising anticipations of inflation;
- b) and the initial effects of the Banque du Canada's more restrictive monetary policy

Over the long term, however, they will decrease, when this latter policy will have brought a part of the inflationist psychosis under control.

iv) Liquidity problems

Between April 1973 (when the rise in interest rates began) and March 1974 the Caisses populaires liquidity rate dropped from 46.9% to 42.6%. There are two main reasons for this phenomenon:

- a) The effect of badly anticipated inflation on the growth of the Caisses' assets and liabilities

Since, generally speaking, the real interest rates given by the Caisses and financial institutions have diminished since 1973, this has stimulated an accelerated demand for loans on the assets side of the Caisses, and has provoked a lower rhythm of savings growth on the liabilities' side. In March 1973, total loans grew on an annual basis of 24.3%; in March 1974 this growth corresponded to 30%. During this period, the deposit-liability showed a rate of increase of 21% with a slight slowing down at the beginning of 1974, giving 19%.

- b) The effect of badly anticipated inflation on the assets and liabilities structure

Here, two arguments can be put forward. Everything depends on the creditors' and debtors' inflation anticipations.

First let us suppose that they anticipate high rises in future inflation. This will have the effect of rejuvenating the liabilities structure of the financial institutions and of ageing the structure of their assets, thus creating a liquidity problem. This is explained as follows: when the saver anticipates future inflation rises, he will be led to place his savings in short-term assets, for he fears that an inflation rise may eat away a large part of this long-term assets. Thus, the supply of savings becomes more liquid than it would otherwise be. At the level of assets in financial

institutions, the result is the reverse: the demand for longer terms loans (such as mortgage loans), grows as compared with the demand for short-term loans. For if the borrower anticipates future inflation rises which are not entirely reflected in the long-term rates of interest, the cost of the loan will be reduced by a corresponding amount. The opposite argument can however be put forward if we suppose that the debtors and creditors anticipate a long-term decrease in inflation (even if the latter has been accelerating during the past three years). For it is a fact that they may foresee that the government is going to fight inflation which, sooner or later, will have to get back to a mere normal level. In this case, the liquidity of financial institutions, as opposed to the preceding case, will be improved.

It is still too early to analyse effectively whether the net effect of the changes in the structure of the balance sheet has been the bringing about of an increase or a decrease in the Caisses' liquidity. However, when one studies the differentials between the long-term and the short-term rates of interest since 1973, we see that this liquidity has dropped rather than risen. For example, the differential between the yield of ten-year or more than ten-year bonds, and that of three-year bonds, has decreased constantly since 1973, dropping from 1.68% in January 1973 to .44% in July 1974. This implies that, generally speaking, the savers have preferred long-term savings rather than short-term savings. Consequently, the structure of the balance sheet would not have had a downwards effect on the Caisses' liquidity; it would rather have had the reverse effect.

It is important to stress that, if all the economic agents anticipate the same inflation rate without making a mistake in their forecasts, the differential between the long-term and short-term rates of interest will permit debtors and creditors to protect themselves fully against future inflation.

v) Short-term dispositions by the Caisses populaires confronted with Profitability and Liquidity problems

The serious profitability and liquidity problems which the Caisses populaires have had to face since 1973 make the adoption of a common solution a necessity: short-term dispositions have to be set up so as to increase the liquidity of assets and decrease that of the liabilities.

Therefore, in July 1974, the Caisses populaires adopted seven important concrete proposals:

- a) To strictly respect the assets established liquidity norm due to members and to induce Caisses which have a liquidity lower than the norm to take the necessary steps for the restoring of this situation;
- b) To give preferential treatment to personal loans at the local, regional and provincial level, for such loans have a high circulation

rate; under the present economic situation, they are more liquid and more profitable;

- c) To suspend mortgage loans for Caisses whose liquidity rate is below the norm. For the others, to limit as far as possible the granting of mortgage loans of amounts remitted monthly in this same category. These loans are indeed only very slightly liquid and they diminish the profitability of the Caisse when interest rates on mortgage loans do not reflect future inflation to the full;
- d) To see that forward deposits preserve their special character by preventing their being paid out before their final date. In a case where such a deposit is refunded earlier, to fix a realistic penalty.

This proposal enables the stability of savings in the Caisses to be strengthened, and it reduces liquidity problems. It also reduces profitability problems, for a rise in the interest rate only has a delayed reaction on this kind of deposit;

- e) To examine attentively the various income and expenditure items in the budget operation, and to take all steps likely to increase the first-mentioned and to reduce the second, if need be;

At the Regional Unions' Level (Federations des Caisses)

- f) To constitute and maintain primary and auxiliary reserves of sufficient size, and made up of good quality securities;
- g) To see that the Caisses commit themselves to a growth strategy, taking care that this is supported by a structured and controlled mechanism, with a view to exploiting the best sources of funds and directing them towards the best investment opportunities.

It is of course too early to carry out a thorough study on the impact of these measures on the profitability and liquidity of the Caisses. The measures seem to reflect, in concrete terms, the desire of the Caisses populaires to adjust themselves to the market and to prevent a decrease in their net income, so as to remain competitive. Consequently, insofar as the market mechanisms foresee a too great a drop in financial institutions' savings, the above measures constitute a concrete strategy over the short term which will, we believe, enable a large part of inflation's harmful effects to be wiped out.

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C O N C L U S I O N

SUGGESTIONS FOR THE PROTECTION OF THE THRIFT AND CREDIT COOPERATIVE SAVINGS

The analysis we have elaborated attempts to show that market mechanisms through their positive effects on interest rates in an accelerated inflation context, enable a large part of thrift and credit cooperative savings to be protected.

The competitive strategy adopted by the Quebec Caisses populaires during recent years shows that it is possible to fight the effects of inflation on savings efficaciously by giving competitive rates of interest. The measures taken by the Caisses to make their operations profitable have permitted them to protect a large part of their assets.

Our first suggestion would therefore be that thrift and credit cooperatives be induced to adapt themselves as quickly as possible to the rates of interest of their competitors.

Our second suggestion would be that the thrift and credit cooperatives be invited to attract public savings by adopting policies directed towards:

- a) increasing information to the public on thrift and credit cooperatives (their objectives, the way they operate and their role in incentives to saving);
- b) improving the various services they offer to savers.

At a more general level, we have tried to show that the present inflation in Canada and abroad has as its fundamental source the excessive growth in the volume of money in the various countries. Further, we have brought forward the argument according to which the growing integration of international financial markets must induce each country to consider inflation as a world phenomenon.

In this context, we suggest that, in its capacity of an international pressure group; the thrift and credit cooperatives make representations to the various governments with a view to their adopting coordinated and stable monetary policies.

Finally we suggest, that within each individual country, thrift and credit cooperatives induce the various government authorities to adopt taxation policies which protect public savings, to some extent at least. The Canadian formula of a basic exemption on the first \$1,000 yield on savings can serve as an example, for lack of a better one.

Presented by: La Fédération de Québec des Caisses
Populaires Desjardins.
La Fédération de Montréal des
Caisses Desjardin.
La Fédération des Caisses d'Economie
du Québec.

INFLATION IN THE FEDERAL REPUBLIC OF GERMANY

I INFLATION WITHIN THE COUNTRY

1. a) CHARACTERISTICS:

According to the Deutsche Bundesbank's declarations (monthly report; June 1974), scarcely 50% of inflation is derived from imports (fiscality on raw materials being only partially recovered by the re-evaluation of the DM). Another important factor is constituted by production costs (interest charges included) whereas the public economy and monetary policy (volume of money) have rather had a restrictive effect.

b) SCOPE:

Lower than in all the other OECD countries.

2. Period when an acceleration in monetary inflation began to be noted: 1970.

3. Its manifestations: industry's production costs rise more rapidly than consumption prices.

4. Its principal consequences: unsound structural developments (for example, escape into sheltered values and main residences) and accentuation of social conflicts. Important: consequences of the anti-inflationist policy.

5. a) Principal causes: causes due to the structure of the economy itself: the increased importance given to services with their low productivity rates gives rise to a "dead weight" representing about 1 to 1.5%.

b) Principal causes: causes of a national character: See 1 a). It must be added that possibilities for the increase in prices are reinforced by the cartelisation of the markets (see the 1973 Bureau des Cartels report).

c) Principal causes: causes of an international character: raw materials prices explosion (petrol).

6. Figures on the accelerated monetary circulation: see Appendix 1.

7. Figures on price indices: see Appendix 2.

8. a) What technical means does your Government use to fight inflation: technical monetary means: discount rates, and rates of advances on securities by the Bundesbank, increase of compulsory reserves, reduction in rediscount quotas, suspending of the Bundesbank's advances on securities, and seeing that the importing of capital becomes more difficult (deposit of guarantees in cash, interdiction to remunerate foreign deposits).

b) What technical means does your Government use to fight inflation: political means: financial policy: limitation on the increase of public expenditures by the nation and by regions and districts: levying of a stability tax (10%), a tax on investments (11%), suspension of special amortisations on apartments and individual dwellings.

c) What technical means does your Government use to fight inflation: other means: an effort at persuasion strategy as an incentive to trade unions to be moderate in their wage claims - but not fixed rules for wages, nor control of prices and wages.

9. Is the inflation problem perceived by the public? Yes, in a rather market manner, seeing that the 1923 and 1947 experiences are still present in our minds.
10. How does this awareness reveal itself? Flight towards sheltered values - a tendency to vote for the opposition party.

II

INFLATION AND THRIFT AND CREDIT COOPERATIVES

1. What repercussions does inflation have on savings and the amounts of the deposits? There are moments when the repercussion is a regression of savings withdrawable at sight and an increase in fixed income securities and shorter amortizations. However, (since the Spring of 1974) there is a marked return movement towards the savings book following on the economic recession provoked by the restriction policy.
2. On the operating of Mutual Credit Banks?
3. What measures have been taken to encourage saving? Increase in the rates of interest (savings plan, forward deposits), and reduction in the period for refunding of loans.
4. What consequences does inflation have on savings by the mass of the people? On savings taken as a whole: none at all, but there is a restructuring in the forms of saving (see II, 1 to 3). Decrease in the savings of the population sector where net income is decreasing.
5. What special measures have been taken for short-term saving?
6. What special measures have been taken for medium-term saving?
7. What special measures have been taken for long-term saving?
8. a) Have these measures had positive effects? Yes, considering that, taken as a whole, savings have not dropped.
b) What criticisms can be made of them? Incidence on the long-term capital market; necessity for the reinforcement of roll-over financing and thus a greater instability on financial markets.
9. a) Do these measures have repercussions on lending and borrowing interest rates? Yes.
b) What repercussions? Increase in the rates of interest (see II, 3).
10. How are these new rates passed on to prices? It can be presumed that they have a partial repercussion on prices, but the effects are not quantifiable.
11. Consequences of anti-inflationist measures on the management of credit banks and their federations. As a result of a lowering of the margins of interest, a search for profits in other sectors (currencies market).
12. Consequences of governmental anti-inflationist decisions on the thrift and credit cooperatives in your country.

III

AT THE INTERNATIONAL LEVEL

Is the free circulation of capital at the international level an encouragement to inflation in your country at the national level? Following on the introduction of restrictions on the importing of capital (see I, 8 a)) and the freeing of the DM exchange rate, this influence is now on the decrease; in addition, the Bundesbank tries to counterbalance it by compulsory reserves.

In what form; investments, over expansion, influence on the trade balance or on the balance of payments of each country? Repercussions due to the international structure of prices exceptionally favourable trade balances, great increases in the prices of imports but a partial possibility of transferring this to exports.

