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Submission: Inquiry into the future monetary policy framework

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INTRODUCTION

Democrats for social credit (DSC) welcome the opportunity to make this submission on the future of New Zealand's monetary policy framework. It has been obvious to us for many years that the techniques promulgated by orthodox economists, from the left or the right, do not work for the best interests of a modern society. It comes as no surprise that the experts are baffled; of a wide variety of tools and instruments used to tinker with the economy, none has been more than slightly successful or sustainable. Current monetary policy drives the "boom and bust" cycles, at best hindering healthy economic growth and at worst damaging the economy irrevocably. Recent attempts to correct economic difficulties with blunt instruments such as the Official Cash Rate are a case in point.

In short, current monetary policy is failing New Zealand, as evidenced by:

- Crushing consumer and commercial debt,
- The widening gap between rich and poor,
- Mounting social distress,
- Environmental damage,
- Share market fluctuations,
- Currency instability driving companies overseas, and
- Commercial banks undermining and even usurping the role of the Reserve Bank.

The world wide nature of inflation suggests that stable prices will prevail only when different policies which arise from an unorthodox theoretical base are applied.

Orthodox economic policies are based on faulty doctrine, which defines the relationship between income and prices. J. M. Keynes, a British economist, advanced theories on macro-economics which are still the foundation for policies applied by successive New Zealand governments.¹ In "The General Theory of Employment, Interest and Money" he states:

¹ Les Hunter, "Inflation and People", p. 5

“Provided it is agreed that income is equal to the value of current output... all of which is conformable to common sense and the traditional usage of the great majority of economists...”²

We do not agree with this fundamental doctrine. It is glaringly obvious to *Democrats for social credit* that income does not equal the value of current output, as witness the overwhelming number of families in New Zealand, and indeed all over the world, who must borrow to exist. Goods would remain on the shelves unsold, without the expensive credit issued by commercial banks.³

New Zealand Gross Domestic Product (GDP) data at March 2007 was \$163.387 billion while our Real Gross National Disposable Income (RGNDI) data at the same date was \$120.596 billion, leaving a shortfall of \$42.791 billion. To be able to purchase these goods the New Zealand consumer can only do so by going into debt. It is no wonder we see a plethora of advertising from businesses wanting us to buy, and banks and finance companies encouraging us to borrow.

The following submission starts from the above observed fact, building and adapting theory based on evidence.

² J.M. Keynes, “The General Theory of Employment, Interest and Money”, Ch. 6 Pt II.

³ See