What in your opinion is the repercussion of inflation in industrialised countries on developing countries? Since the underdeveloped countries, poor in raw materials and petrol, cannot purchase investment goods from industrialised countries, the trade balance of these countries deteriorates

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Frankfurt-am-Main
Abt. Volkswirtschaft und Presse
Vi/Ha/He

Presented by:
Bank Für Gemeinwirtschaft
Frankfurt/Main

I N F L A T I O N I N J A P A N

I. INFLATION WITHIN THE COUNTRY

Characteristics of inflation here in Japan for the past three years could be roughly described as follows.

- a) After the revaluation of Japanese yen in 1971, influx of U.S. dollar to Japan was envisaged with resultant increase of liquidity on the part of city banks. Thus, loans granted by the city banks has been on the increase which gradually but inevitably pushed up prices.
- b) In 1973, due mainly to the price hike of imported agricultural products, the spiral of increasing prices has been accelerated. Moreover, the rise of price of crude oil which suddenly hit the Japanese economy in the fall of 1973 led to an unreasonable high prices.
Causes of inflation in Japan could be found in the external factors such as chaotic international monetary situation and the increasing price of crude oil, supply of which is almost exclusively dependent on import, and domestic factors have been played a comparatively small part. It could be said that the impact of inflation has been given to almost all commodities and an acceleration in monetary inflation began to be noted since the second half of 1973.

Means used to cope with inflation

a) monetary means

1. increase of the discount rate of the Bank of Japan

This rate applied to the discount of commercial bill by the central bank of Japan and has been increased from 4.25% per annum in June 1972 up to 9% per annum in December 1973.

2. Increase of reserve rate

This rate, applied to the compulsory reserve deposits with the Bank of Japan, has been raised from 1% per annum to 3.5% per annum on an average during the same period mentioned above.

3. Quantitative credit control imposed by the Bank of Japan

The increment of loans to be made by banks has been restricted by the Bank of Japan. This curb on credit has been imposed for every quarter of the year and the rate of the decrease of the increment for the previous corresponding quarter of the year has been 10% and at the extreme case, it reached as high as 50% that means the increase of loans for the particular quarter of the year was halved in comparison with the corresponding 3 months in the previous year.

4. qualitative credit curb adopted by the Bank of Japan

The objective of this curb was to restrict specific loans to be made by banks, e. g. loans for construction, trading firms, etc.

b) political means

The Japanese Government deferred the release of the public finance by controlling the public works expenses and also froze prices of important materials. At the outset of the oil crisis at the end of 1973, more than 50 items were subject to this control.

Reaction by the public

The inflationary impact has been penetrated deep into the general public, and the public has been reacted very sensitively to every measures which might affect prices. Recent consumers' movement in this connection was manifested by the campaign "to pay the electricity bill less one Japanese yen" which was initiated after it was reported that one of the nine electricity companies in Japan has been making political fund contribution to the conservative party, while asking the general public to pay more charge than ever.

"Minus one yen" meant the firm stand taken by the public against the political contribution by the company which should bear the moral public responsibility.

In the light of increasing prices, especially prices of food, the consumers' cooperative movement has gained its strength while the problem of direct transaction between producer and consumer has become a matter of primary concern among the general public.

In the political scenery, such public feelings have been manifested at the time of the election of members of House of Councilors (Upper House of the Parliament in Japan) held in July 1974. The ruling conservative party lost some seats by this election and since then the Government has been taking rather strict economic policies.

II. INFLATION IN THRIFT AND CREDIT COOPERATIVES

As the inflationary impact has been brought by factors almost all of which are beyond control of the cooperative movement, the brief report to be followed are concerned about general measures and not limited to the exclusive cooperative efforts which are seldom here in Japan in this context.

Fixed interest rate prevent drastic change of amount of personal savings

Some decrease in the rate of increase of savings has been recorded. But this has been caused by the recent tapering tendency of the proceeds of sales of land, and not by the inflation itself. Rather, the personal consumption has been almost self-restrained. This phenomenon is perhaps

peculiar to current situation in Japan where the personal investment opportunities have been limited to a degree.

The regulatory measures on the interest rate have been enforced, taking due consideration of the balance between the interest rates of savings, bank debentures, corporate bonds etc. And now in Japan, there is no such investment papers as "commercial papers" in the U. S. A.

Measures taken to encourage savings and their receptivity

The guide line to the interest rate of deposits set out by the Bank of Japan shows maximum limits. This maximum guide line has been adopted by all savings institutions and the interest rate of deposits in Japan is lacking flexibility.

The guide line to 1 year time deposits has been increased from 5.25% per annum in July 1972 to 7.75% per annum in September 1974.

Income tax relief for the personal income from the interest of savings has been applied to promote personal savings, and the maximum of such personal savings to be exempted from income tax has been increased from 3 million yen to 5 million yen per person.

For the purpose of absorbing personal savings at the time of influx of bonuses--- it is customarily paid out twice a year in Japan namely in June and December--- the six months time deposits which are deposited with banks during such bonus periods receive 1% per annum extra interest. Other measures includes the sales of certificate for 6 months time deposits with lottery numbers. The rate of interest of this deposits is 3% less than the ordinary 6 months time deposits, but the first prize winner receives 10 million yen out of a batch of 3,000 million yen 6 months time deposits. Receptivity of the preferential treatment for the 6 months time deposits at the time of bonus seasons has been remarkable, but that of the lottery-number bearing 6 months time deposits is getting lower just after the popular initial sales.

Up until the middle of 1973, terms of time deposits in Japan have been 1 and a half year, 1 year, 6 months and 3 months. In July 1973, 2 year time deposits was introduced for the first time with annual interest rate of 6.5% which is now raised to 8% per annum. 1 and a half year deposits was abolished in January 1974.

There are no longer term savings than the above mentioned 2 year deposits. The long term personal investments have been made by purchasing bank debentures and industrial bonds, and their rate of interest has been also raised recently.

Average contracted interest rate of loans and discount of all banks in Japan has been increased from 6.888% per annum in May 1973 to 9.193% in May 1974.

III. INTERNATIONAL EFFECTS

Under the floating of currencies, the outflow of foreign currencies from Japan will accelerate the domestic inflation because of the resultant

price hike of imported goods and material caused by comparatively weak position of the Japanese yen in this case (The influx of foreign currencies will have reverse effects).

IV. CONCLUDING REMARKS

As mentioned before, thrift and credit cooperatives will have very little answer in solving sophisticated worldwide inflation. As also cited above, the situation is even more worse in Japan where flexibility of the interest rate of savings has been almost lost.

Nevertheless, cooperatives in Japan could do something to make up for a decline in the real value of deposits under inflation, e. g. the increase of the patronage dividend by rationalizing business activities. We could not, however, put over emphasis on such an action because of its limitations

We do believe that for the time being, the exchange of current information and expertise between our own thrift and credit cooperatives is one of the most pressing needs in this changing world of today.

Presented by: The Central Cooperative
Bank for Agriculture
& Forestry.
Tokyo, Japan.

Consumer Price Indexes (1970 = 100)

Wholesale Price Indexes (1970 = 100)

	Consumer Price Indexes (1970 = 100)		Wholesale Price Indexes (1970 = 100)	
	Index	Annual Changes (%)	Index	Annual Changes (%)
1971	average	106.1	99.2	(-) 0.7
1972	average	110.9	100.0	(+) 0.8
	Mar.	109.2	98.7	(-) 10.7
	June	110.7	99.1	(-) 10.4
	Sept.	112.2	100.5	(-) 9.1
	Dec.	113.4	104.3	(-) 5.0
1973	average	123.9	115.9	(+) 15.9
	Mar.	118.4	109.6	(-) 11.1
	June	123.0	112.6	(-) 11.4
	Sept.	128.6	119.3	(*) 18.7
	Dec.	135.1	134.5	(+) 29.0
1974	Mar.	146.8	148.4	(-) 35.4
	June	152.0	152.4	(-) 35.3

(#100 Million)

Money Supply
Money (M 1)

Quasi-Money (Time & Money & Quasi-Money
savings Deposits) (M 2)

	Money Supply Money (M 1)		Deposit Money	Quasi-Money (Time & Money & Quasi-Money savings Deposits) (M 2)	
	Outstanding	Cash currency in circulation		Outstanding	Outstanding
1970					
Sept.	185,761	40,009	145,752	317,091	502,852
Dec.	213,595	50,978	162,617	328,778	542,373
1971					
Mar.	211,873	45,451	166,422	338,147	550,020
June	232,536	48,468	184,068	355,915	588,451
Sept.	240,976	-	193,637	378,106	619,082
Dec.	276,931	59,577	217,354	397,051	673,982
1972					
Mar.	270,625	52,873	217,752	411,623	682,248
June	278,776	57,060	221,716	443,831	722,607
Sept.	288,134	57,388	230,746	467,204	755,338
Dec.	345,261	77,061	268,200	495,144	840,405
1973					
Mar.	344,753	67,262	277,491	508,709	853,462
June	362,053	72,553	289,500	539,287	901,340
Sept.	365,878	71,327	294,551	562,438	928,316
Dec.	403,115	91,133	311,982	578,770	981,885
1974					
Mar.	397,788	80,768	317,020	584,570	982,358
June	418,998	90,248	328,750	602,595	1,021,593

1. The figures for "Cash Currency in Circulation" represent the amount of the issue of bank notes and subsidiary coins less the amount of cash currency held by all banks.
2. The figures for "Deposit Money" represent the total of demand deposits (current deposits, ordinary deposits, deposits at notice and special deposits) in private and public deposits, minus the checks and bills held by all banks.
3. The figures for "Quasi-Money" (time and savings deposits) represent the total (excluding the above mentioned demand deposits) of private deposits and public deposits plus installments of mutual loan and savings banks.

		(U.S.\$ million)					
<u>Balance of Payment</u>		Trade Balance	Exports	Imports	Services	Transfer	Long-Term Capital
1970	1,970	3,963	18,969	15,006	△ 1,785	△ 208	△ 1,591
1971	5,797	7,787	23,566	15,779	△ 1,738	△ 252	△ 1,082
1972	6,624	8,971	28,032	19,061	△ 1,883	△ 464	△ 4,407
1973	136	3,688	36,264	32,576	△ 3,510	△ 314	△ 9,750
<u>Short-Term Capital</u>		<u>Errors & Omissions</u>		<u>Overall Balance</u>			
1970	724		271		1,374		
1971	2,435		527		7,677		
1972	1,966		638		4,741		
1973	2,407	△ 2,595			△ 10,074		

Discount Rate of the Bank of Japan

1972 June	4.25%
1973 April	5.00%
1973 May	5.50%
1973 July	6.00%
1973 August	7.00%
1973 December	9.00%

Reserve Rate on Balance of Deposits (Reserve Deposits should be deposited with the Bank of Japan)

As of June 1972

(A) All Banks

- (1) Deposits of More than ¥100 Billion
- | | |
|----------------|-------|
| Time Deposits | 0.50% |
| Other Deposits | 1.50% |
- (2) Deposits of ¥100 Billion or less
- | | |
|----------------|-------|
| Time Deposits- | 0.25% |
| Other Deposits | 0.75% |
- (B) Mutual Loan and Savings Banks & Credit Associations (Deposits of More than ¥20 Billion)

Deposits of ¥100 Billion or less but more than ¥20 Billion

Time Deposits	0.25%
Other Deposits	0.75%

(C) The Central Cooperative Bank for Agriculture & Forestry

Time Deposits	0.25%
Other Deposits	0.75%

As of December, 1973

(A) All Banks

- (1) Deposits of More than ¥1,000 Billion
- | | |
|----------------|-------|
| Time Deposits | 2.00% |
| Other Deposits | 3.75% |
- (2) Deposits of ¥1,000 Billion or less but more than 100 Billion
- | | |
|----------------|-------|
| Time Deposits | 1.00% |
| Other Deposits | 2.50% |
- (3) Deposits of ¥100 Billion or less

Time Deposits	0.25%
Other Deposits	1.50%

(B) Mutual loan and Savings Banks & Credit Associations (Deposits of more than ¥20 Billion)

Deposits of more than ¥20 Billion

Time Deposits	0.25%
Other Deposits	1.50%

(C) The Central Cooperative Bank for Agriculture & Forestry

Time Deposits	0.25%
Other Deposits	1.50%

The guide-line to the interest rate of deposits set out by the Bank of Japan. (% per annum)

	Time Deposits			2 years	Installment Savings	Deposits for Tax Payments	Ordinary Deposits	Deposits at Notice
	3 months	6 months	1 year					
1970								
April 1st	4.0	5.0	5.5		3.9	3.0	2.25	2.5
April 20th			5.75					
1971 Feb.			↓	6.0		↓	↓	↓
1972 July	3.75	4.75	5.25	5.5		2.75	2.0	2.25
1973 April	4.0	5.0	5.75	6.0		3.0	2.25	2.5
July			↓	6.25		↓	↓	↓
Oct.	4.25	5.25	6.25	6.5	4.1	3.25	2.5	2.75
1974 Jan.	5.25	6.25	7.25	(abolished)	4.6	3.75	3.0	3.25
Sept.	5.5	6.75	7.75	8.0	4.8	3.75	3.0	3.25

In the case of deposits of Agricultural Cooperatives, Fisheries Cooperatives, Credit Cooperatives, Credit Associations and Labour Credit Associations:

following rate could be added to the above table:	Time Deposits	0.1%
	Deposits for Tax Payment	}
	Ordinary Deposits	
	Deposits at Notice	

<u>Accounts of All Banks</u>		<u>(#100 million)</u>		<u>Average Contracted Interest</u>
	<u>Balance of Deposits</u>	<u>Balance of Loans & Discounts</u>		<u>Rate on Loans & Discounts of</u>
				<u>All Banks (%)</u>
1971 Mar.	426,836	411,751		7.66
June	453,056	431,980		7.62
Sept.	488,038	457,355		7.54
Dec.	522,757	490,480		7.46
1972 Mar.	547,159	511,022		7.27
June	571,728	532,155		7.13
Sept.	612,004	569,631		6.81
Dec.	660,378	615,993		6.72
1973 Mar.	690,200	640,269		6.71
June	703,817	660,254		7.02
Sept.	730,587	688,785		7.50
Dec.	744,172	718,533		7.93
1974 Mar.	761,190	735,407		9.03
June	766,818	750,722		9.22

Agricultural Credit Cooperatives in Japan (in Million U.S. dollars)

	31st March, 1973		31st March, 1974	
Source of Fund		%		%
Deposits	35,568	78.6	43,595	78.6
Debentures	2,262	5.0	2,735	4.9
Borrowings	12	0.0	14	0.0
Bills sold	-	-	548	1.0
Trusted money for loans	3,704	8.2	4,120	7.4
Other a/c	3,692	8.2	4,478	8.1
Total	45,238	100.0	55,490	100.0
Employment of Fund				
Cash & Deposits with others	2,358	5.2	2,272	4.1
Securities	9,836	21.7	9,270	16.7
Money trust	35	0.1	18	0.0
Loans	26,532	58.7	35,896	64.7
(Agricultural Organizations)	(18,346)	(40.6)	(26,683)	(48.1)
(Fisheries & Forestry Organizations)	(1,008)	(2.2)	(1,342)	(2.4)
(Related Industries)	(3,826)	(8.5)	(4,459)	(8.1)
(Non affiliated Organizations with primary & secondary cooperatives)	(1,887)	(4.2)	(3,123)	(5.6)
(Financial Institutions)	(1,465)	(3.2)	(289)	(0.5)
Entrusted Loans.	3,733	8.2	4,149	7.5
Other a/c	2,744	6.1	3,885	7.0
Total	45,238	100.0	55,490	100.0

※ Conversion rate applied : 1 US \$ = 290 Japanese Yen

2. Consolidated Banks' system Balance Sheet

Balance Sheet as of 31st March, 1974

*(in Million U.S. dollars)

Primary Agricultural Cooperatives		Prefectural Credit Federations	
Assets	Liabilities	Assets	Liabilities
Cash	166	Cash	65
Deposits with Others	38,968	Deposits with Others	19,659
Securities	17,813	Money trust	7,233
Loans	1,569	Securities	18
Other a/c	21,327	Loans	5,241
Total	43,512	Other a/c	10,983
		Total	24,465
			Total
			24,465

* Conversion rate applied : 1 US \$ = 290 Japanese Yen



*
Agricultural Credit Cooperatives in Japan (in Million U.S. dollars)

	31st March, 1973		31st March, 1974	
Source of Fund		%		%
Deposits	35,568	78.6	43,595	78.6
Debentures	2,262	5.0	2,735	4.9
Borrowings	12	0.0	14	0.0
Bills sold	-	-	548	1.0
Trusted money for loans	3,704	8.2	4,120	7.4
Other a/c	3,692	8.2	4,478	8.1
Total	45,238	100.0	55,490	100.0
Employment of Fund				
Cash & Deposits with others	2,358	5.2	2,272	4.1
Securities	9,836	21.7	9,270	16.7
Money trust	35	0.1	18	0.0
Loans	26,532	58.7	35,896	64.7
(Agricultural Organizations)	(18,346)	(40.6)	(26,683)	(48.1)
(Fisheries & Forestry Organizations)	(1,008)	(2.2)	(1,342)	(2.4)
(Related Industries)	(3,826)	(8.5)	(4,459)	(8.1)
(Non affiliated Organizations with primary & secondary cooperatives)	(1,887)	(4.2)	(3,123)	(5.6)
(Financial Institutions)	(1,465)	(3.2)	(289)	(0.5)
Entrusted Loans.	3,733	8.2	4,149	7.5
Other a/c	2,744	6.1	3,885	7.0
Total	45,238	100.0	55,490	100.0

* Conversion rate applied : 1 US \$ = 290 Japanese Yen

Balance Sheet as of 31st March, 1974

*(in Million U.S. dollars)

Primary Agricultural Cooperatives		Prefectural Credit Federations	
Assets	Liabilities	Assets	Liabilities
Cash	166	Cash	65
Deposits with Others	17,813	Deposits with Others	19,659
Securities	1,569	Deposits with Others	7,233
Loans	21,327	Money trust	18
Other a/c	2,637	Securities	5,241
Total	43,512	Loans	10,983
		Other a/c	925
		Total	24,465
		Total	24,465

* Conversion rate applied : 1 US \$ = 290 Japanese Yen



* The Central Cooperative Bank for Agriculture & Forestry

(in Million U.S. dollars)

	31st March, 1973 (A)	31st March, 1974 (B)	B/Ax100 %
Assets			
Cash & Deposits with Others	1,275	1,209	94.8
Securities	3,664	2,459	67.1
Loans	6,912	9,677	140.0
(Agricultural organizations)	(1,412)	(3,716)	(263.1)
(Fisheries & Forestry organizations)	(1,008)	(1,341)	(133.0)
(Related Industries)	(3,827)	(4,460)	(116.5)
(Financial Institutions & Others)	(655)	(160)	(24.1)
Other a/c	275	324	117.8
Total	12,126	13,669	112.7
Liabilities			
Deposits	8,898	9,184	103.2
Debentures	2,263	2,735	120.8
Borrowings	12	14	116.6
Bills sold	-	548	-
Other a/c	953	1,188	124.6
Total	12,126	13,669	112.7

* Conversion rate applied : 1 US \$ = 290 Japanese Yen

THE EURO-MARKET
AND THE PROTECTION OF DEPOSITORS

When, in the past, the problem of protecting savings - and in most countries public authorities are constantly on the alert to this problem - has been raised, the idea of such protection has been confined to national capital markets only. And, incidentally, this is not unduly surprising.

First of all, is it necessary to recall that parallel international markets are of recent origin. Only a decade ago, no-one would have dared forecast the extraordinary growth that the Euro-currencies and Euro-issues markets were about to experience as from the beginning of the second half of the sixties. And going still further, how could one possibly have predicted at that time that the Euro-markets, the international money markets and the international capital market, to a certain extent taking over from the national financial markets and even taking their place, would subsequently generate the difficult problems of growth which preoccupy us at the present time?

To protect savings and depositors is to
meet a risk

No deal is without risk. All bankers confirm this. And this is certainly true of the Euro-market too. At the outset, and up till one or two years ago the risk run by those who set out on this path appeared however as a normal risk which no-one believed could be considered excessive, or out of proportion with the risk incurred by bankers every day when they had to confront the risks of national financial markets. This belief stemmed from a certain number of characteristics which, at that time, applied to transactions going through the Euro-market channel. . . Certain of these characteristics deserve to be recalled:

- a) Access to the Euro-currencies and Euro-issues markets was restricted to debtors and creditors of very high financial and good quality.
- b) The great liquidity of these markets and the fact that they continuously had fresh, new funds available enabled them to develop without being subject to shocks and insecurity.
- c) Admittedly, exchange risks have never been absent from the Euro-currencies and Euro-issues markets. However, departing from 1958 to 1968, i.e. during the first ten years of their existence, under the system of fixed parities with the possibility of converting of currencies into gold, they adapted themselves very well to this risk since it was limited by very narrow margins of fluctuation. (The progressive abolition of the convertibility of currencies into gold and the advancement of the international monetary system towards a quasi generalized system of floating currencies - this evolution having been consecrated in March 1973 - clearly modified the situation appreciably, conferring new dimensions on the exchange risks).

d) Up to 1971 - 1972, the Euro-currencies and Euro-issues markets operated one beside the other, each with its specific purpose. Thus, at that time and and prior to the spectacular rise of a market which became inserted between the two, i.e. the Euro-credits market, there were no acute problems in the field of the transformation of expiration periods.

e) At the commencement of the Euro-market and up till recently, the risk on the Euro-Market, if there was one, was located at the level of a few large Euro-banks which were alone engaged on this market.

The recalling of these characteristics brings simultaneously into relief how very greatly this situation has changed in a very short time, and how it results in a fundamental modification of the nature and dimensions of the risk.

Is there any need to go over this evolution again? Perhaps it will suffice to put the emphasis on a few of its most serious and critical consequences, specifically those which have given rise to the problem of the protection of deposits at the Euro-market level.

Risks which have increased progressively

In this connection, it is of some interest to point out that, at its beginnings, the Euro-market was restricted to a few privileged banks which had really supranational dimensions but that, little by little, its attractions began to influence what can be called the "second-line addressees". Here it is to be noted that, in the Luxembourg center which has undoubtedly taken a non negligible part in the development, firstly of Euro-issues and, secondly, in the rise of the Euro-credits market, the number of banking institutions rose from 19 at the end of 1960 to 74 on 31st December 1973. Knowing that pretty well all the new banking institutions were set up on account of international considerations - in other words, so as to be right on the spot for the Euro-currencies and Euro-issues markets - we have a measure of the irresistible forces of attraction that the parallel international markets have exercised on banks, no matter what their countries of origin may be. The example of Luxembourg is perhaps not a good choice when it comes to giving a faithful picture of the rhythm of growth in the number of Euro-banks. For, after all, by taking care to fix selective criteria, as regards the size of ownership funds, for example, and by requiring a minimum capital which, at present is 250 million Francs, and which is doubtless the highest in Europe, the Grand Duchy has taken care not to encourage the growth of the number of Euro-banks on its territory at any cost. In this connection the Swiss example is much more eloquent. We know, for example, that in the course of the second half of the sixties decade there were 25 institutions on Swiss soil which were specialized on the Euro-currencies market and that, in the meantime this number has attained a figure of 600. Under such conditions we may have doubts as to whether - and such doubts have been confirmed by recent events, all the institutions operating on the Euro-market can claim to have the required financial capacity and the indispensable experience they need to face up to the hazards of a market on which risks resulting from a whole set of causes have not ceased to grow.

Do we need to list these risks?

- a) First, the substituting of the Euro-issues market, for reasons known to us, by the Euro-credits market has proceeded at the same pace as the rupturing of the equilibrium of maturities, the renewable, so-called "roll-over credits" today being financed essentially by short-term deposits. Thus, each time they fall due, the delicate problem of refinancing can hardly be avoided. In this connection, it is not without interest to recall, if need be, that the volume of Euro-credits reached 25 milliard dollars in 1973 and that it will considerably exceed this figure in 1974, in spite of the confidence crisis hanging over the Euro-market, since last June and which was provoked by a few resounding bank collapses. Now, the calls for Euro-loans to finance investments are continually decreasing, their volume having fallen from 5 milliard in 1972 to 3.7 milliard in 1973. It will have difficulty in reaching 1.5 milliard dollars in 1974, judging by the results of the first three quarters of this year. Simultaneously, access to the Euro-credits market has, little by little also opened to so-called second zone debtors. Thus, to the risk arising from the growing lack of harmony of maturities is further added that resulting from the degraded quality of the debtors.
- b) In addition, with the petrol crisis, the political risk has made its appearance on the Euro-market. The balances of payments of certain number of industrial countries which are heavy consumers of petrol products derived from the Middle East have deteriorated to a point where the Euro-banks respond increasingly more reservedly to requests for credits from these countries, since they present great risks. Italy, for example, whose debts to foreign countries are beginning to reach alarming proportions, is experiencing the backlash of this development at the present time.
- c) But of all the phenomena which oppose the harmonious developments of the Euro-market, the exchange rates risk is the one which has doubtless provoked the most disturbing repercussions. The floating of currencies having become generalized in 1973, the exchange rate risk, which had been kept within limits lower than 2% in compliance with the parities system fixed as had been provided for in the Bretton Woods agreements, abruptly reached dangerous proportions for all those dealing on the Euro-market, for both financial intermediaries and their clients. It was, incidentally, under the impact of the exchange rate risk, which - considering the great extent of the variations in the exchange rates risk, which - considering the great extent of the variations in the exchange rates quoted - can attain 20% of the funds concerned, that the Euro-currencies market found itself confronted with a string of accidents.
- d) A further characteristic of this recent evolution: Today, not only the financial intermediaries and depositors of great sum risk suffering directly or indirectly under the repercussions and misfortunes likely to arise through disturbances in the international financial market; the small saver is very unlikely to be able to escape their effects. There are various reasons for this. Firstly, many are the small savers who, rather than placing savings in a savings-bank book where the yield in interest is not high enough to compensate for the fall in purchasing power, prefer to have the benefit of the more remunerative rates given on the international money markets and to invest their

money for periods of 1 to 12 months. Many of them, so as to reach the minimum deposit of about 1 million Belgian francs necessary for the entrance into the Euro-market, have not even hesitated to form groups and to pool their economies. But even those small savers who have not proceeded to make forward investments on the international money market are not protected against repercussions in every case. Through the channel of inter-bank deposits, which have developed rapidly recently, the banking system, has become an integrated entity at the international level. Is there any need to point out that it is not rare for banks dealing in the Euro-market to draw their financial means, up to as much as 90%, from inter-bank deposits? From that moment on, if there is a breakage at one point, it is hardly likely that the other links in the chain will not feel it. This means that it is not impossible that a wave started up by throwing a brick into a pond - as one banker put it - will not reach the edges of the pond and result also in damage to the small saver.

Action at three levels

"It's an ill wind that blows nobody any good" as the proverb says. The effects of the confidence crisis started on the Euro-market have been salutary in the sense that they have helped towards a real awareness to the situation. More than ever, all concerned - the monetary authorities included - are convinced that it is time to organize defense lines and to set up a system of protection and support.

In recent months it has become clear that the efforts made are driving in three directions with the three following objectives:

- Indemnification of the victims of bank collapses
- Reinforcement of controls, in particular with respect to the supervising of forward operations on currency market and, lastly,
- The setting up of systems of bank inter-aid, whose task it will be to rescue credit institutions cornered by temporary liquidity difficulties.

When speaking of indemnifying victims of bank failure, we obviously think first of all of the most spectacular accident which happened in the Euro-market, the collapse of the Bank Herstatt. In the Federal Republic, Banking solidarity immediately acted in favour of the small saver. The day following the closing of this credit institution, the Managing Board of the Federal Association of German Banks decided to call on the relief fund instituted by the banking profession - the Fund known as the "Feuerwehrrfonds" - to ensure the 100% refund of all assets below 20,000 DM per person. ^{as a} ^{on DM,} ^{meas-} able to do this, the relief fund, endowed with 30 million DM, was immediately supplied with additional resources. ^{to,} ^{ff-} It was inspired by highly social objectives, its purpose was to give priority to the protection of small savers against the effects of the collapse. As the liquidation of this bank is

still in progress, it would be premature to judge how far the interests of depositors will be protected. What can however be stated is that a clear tendency is revealed to fix the shares so as to take into account of the social category of the depositors.

But the repair of the effects of a collapse are not enough. Prevention is better than cure and, while preventing, measures should be taken to avoid all repetition of similar cases and to put an end to the confidence crisis from which the Euro-market is suffering at the present time. This is precisely one of the principal lessons that financial milieus as well as public authorities believe they must draw from the unhappy events of the past. This was first done at the national level. The supervision of forward operations on the currency market have been reinforced. Wherever banks had not so far been required to send in statements of their currency positions to the control authorities regularly, this obligation has been introduced. Thus, countries such as the United States, the Federal Republic, Great Britain and Switzerland, among others, have come to support their control arrangements better and to make them more forceful.

A safety device set up at the international level

It none the less remains true that the re-establishment of a favourable climate and the return to normal activities on the Euro-market which stretches over frontiers requires concerted action of international scope. Finance Ministers and monetary authorities have at last realized this. Meeting in Champs-sur-Marne near Paris on 7th and 8th September, the great money-lenders of the most important industrial powers have at last agreed to intensify their exchange of information on operations utilizing the Euro-market channels, to work together on the indispensable supervisory measures, and to see that their assistance is given, through the intermediary of their central banks, to banks cornered by passing liquidation difficulties. The following day, i.e. the 9th September, the Governors of the Issuing Banks of the German Federal Republic, France, Great Britain, Italy, Japan and the United States, meeting in Basel, confirmed their intentions to give proof of solidarity. They agreed, as is stated in their press release, "to intensify the exchange of information between central banks on the activities of banks operating on the international markets and, in the event of necessity, to tighten still further the regulations applicable to places of exchange". Within this context, there were some who even talked of placing the Euro-dollar market under supervision. Admittedly, this is an unsuitable term to use for a market that is so difficult to grasp. None the less, it is true that the will to find a way to manage and support it is becoming progressively more pronounced today among monetary authorities, particularly in the sense that the central banks, during their meeting in Basel, showed that they were aware of the role they will have to play in the immediate future, in their capacity of "lenders of the last resort".

"The Governors", as they confirmed in their press release "also proceeded to exchange their views on the question of the "last resort lender" where Euro-markets are concerned". They recognized that it would not be practical to fix in advance in a detailed manner the rules and procedures permitting the temporary providing of liquidities but that they had ascertained that the means for so doing were available and would be utilized if the occasion arises".

Generally speaking, this declaration was received with satisfaction and relief by international financial milieus for, in spite of the prudent way it was stated, they perceived in it the expression of the Issue Banks' determination no longer to remain indifferent to failures which might occur on the Euro-market but rather, in such a case, to act as a last rampart whenever deep defense lines are needed. Some of those present, such as Mr. Franz Heinrich Ulrich, spokesman for the Deutsche Bank Directorate, said they considered the Basel declaration to be an important landmark on the way, seeing that the Governors of the central banks, in giving proof of their solidarity, had contributed appreciably to doing away with the confidence crisis that had overpowered the international capital markets. At the same time, the Directors of the large Euro-banks welcomed the fact that no automatic mutual aid machinery had been set up by the Presidents of Issure Banks, but that it was their intention to examine each case separately as it came up. For, they said, today the Euro-market needs to be rejuvenated, and the natural selection process now about to be realized here should not be rendered impossible. This is why, in their opinion, it would be a mistake to want the heads of the central banks to repair mistakes and imprudences at any price - allusion is made to improper speculations on the exchange market, among other things - which are dishonourable to the profession and it would be unpardonable to encourage them.

In brief, ideas on the manner of organizing the Euro-market's defenses and on the direct or indirect protection of depositors are gradually taking on specific form. The framework exists; it still has to be filled out. International centers are now setting about this arduous task. I shall restrict myself to mentioning in this connection the case I know best, that of the Luxembourg center for whom this problem precisely because of its being located in a small country which has no central bank, is of particular importance.

As it is not my intention here to give you an account of the arrangement at present set up in my country, I shall just say that, as in Germany, a liquidity and mutual aid fund is about to be set up and that this project is later to develop into the creation of a rediscount and guarantee Clearing House, the capital of which will be provided by the institutions in Luxembourg and which will operate under the guarantee of the State of Luxembourg. Simultaneously, the shareholders of the banks established in Luxembourg - large foreign banks - have undertaken the obligation to

provide their subsidiaries and branches with all the help they may need, such help being the first safety line.

This means that Luxembourg's great concern at the present time, is its intention to join with other countries and, by its efforts, to give a concrete contribution by participating in the setting up, on an international scale, of a concerted and integrated policy in this field.

Presented by: Ernest Muhlen
LUXEMBOURG.

INFLATION IN THE UNITED KINGDOM

PART 1.

THE INFLATIONARY RECORD

(1) THE SIXTIES

The table below shows the developments in costs and prices from 1959 to 1970 when the acceleration in prices began to appear.

TABLE 1 - Movements in U.K. Costs and Prices from 1959-1970

	Annual per cent rates of changes				
	1959/66 Trend	1966 67	1967 68	1968 69	1969 70
Retail Prices	3.2	2.5	4.7	5.4	6.4
Consumer Prices	3.1	2.5	4.5	5.3	5.4
G.D.P. deflator (factor cost)	2.9	3.6	2.9	3.5	7.6
Hourly wage rates	5.0	4.0	6.8	5.4	10.3
Wages and salaries per head	5.4	5.8	7.4	7.1	12.5
Output per head	2.3	3.9	4.4	2.2	2.8
Wages and salaries per unit of output	3.1	1.9	2.9	4.8	9.5
Import prices	2.3	1.5	10.9	2.4	6.5
Indirect taxes	5.3	-0.8	10.8	14.8	3.4
Export prices	1.4	2.4	8.3	2.3	8.2

All the indications of inflation in the economy, The Retail Price Index, the Consumer Price Index and the G.D.P. deflator showed a large rate of increase in 1970. This compares with a trend rate rise over the period 1959-66 of about 3%. The lower part of the table gives some details which bear on the question of the proximate cause of the acceleration of inflation.

In 1970 basic hourly wage rates shot up by more than 10%; wage and salaries per employee by 12.5%, compared with trend values of 5% and just under 5.5% respectively, whilst output per head recorded a small increase of just over 2%. This means that wages and salaries per unit of output went up by 9.5%, over three times the trend increase.

In 1968 and 1969, the rates of price inflation were also markedly out of line with the trend. In those two years, the rises in hourly wage rates and in wage costs per unit of

cont...

out put were relatively modest. However, under the impact of the 1967 sterling devaluation and the demand management policy associated with it, import prices and indirect taxes went up sharply.

TABLE 2 - Contributions to the Rise in the Consumers' Price Index

	<u>III 1968</u> <u>III 1967</u>	<u>III 1969</u> <u>III 1968</u>	<u>III 1970</u> <u>III 1969</u>	<u>II 1971</u> <u>II 1970</u>	<u>II 1972</u> <u>II 1971</u>	<u>II 1973</u> <u>II 1972</u>
Consumers Price Index	5.2	5.2	5.7	8.3	5.1	7 $\frac{3}{4}$
of which accounted for by:						
Import Prices	2.0	0.3	1.3	0.8	0.1	3 $\frac{1}{2}$
Indirect Taxes	2.0	3.0	-0.1	0.7	-1.2	3 $\frac{1}{2}$
Unit Labour Costs	0.8	1.6	4.4	3.8	3.0	+4
Unit Non-Labour Cost	0.9	-0.3	0.3	2.5	1.4	0

(SOURCE: NIESR ESTIMATES)

Table 2 shows that the main elements responsible for the surge in prices in the 1967-68 period were import prices and indirect taxes: these two accounted for more than two-thirds of the increase. In 1968-69, indirect taxes alone were responsible for more than one-half of the total rise. The situation was completely different in 1970 when unit wage costs made the running, accounting for over 80% of the rise.

(2) THE 1970-1972 PERIOD

As table 3 shows, this period was characterised first by a wages explosion in 1970 and 1971 during which hourly wage rates went up by 10.3% and 13.2% respectively. Wages and salaries per head rose even higher during this period; the rises ranged between 12 and 14% per annum.

In the year to mid-1972 however, some modest success appeared to be achieved in halving the acceleration in wages, as the rate of rise of basic hourly wage rates dropped slightly. In terms of earnings, the deceleration was even bigger, as the effects of the 1971-72 recession began to hit overtime workings, etc.

cont....

TABLE 3 - MOVEMENTS IN COST AND PRICES FROM 1969-1972

	Annual per cent rates of change				
	1959 66 Trend	1969 70	1970 71	1971 II 1972 II	1972 II 1972 IV
Retail Prices	3.2	6.4	9.4	6.2	8.3
Consumer Prices	3.1	5.4	7.7	5.1	6.6
G.D.P. deflator (factor cost)	2.9	7.6	10.7	8.9	10.0
Hourly wage rates	5.0	10.3	13.2	12.2	20.4
Wages and salaries per head	5.4	12.5	13.6	11.2	17.9
Output per head	2.3	2.8	2.6	3.4	5.7
Wages and salaries per unit of output	3.1	9.5	10.7	7.5	11.7
Import prices	1.3	6.5	4.1	0.6	16.4
Indirect taxes	5.3	1.4	-1.3	-6.9	
Export Prices	1.4	3.2	6.7	2.7	8.4

Other factors working in the same direction were: the cuts in S.M.T. in 1971 and purchase tax in both 1971 and 1972, the small revaluation of sterling immediately following the Smithsonian realignment in December 1971 and rather fortuitously, the marginal rise in import prices. The latter development helped considerably the C.B.I.'s efforts to limit voluntarily the rise in prices of manufacturers. These were further helped by the rise in productivity as the economy began its recovery.

In all the rate of rise of the retail price index slowed significantly from a peak of about 10% per annum to about 6%.

The slowdown in prices was, however, short lived, and its success was not complete. When set against the sharp rise in unemployment during that period (1971-1972: see graph 1), the overall decline in inflation - at least in wage terms - was relatively small. Furthermore, in June 1972, the pound was effectively devalued by about 7% and by a further 2-3% in November. Of itself this might have added something like 1-1½% to the retail price index, but at the same time world prices - particularly those of food - raced away during the latter part of 1972. In sterling terms, import prices rose through the half-year at an annual rate of about 17%, equivalent to a total of 1½-2 percentage points on the retail price index.

Anticipating some official action on prices and incomes, wages accelerated sharply. In October and November the basic hourly wage rates index rose to reach a figure of about 17.5% above

cont....

the level of a year previously during that explosive period. Wage rates were running at an annual rate of about 20%.

Prices too joined this rising band wagon. In the period between the ending of the C.B.I.'s initiative and the implementation of the freeze prices were raised upwards. The final result was an annual rate of rise in the retail price index of 8 $\frac{1}{2}$ % between May and November which left it at the year end some 7 $\frac{1}{2}$ % above the 1971 December level, with still further cost increases in the pipeline as a result of further rises in import prices and the pre-freeze rush of wage settlements.

Since the 1970 wages explosion, wages have remained the largest contribution to the rise in prices (Table 2) though not as predominantly as in 1970. From mid-1970 to mid-1972 unit wage costs accounted for over half of the rise in prices. Unit non-labour costs (which include profits, income from self-employment and rents) show a significant contribution in 1971. This was due in part to some recovery in profit margins.

(3) THE PRICE SURGE

As chart 1 shows, despite the introduction of statutory controls on incomes and prices inflation has continued to roar away.

The initial impetus to the present inflation was provided by the sharp upward push in commodity prices relative to all other price movements which occurred from the middle of 1972 onwards. This was in turn caused by the coincidence of expansion in demand which took place world wide at a time when severe short-term supply constraints operated; an adverse position which was accentuated by the prior running down of stocks to historically low levels. The severity of these pressures appeared to ease approximately a year ago, when many commodity markets showed signs of coming off the top but the lull in the upward progression only lasted until October. Then the disruptive consequences of the war in the Middle East not only led to a resumption of speculative buying in virtually every commodity market, but it gave a further and even more vicious upward twist to inflation with the massive links in oil prices.

The exogenous inflation resulted in sharp rises in import unit values, wholesale prices and finally retail prices.

cont....

Inevitably this highly explosive situation led to wage earners pressing for higher wages and at this point the inflation switched from being an essentially exogenous phenomenon to a basically endogenous phenomenon (please refer to our Appendix 1 for data on the changes in Money Supply M3, Wholesale Prices, Retail Prices, and Basic hourly wage rates.

PART II.

CONSEQUENCES OF A RUNAWAY INFLATION

FEELING OF INSECURITY:

Unlike the pre-1967/68 period of inflation when the rise in prices was of the order of 3% per annum the present phase of rising prices, with the latter increasing by about 10% plus, has made everyone more conscious of rising prices.

Every wage earner tries "to get in first" with his/her income claim. Inflationary expectations are raised at every wage bargaining round, and the whole process appears to get out of control.

MISALLOCATION OF RESOURCES

As money rates of interest lag behind the price rise, excessive indebtedness and inefficient allocation of scarce resources occur in the economic system.

Moreover, the high rates of inflation create an atmosphere of uneasiness and uncertainty as to what exactly the price rise is likely to be over a number of years. This distorts seriously business men's judgement and inhibits long-run lending and investment decisions.

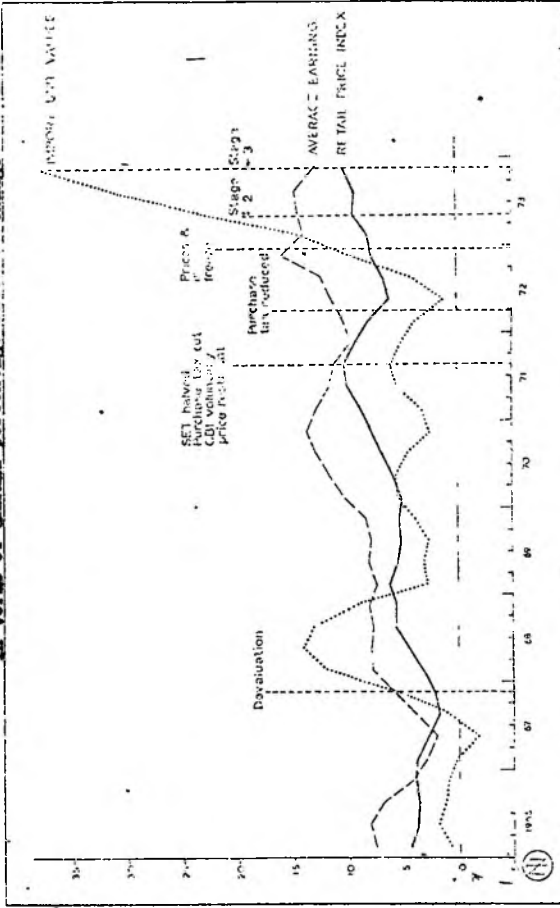
SOCIAL AND POLITICAL

Under highly inflationary conditions, income gains and the accumulation of wealth appear to be the result not so much from hard work or sacrifice but from the exercise of politico-economic power and influence.

There also exist opportunities for speculations to "hedge" against inflation; the main disadvantaged group remains the old, the handicapped people.

cont...

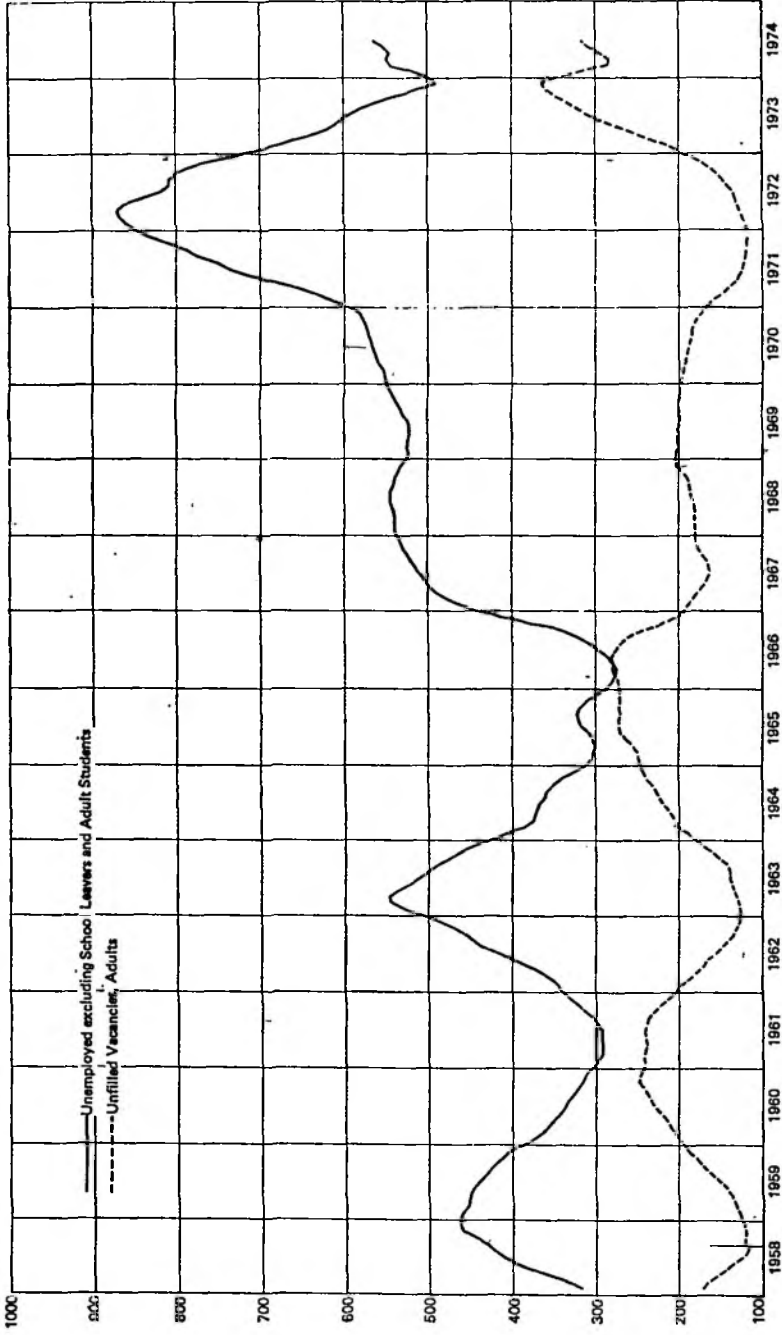
Chart 1 Retail prices, average earnings and retail price index
in terms of annual percentage rates of change



Source: Economic Trends.
(5) Unit values.

Unemployed and vacancies: Great Britain

The numbers shown average seasonally adjusted THOUSANDS



From April 1974 this chart relates to vacancies notified to employment offices and includes some suitable for young people.

Resentment against inflation is indeed widespread throughout the community and under certain circumstances could easily be manipulated by reactionary political forces.

THE POOR COUNTRIES

Apart from affecting adversely the poor nation's terms of trade, rising inflation and rising interest rates could affect the debt burden of these nations. Furthermore, as donors are preoccupied with fighting inflation and the consequent balance of payments problems, the notion of assisting the poor nations - to which the whole world is committed - is constantly pushed into the background.

A notable feature of this present inflationary era is the concentration of massive petro-dollar power in the hands of a few nations - some of which have highly offensive political regimes - which could easily jeopardise the whole international monetary network.

PART III

ANTI-INFLATIONARY POLICIES

This part does not attempt to discuss the effectiveness or otherwise of these policy instruments. Time permitting, we shall return to the subject later on, but for the sake of simplicity, the types of policies pursued are summarised below under the following headings:-

1) Fiscal Policy: together with monetary policy has been the most widely used of anti-inflationary policies. It has taken, in most cases, the form of increases in Taxes intended to relieve pressure of demand. The emphasis has varied between higher direct taxes and higher indirect taxes. Apart from increased taxes, government action has also been taken through the budget either to reduce the government expenditure or at least to restrain the rise in it.

In recent years, when the phenomenon of stagflation has become increasingly common, the reduction of taxation becomes increasingly appealing to the government of the day. At one stroke, the rise in prices is reduced whilst relieving pressure is brought onto spending, output and employment.

2) Monetary Policy: in most cases fiscal policy has been supplemented by monetary measures to combat inflation. These have taken the form of higher interest rates, of direct limitations on credit. These limitations were effected by changing the banks' liquidity structure (via the special deposit scheme), placing ceilings on credit, issuing guidelines

cont..

to the categories of priority borrowers. Sometimes straight directives have been issued, at other times "requests" have been made. Another common form of restriction is hire purchase control regulations.

3) Direct intervention in prices or incomes:

- system of prior notification of proposed price rises
- system of controlling prices of key items
- nationalised industries prices to play a major role in restraining price rise.
- reduction of profit margins
- limitation on the rate of dividend increase
- limitation on the rate of pay rises
- system of extra payments for working unsocial hours, dealing with anomalies created by the standstill, dealing with the problem of working in London
- threshold safeguard to be triggered once the price retail index reaches a certain level

4) Other Policies:

- a combined socio-industrial policy: Social Contract
 - tougher competition policy
 - more effective man power and regional policies
 - more cost-consciousness in the field of government spending
 - encouraging the agricultural sector: replacing, where possible, food imports by low-costs home produce.
-

Presented by:
Cooperative Bank Ltd., Manchester

MONEY SUPPLY (M3), COSTS & PRICES IN THE U.K.

	Money Supply (M3) average amounts outstanding-£m.	% age inc. on a year ago.	Index of Retail Prices - Jan. 16th 1962 = 100	% age inc. on a year ago	INDEX OF WHOLESALE PRICES 1970 = 100				Basic Hourly Wage Rates 31/7/72 = 100	% Age inc. on a year ago
					Basic Materials and Fuel Used	% age inc. on a year ago	Manufactured Products Home Sales	% age inc. on a year ago		
1967	13,934	+9.5	119.4	+4.7	83.9	+9.1	86.4	+4.0	63.3	+6.8
1968	15,252		125.0		91.5		89.9		67.6	
1969	15,951	+4.6	131.8	+5.4	95.0	+3.8	93.4	+3.9	71.2	+5.4
1970	16,930	+6.1	140.2	+6.4	100.0	+5.3	100.0	+7.1	78.5	+10.3
1971	18,831	+11.2	153.4	+9.4	104.6	+4.6	109.0	+9.0	88.9	+13.2
1972	22,941	+21.8	164.3	+7.1	109.2	+4.4	114.8	+5.3	101.4	+14.1
1973	29,151	+27.1	179.4	+9.2	144.4	+32.2	123.2	+7.3	115.5	+13.9
1974:										
Jan.	32,850	+27.6	191.8	+12.0	210.7	+71.7	134.1	+12.7	123.7	+14.1
Feb.	33,094	+26.5	101.7 *	+13.2	215.1	+70.7	138.5	+15.8	124.7	+14.5
Mar.	33,103	+25.0	102.6	+13.5	217.0	+67.7	142.2	+18.5	126.4	+15.4
Apr.	33,261	+23.1	106.1	+15.2	217.4	+66.6	146.3	+23.1	127.1	+13.1
May	33,308	+23.2	107.6	+15.9	216.0	+63.1	148.9	+24.0	130.9	+15.5
June	33,507	+20.6	108.7	+16.5	213.9	+55.8	151.1	+24.6	135.5	+17.0
July	34,789	+19.6	109.7	+17.1	214.6	+47.9	153.5	+25.1	138.0	+18.3

* = base of index Jan. 1974 = 100

SAVINGS IN AN INFLATIONARY AGE:
THE U.K. EXPERIENCE

1) AGGREGATE PERSONAL SAVINGS & INFLATION

As Table 1 indicates, despite the strong upsurge in prices, total household savings in the UK have remained fairly resilient during the past 12 years.

Indeed, over the past two years, a period when prices have soared away, personal savings, as a percentage of personal disposable income, have actually increased. The ratio rose from 9% in 1971 to 9.60% in 1973. This improved personal savings trend has continued in the early part of 1974. In the first quarter of 1974, whilst prices rose by about 12 - 13%, over the levels of a year ago, the personal savings ratio went up from 7.20% to 9.30%.

2) SAVINGS, INFLATION, AND TRANSACTIONS OF LIQUID ASSETS OF THE PERSONAL SECTOR

a) National Savings

At the end of 1965, the UK personal sector had £8,189m. held in the form of National Savings assets. Although these went up to £10,072m. by the end of the second quarter of 1974, i.e. an increase of about 23%, prices - as measured by the retail price index - rose even faster. In 1965, the retail price index stood at 112.1; 9 years later it hovered at around the 200.0 mark; a rise of about 80%.

Thus, measured in real terms, there has been a decline in the past few years in the use of this outlet by UK householders as a means of investing personal savings.

Another feature of this savings media is the decline - in money terms - of National Savings assets held by UK householders. At the end of the fourth quarter of 1973, the figure was £10,114m; more than £40. higher than the level of the second quarter of this year.

b) Building Societies

These savings outlets have enjoyed a strong degree of popularity amongst UK householders. At the end of the second quarter of 1965, deposits by the personal sector with these institutions amounted to £4,639m. Nine years later, the figure went up by almost fourfold to about £17,000m; well above the rate of increase in prices experienced during that nine-year spell.

Despite this satisfactory long-term performance, the building societies' movement has recently experienced a much slower rate of growth of deposits from the UK personal sector. At the end of the first quarter of 1973, deposits from UK householders totalled £14,585m; 16 months later, they only went up by about 16% - much below the inflation rate of about 20% experienced over the same period.

c) Life Assurance and Superannuation Funds

In 1965, £1,170m. was used by UK householders to acquire assets in these two sectors; 8 years later, the figure went up by about threefold to £2,817m.

TABLE 1

	Personal Savings as a Percentage of Total Personal Disposable Income	Index of Retail Prices - 16th January, 1962 = 100
1963	7.45	103.6
1964	8.00	107.0
1965	8.35	112.1
1966	8.90	116.5
1967	8.30	119.4
1968	7.90	125.0
1969	8.10	131.8
1970	9.00	140.2
1971	9.00	153.4
1972	9.00	164.3
1973	9.60	179.4
<u>1972</u>		
1st Qrtr.	7.80	159.7
2nd "	11.00	162.7
3rd "	9.10	165.4
4th "	10.30	169.4
<u>1973</u>		
1st "	7.20	172.4
2nd "	11.70	177.9
3rd "	11.50	180.2
4th "	11.40	186.8
<u>1974</u>		
1st "	9.30	101.4+

+ = Base of Index
from 1974 = 100

- well above the rate of price rise between the 1965-1973 period.

d) The Stock Market

Net Acquisition of Assets by the Personal Sector (£m.)

	British Government Securities	Unit Trusts	Company and Overseas Securities
1965	-89	-59	-772
1966	-14	105	-585
1967	-227	84	-775
1968	-254	258	-806
1969	79	186	-519
1970	-222	89	-1849
1971	470	46	-1216
1972	5	203	-1218
1973	817	156	-1815

As the Table above indicates, there has been a clear trend of disinvestments in British Government securities by the personal sector from 1965 up to 1970. In the past few years, however, with yields on these fixed interest securities soaring to about the 11% mark (they are yielding currently about 16.5%) compared with the 4% return rate obtained on equities, personal savers seem to have acquired an increasing amount of these stocks, despite the historical fact that the value of 3½% War Loan - that famous undated Government stock - has declined from £103 in 1948 to about £20 today.

As for company securities and unit trusts, the situation is complicated here by the continued inflow of personal savings into the life assurance and pensions industries. These financial sub-sectors in turn have put an increasing amount of their financial resources - despite the recent malaise experienced by stock markets throughout the world - into the stock exchanges both at home and very recently overseas.

3) INFLATION, SAVINGS AND THE UK BANKING SECTOR

	Column 1	Column 2	Column 3	
	% change in the Retail Price Index	Total Personal Savings in £m.	Deposits with Banking Sector in £m.	³ / ₂
1968	+5.4	2330	657	28%
1969	+6.4	2540	308	12%
1970	+9.4	3094	822	27%
1971	+7.1	3438	953	28%
1972	+9.2	4187	1767	37%
1973		5269	3390	65%

As the Table above shows, the banking sector has been the most popular outlet amongst UK savers for the disposal of their moneys. In 1968, 28% of total UK personal savings was deposited with the banking-sectors, despite the strong rise in the retail price index during the past five years. This figure shot up to about 65% in 1973.

As for the Cooperative Bank, the experience from the past few years has been equally gratifying. The number of current accounts open with the Cooperative Bank since the beginning of 1971 has risen by over 25% - with most of the growth concentrated in the last half of the period. The Bank's growth in deposit accounts has also been very exciting. The number of accounts open in the middle of this year was about 15% higher than in the corresponding period of 1973.

4) INFLATION AND THE PERSONAL SECTOR'S INDEBTEDNESS

In 1968, UK householders borrowed about £450m. to finance the purchase of their own property; eight years later this figure shot up dramatically to about £2,800m.

The same upward trend was experienced by the hire-purchase institutions. In 1965, UK consumers' debt went up by only £81m. In 1973, the figure rose by a huge amount of £332m. (please see Tables below for further details).

LOANS BY THE UK PERSONAL SECTOR FOR HOUSE PURCHASE

Charges in HP debts incurred by UK Householders (£m)

1969	858	-21
1970	1246	+58
1971	1835	+165
1972	2757	+296
1973	2796	+332

CONCLUSION

From the above analysis, it seems quite clear that inflation has not affected seriously aggregate personal savings in the UK (not yet anyway).

The personal savings function is a complex one - sex, age, size of household - and professional factors apart, savings depend not only on how the rate of purchasing power of the pound has moved over a period of time, but also on how the desired and actual coefficients of capital to income, the rate of growth of incomes, and the coefficient of spending to income alters over time.

This, however, does not mean that inflation in the UK has not created problems for certain financial institutions.

At the disaggregated level, inflation has resulted in a dramatic escalation in credit demands - mortgages and consumer loans - by the personal sector.

On the other hand, runaway inflation tends to result in high interest rates, which, in turn, increase sharply the level of repayments on the massive debt incurred by the consumers, thereby making them increasingly reluctant to spend. In a purely cost push inflation situation, these two contradictory forces may well exacerbate the price rise spiral and lead to a vicious circle.

of inflation - more savings, more inflation.

With relative yields (both in money and in real terms) on different financial assets seriously distorted by inflation, the National Savings Movement and very recently the building societies have experienced difficulties in attracting funds.

To redress this situation, index-linking moves have been announced by the Government to improve funds flowing into the National Savings Movement. It is too early yet to say whether these will be really effective. Personal savings habits are very difficult to change overnight. This means that any relatively better performance on the part of these institutions as a result of this move may well lead to a general index-linking exercise in the whole financial sector economy which could very well accentuate inflation instead of reducing it.

Presented by: Cooperative Bank, Manchester,
U.K.

INFLATION IN THE UNITED STATES OF AMERICA

REPORT

With consumer prices in the United States rising at an annual rate of 12 percent, credit unions and other thrift institutions have become concerned about the implications which inflation might have on the rate of personal saving. This paper will deal with the problems encountered by credit unions during periods of high inflation. First, we will discuss the scope and causes of present U.S. inflation and analyze government attempts to deal with the problem. A second section will deal with the impact of inflation on credit-union operations. Section three will deal with the inflationary impact of international capital movements and the concluding section will discuss alternative methods for the protection of savings and the means available for getting concrete action on such proposals.

I. Inflation in the United States 1965-1974

Economics textbooks define inflation as an increase in the general price level, particularly prices paid by consumer for final products. At the same time it has been generally accepted that moderate price increases (1% - 2% annually) were part of a climate favorable to economic growth. As a result, as the rate of inflation crept above this rate in the mid-60's, few people expressed concern as it was considered only an aberration. Assuming, however, that inflation at a rate greater than 3 percent per year is something with which we must be concerned, we can see from the data in Column (2) of Table 1 that the present inflation has been building since 1965, and has become the norm rather than a deviation from the norm. However, the nature and cause of the inflation has changed several times during the period.

During the early 1960's the American economy moved from a period of recession to one of growing prosperity - primarily in response to an expansionary

Table 1

Consumer Price Index, National Debt and Money Supply 1965-1974

	Consumer Price Index	Percent Increase from Previous Year	National Debt (\$ billion)	Percent Debt Held by Public	Percent Incre In money Supp
	(1)	(2)	(3)	(4)	(5)
1965	95.3	2.3	\$ 320.9	-	-
1966	98.5	3.2	329.3	-	-
1967	101.5	3.0	362.0	79.1	6.80
1968	106.2	4.7	371.3	78.6	7.81
1969	112.7	6.5	381.2	75.9	3.52
1970	119.0	6.3	400.8	75.1	6.04
1971	123.0	4.1	434.4	75.0	6.33
1972	127.3	4.2	460.2	74.1	8.72
1973	138.5	11.2	480.7	72.6	5.75
1974 *	150.5	12.0			5.71

* first two quarters 1974, figures projected at annual rates

Source : Survey of Current Business

government fiscal policy. The goal at that time was to cut taxes to stimulate demand thereby increasing income and thereby government tax revenue. Thus, over the long run, the government deficit would be turned into a surplus as tax revenues increased faster than government expenditures.

The first real inflationary pressure came in 1965 when, as the economy was moving toward full employment, the Johnson administration attempted to finance expenditures for the Vietnam War by monetizing the national debt (borrowing from the Federal Reserve) rather than borrowing from the public or raising taxes. The rising expenditures generated income, however, the goods produced for the war were not available for domestic consumption and the result was a classic case of excess-demand inflation with " too many dollars chasing too few goods. "

There was a significant lag before workers became aware of the " hidden tax " of inflation. It wasn't until the economy began moving out of the 1970 recession that demands for large wage increases were forthcoming. Organized workers were demanding large increases to :

- a) make up for purchasing power lost due to previous inflation;
- b) cover for expected inflation during the life of the contract; and
- c) allow for rising real income.

This was a classic case of wage-push or cost-push inflation as producers were unwilling to absorb the wage increases by reducing profits and raised prices. Wage increases in excess of 10 percent per year were not uncommon during this period.

In response to the dramatic increases in wages and prices the Nixon administration turned reluctantly to wage-price controls. We can see from the data in Table 1 that the controls " worked ", that is, the rate of price increase in 1971 was only 4.1% and 4.2% in 1972 as compared to 6.3% in 1970. However, the existence of controls did nothing to alleviate the underlying inflationary pressure on all sectors of the

economy. Also, during the period when the controls were in force, several events occurred which increased this inflationary pressure; among them were :

1. devaluation of the dollar and the resulting suspension of convertability. This led to a pool of " excess " dollar reserves held by many foreign nations which they attempted to use to buy U.S products which had become relatively cheaper ;
2. rising prices of raw materials which had been controlled during the freeze;
3. government export policy selling grain to the Soviet Union at a time when world-wide demand was rising and supplies were relatively short; and
4. distortions introduced during the freeze which caused shortages to occur in many products.

Moving through time, conditions began to worsen. The government continued to borrow money at an unprecedented rate (see Column (3) Table(1), and the fact that a declining portion of this debt was held by individuals meant that the government was monetizing the debt ^{and having} an increasing impact on money markets. Column (5) in Table 1 gives us figures for the rate of increase in the money stock (M₁) during the period. Add to this the Arab oil embargo and resulting higher prices, rising price " expectations " on the part of other raw materials producers, and changing weather patterns leading to significant food shortages and the conditions were there for large increases in prices. To top it off, conditions are now ripe for another round of wagepush inflation as organized labor's response to rising prices has occurred much faster this time.

Since the demise of wage-price controls, the major tool used to fight inflation has been monetary policy. The failure of the Federal Reserve to act strongly in the period prior to the 1972 presidential election was part of the problem, however, since that time " tight money " has caused a disproportionate share of the anti-inflation burden to be carried by the construction industry, those industries needing capital

to expand output, and thrift institutions. At present, it appears that the Ford administration is making a concerted effort to reduce the level of federal spending to reduce the impact on money markets to allow the Federal Reserve to allow the money supply to expand at a moderate rate. The administration has disavowed wage-price controls, and has hinted at a tax increase in 1975.

In recent decades, American consumers have reacted to increased inflationary expectations by trying to reduce their discretionary spending and increase their saving. However, at the same time there is the counter pressure brought about by inflationary psychology of "buy now, prices will be even higher in the future." At present the two pressures seem to counterbalance each other. Recent surveys by the Survey Research Center of the University of Michigan indicate that consumer awareness of the problem of inflation has been building since mid-1973. Figures show that it was during this period that pressure started building on personal financial situations. Also, during the past few weeks inflation as "public enemy number one" has received consideration at an economic summit which has done much to increase public understanding of the problem.

II . Implications for Credit Unions

The credit union movement in the United States encompasses some 23,000 economic institutions representing over 27 million members. As of August 31, 1974 the movement had \$ 30.5 billion in assets, \$ 26.6 billion in share deposits, and \$ 23,6 billion in loans outstanding. Data in Table 2 show the growth in the various categories over the past 10 years.

Most credit unions in the United States operate with two basic limitations - they may charge a maximum of 12% (1% per month on the unpaid balance) on loans made to members and may pay a maximum dividend of 6% on member share accounts. In normal times credit unions usually charge/pay less than the maximum. Operating expenses are about 36% of income and dividends 45-50% of income, with much of the remainder of income going into reserve accounts.

However, as inflation increases credit unions are faced with :

- a) the need to increase dividend payments to remain competitive and prevent an outflow of funds. As the competitive rate rises above 6 percent, many credit unions are forced to offer certificates of deposit, that is, borrow from members ;
- b) higher interest payments on money borrowed from outside the movement to serve members needs;
- c) disintermediation in larger accounts ;
- d) rising expenses, particularly wages and salaries;
- e) the need to raise the average interest on loans to members.

The impact of these variables may be seen in a number of changes which have taken place in the past two years. In the third quarter of 1973 to combat potential disintermediation, federally chartered credit unions were given the right to pay a maximum 7% annual dividend, and by the end of the year over one credit union in ten was paying a rate greater than 6%. Certificates of indebtedness increased from \$ 1.3 billion at the end of 1972 to \$ 2.4 billion by the end of 1973. Saving increases in July 1974 were at the lowest annual

Table 2
Credit Union Savings

	Assets (1)	Credit Union Savings (\$ billion) (2)	Loans Outstanding (3)
1965	\$ 10.6	\$ 9.3	\$ 8.1
1966	11.6	10.1	9.1
1967	12.8	11.1	9.8
1968	14.2	12.3	11.3
1969	15.9	13.7	13.0
1970	18.0	15.5	14.1
1971	21.1	18.4	16.2
1972	24.8	21.6	18.7
1973	28.6	24.6	21.7
1974 *	30.6	26.6	23.6

* as of August 31, 1974, calculated at our annual rate
Source : Credit Union National Association

rate in the preceeding 10 years.. Expenses rose 14.8% during 1972 and then 17.9% in 1973. During 1971 credit unions received an annual return on loans of 10.2%, in 1972 the figure was 10.5% and during 1973 the average return climbed to 11%, leaving only a small margin with which to work.

The only factor which has allowed credit unions to exist within the present interest framework is the fact that share accounts and loans outstanding have increased and the resulting increase in income has been sufficient to cover the increased expenses. If credit unions experience :

- 1) declining deposits in share accounts;
- 2) declining loan demand; or
- 3) more rapidly increasing costs,

it will be necessary to seek relief from the 12% ceiling.

The impact of inflation has not been spread equally among thrifts. Credit unions have been experiencing a rise in their deposits while massive disintermediation has been experienced by savings and loan institutions and mutual savings banks. All thrifts have undertaken promotional programs to attempt to increase both the number of accounts and the average balance in each account. However, higher interest rates available elsewhere plus declining real disposable income have retarded member's desire and ability to save at thrift institutions.

If we analyze member savings in credit unions we find :

- 1) the dollar value of savings increased at approximately 12 percent per year since 1965, but the increase expressed in constant dollars was only about 6 percent;
- 2) that in the past two years, even if the credit union was paying a 6 percent dividend, the purchasing power of each dollar in a member's share account declined.

At present, there are no special measures for protection of savings in thrifts from the ravages of inflation. Alternative solutions to this problem will be discussed in the concluding section. Protection in the United States has taken the form of " share insurance " which offers protection from poor management, theft and embezzlement.

The present anti-inflation measures have not had a serious impact on credit union operations. However, one tool which is under consideration, that is, credit controls, could have serious implications for future operations. As a means of controlling excess demand in certain segments of the economy, particularly consumer credit, the government could impose regulations limiting the type and duration of loans, down payments and interest charged.

III - International Implications of Capital Movements

The free circulation of capital has a definitive impact on the rate of world-wide inflation. During the early portion of the period in question, capital movements from the United States and the resulting foreign accumulation of dollars allowed the United States to "export" a significant portion of its inflation. The attempt by Germany and Japan to maintain the value of their currency and prevent the United States devaluation resulted in large increases in their respective domestic money supplies.

The devaluation in 1971-1972 turned the direction of flow around, and the oil price increases diverted an ever increasing number of dollars to the Arab markets. The return flow of funds to the United States caused shifts in many sectors of the economy, particularly food, as foreign nations attempted to buy more American products. The continuing need for all nations to obtain funds to finance oil purchases indicate that further capital movements, with their resulting inflationary implications may be expected. The problem is further complicated by the Arab expectation of "protection" for the value of their deposits with the implied threat of further oil price increases if such protection is not forthcoming.

Inflation in more developed countries (MDC's) has differing impact on less developed countries (LDC's) If the LDC is attempting to increase their domestic growth rate by importing capital goods from the MDC's, then prices increases in these sectors would decrease their ability to import. However, if they are exporters of raw materials whose prices have increased faster than the general rate of inflation, then their foreign exchange earnings may show a relative increase. A major problem is only peripherally related to inflation per se, and that is

food shortages. Food prices have increased somewhat due to increasing costs, but the major cause of the increase has been the increase in demand for food products being greater than the increase in supply. Nations with food deficits who must also import significant amounts of oil have problems of a monumental magnitude.

IV. Alternative Methods for Savings Protection

It is apparent from figures in section II that individuals who had funds in credit union accounts (or other savings accounts) experienced a net loss in purchasing power during the past two years. Since the small saver has a positive time preference, that is, prefers consumption today to consumption tomorrow, this has serious implications for savings in the long run. In order to ensure a continuing flow of savings in the long run some method must be found to protect the purchasing power of the funds.

One method of maintaining the purchasing power of a savings account is to use a system of indexing, that is, tying the interest rate paid on deposits to some variable such as the consumer price index. This program, however, would necessarily raise the credit union's cost of obtaining funds during inflation to significantly higher levels and would require the removal of the 12% interest ceiling on loans.

A program such as this might, however, prove to be counter productive in the long run. A inherent problem with indexing is that its use generally constitutes acceptance of continuing inflation as inevitable and thereby avoids the main issue. In the long run the only realistic method of protecting savings and ensuring a flow of capital from private sources is to curb inflation. The methods of curbing inflation are well known and will not be reiterated here. Of course, the particular methods which would be used by any specific country would depend upon the type of inflation facing that country. Attached please find CUNA's summary views on questions arising at a recent financial conference on inflation called by the President of the United States.

SUMMARY VIEWS ON MONETARY POLICY
CREDIT UNION NATIONAL ASSOCIATION, INC
FINANCIAL CONFERENCE ON INFLATION

September 20, 1974

While there is reliable evidence that the Federal Reserve has expanded the money supply excessively in recent years, monetary policy in the immediate past period seems to have been appropriate, given the economic conditions of the period. However, the policy was becoming unduly restrictive as a result of the failure to use other appropriate anti-inflation tools, including fiscal measures. Recent signs indicate that the Fed has, in fact, loosened the policy somewhat, and it would be hoped that the money supply would be allowed to grow at a rate approximating the long term rate of growth of the U.S. economy.

SUMMARY VIEWS ON FISCAL POLICY

CREDIT UNION NATIONAL ASSOCIATION, INC.

FINANCIAL CONFERENCE ON INFLATION

September 20, 1974

Persistent and substantial growth in Federal government spending without corresponding tax increases has been a notable aspect of fiscal policy during the past ten years. The resulting monetization of the federal debt has been one of the major causes of present inflation and high interest rates. Therefore, any anti-inflation fiscal policy must set government and agency spending at a level which will have minimal impact on financial markets. Failure to achieve such a revenue-expenditure balance will, in large part, offset any gains which could be made from the easing of monetary policy.

A positive factor for the long run is the development of the new Congressional budget process. The use of this process, developing a closer relationship between Congress and the Executive on budget matters, will allow for greater discussion and better understanding of the impact of federal spending on the level of economic activity.

At this time it would be unwise to commit the 1976 budget to any particular level of spending or surplus deficit position. In light of the many economic problems facing the nation, it would be well to maintain maximum flexibility and adjust spending in response to the changing economic circumstances of the intervening months. Excessive focus on the Federal budget carries the danger of oversimplifying the problem.

CREDIT UNION NATIONAL ASSOCIATION, INC

FINANCIAL CONFERENCE ON INFLATION

September 20, 1974

Persistent inflation has caused severe problems for the capital markets of the U.S. To the extent that individuals view inflation as permanent, long term commitments to the debt or equity markets become less attractive.

In order to support the capital requirements necessary to expand our productive capacity and thereby lessen supply-induced inflation, it may be necessary to increase incentives to those willing to commit their funds to the long term markets. It is important, however, that any incentives created apply equitably to all forms of capital commitments, be they equities, debt or deposit and share accounts at financial institutions.

To encourage savings and investment, all financial institutions should be granted the power to establish term savings, deposit or share accounts. Those individuals who prefer to make capital commitments through financial institutions should be given equivalent incentive to those that wish to invest directly in stocks or bonds. This incentive approach should increase the proportion of disposable personal income going to savings and lessen the demand-induced price pressures in the consumer sector. It would make more capital available to housing, and because of the time commitments, lessen the disintermediation impact on financial institutions during tight money periods.

CREDIT UNION NATIONAL ASSOCIATION, INC

CONFERENCE ON INFLATION

September 20, 1974

The effort to reform the structure and regulations of financial institutions that began with the appointment of the Commission on Financial Structure and Regulation in 1970 now appears to have a better chance to be accomplished by means of omnibus legislation. But it is more apparent than ever that the specific recommendations contained in FIA ' 73 fall far short of the desired goal.

The change in economic and political conditions since the submission of the Hunt Commission Report and the legislative package drawn therefrom, dictates a fresh approach to the task of reforming the structure and regulations of financial institutions.

We think each regulatory agency and the regulated industry should conduct a review of their existing regulations for the purpose of eliminating those that are unnecessary and updating the others. The goal should be to make financial institutions more efficient and competitive.

Then the Treasury should meet with the various financial institutions to revise and reform FIA ' 73. Suggestions for revision from the various financial institutions should be treated positively, while negative reactions from competing financial institutions should be of lesser influence.

Through full participation and openness, a more credible and equitably balanced package can be formulated to gain wider industry and Congressional support.

In keeping with this approach, the credit union movement is presently studying the full range of credit union member needs. Among the matters under discussion are (1) the cost-price impact of the 12% maximum loan rate; (2) third party payments; (3) shares with varying rates and maturities; (4) a liquidity facility; and (5) greater credit union participation in the residential mortgage market. These studies are responsive to credit union members demands for a broader and more flexible range of financial services.

It is time for a new look^{at} the Financial Institutions Act. The new look should be made openly and forthrightly.

Presented By:
World Council of Credit Unions, Inc.
U.S.A.

"FINAL REPORT"

The experts, who met in a Thrift and Credit Cooperation International Liaison Committee Symposium on 30th and 31st October 1974 in Bischensberg (France), pooled all the analyses they had made on inflation and compared the experiments carried out to "rescue savings in the face of inflation". On the basis of the reports presented by Canada, the United States, Japan and various European countries, they made the following observations:-

It is to be remembered that, when speaking of inflation, what is meant is a constant rise in the general level of prices, and they note that, in all countries, this rise which had on an average been below 3% around the year 1960 and had remained at about 3,7% during the 1961 - 1971 decade, had risen to 12,5% or more in the course of the 12 month period from April 1973 to April 1974;

They restrict themselves to this definition as a description of the inflation phenomenon, as it provides a single characteristic common to all countries where inflation prevails, no matter what its profound causes may be, while realizing that this perhaps rather rough definition reveals how very perplex theory becomes when confronted with the multiple possible aspects of inflation;

However, they nonetheless wish to stress the complexity of the phenomenon inextricably bound up with the "mechanisms and wheels" of economic social and political life, as well as its worldwide aspect resulting from international relations. Inflation is not exclusively a matter for "the others"; it most certainly concerns all of us;

They note that the disorders generated by inflation are very numerous, and that its cost at the social level is a general deterioration in the social climate. As representatives of movements for savings by the public they note that inflation is advantageous to those who are the cleverest, the most aggressive and the quickest to adjust their incomes to the new prices; and also that it alters the fairness of economic relationships to the advantage of the debtor and at the expense of the creditor.

Their remarks are based on the following ascertained facts:-

In all countries represented at the symposium, savings continue to rise in spite of inflation. But we must not think that, in this phenomenon, we see a tacit agreement with the savings policies followed by Governments. Under the circumstances prevailing at present, savings made as precautionary measures by the mass of the people are only makeshift arrangements, as a guard against the risks of an uncertain future. This reflex is accompanied by a feeling of discontent which is very real indeed, even if it does not yet take on the form of a flight from savings.

It is absolutely necessary that public authorities be made to realize that the modest saver no longer trusts appearances and that he is becoming more and more aware of the economic realities behind such appearances.

When - as is the case more or less everywhere throughout the world - the savings organization is no longer in a position to pay him an interest which is at least equal to the monetary erosion, he feels this frustration and analyses it as a fiscal levy which does not dare declare itself and to which is then added as an absurd indignation.

But we would be wrong in taking up the public savings problem from the standpoint of its economic aspect only. What must hold our attention is its social aspect, if we want to avoid a failure in this new field having repercussions at the political level.

Admittedly, the impact of inflation on the incomes and patrimonies structures varies from one country to another, depending on the setting up or absence of such mechanisms as the indexing of incomes or of scales of taxation, the dynamic nature of pensions, taxation on added value, etc...

The damage which the various strata of society may suffer as a result of inflation is conversely proportional to the power of these groups to impose a repercussion of, or a compensation to the rise in prices.

Thrift and credit cooperatives unite, first and foremost, savers among the mass of the population. At both the national and international levels, their actions are directed towards the protection of public saving, and they will support to the utmost of their powers all national governments and international organizations in their fight against inflation, wherever such defending and promoting of savings forms a part of their anti-inflation programs.

They do consider that inflation is a passing plague which it is possible to cure by therapeutic treatments that only attack the symptoms. On the contrary, they know it to be a fundamental type of disease eating away at the vital forces and basic structures of our consumption society. Therefore it must be attacked at its roots by finding a remedy for the imperfections of our economic organization for the bad distribution of wealth and for the unsatisfactory way in which economic powers are balanced. A revision of our excessively materialist system of values and a reform resulting in more equitable relationships could constitute definite steps in the right direction, and they could contribute towards the mastering of inflation without risking the reversal of the economic situation, i.e. the replacing of the prevailing inflation by a recession which would be no less dangerous to the equilibrium of our society.

They call to mind that the development of savings presupposes respect for the saver, and that rates of interest must fulfil two functions:-

- the maintaining of the purchasing power of capital saved,
- the yielding of a remuneration.

Taking into account the national and international economic situations and the intensifying of the integration of national economies in world economy, the Thrift and Credit Cooperation International Liaison Committee proposes that the following objectives be pursued:

- the maintenance of the purchasing power of public savings,
- without such maintenance contributing to inflationist pressures.

Keeping this standpoint in view, guarantees should only be given:

- for savings made by the general public, i.e. derived from the personal resources of such persons as have low or average means, below ceilings which shall be set.

In this respect, the following rules can be suggested:

- the amount of the guaranteed savings shall have a ceiling,
- the financing of this guarantee as well as the utilization of the sums saved should be harmonized with the economic policies of the various governments.

In view of the great diversity in these policies, it is difficult for the Liaison Committee to put forward suggestions which could be uniformly applied in all the countries concerned. However, it is of the opinion that the two following formulas should be explored:

- the first would consist in having the capital guarantee supported by public resources. The cost of this would be borne by fiscal resources taken from those benefitting from inflation. This solution does not appear to be technically impossible and it would not be inequitable, since it would take the form of a transfer in favour of the savers.
- the second, more ambitious formula would consist in giving the thrift and credit cooperatives new investment instruments to be utilized for the financing of operations yielding added values which could support all or part of the guarantee costs.

Finally, the thrift and credit cooperatives have considered the serious impact of inflation on developing countries requests the assistance of Inter-governmental finance Institutions in order to help to finance the growth of cooperative organization in these countries and emphasizes the need for national cooperative solidarity in furthering development.

Presented by: International Liaison Committee
On Cooperative Thrift and Credit.

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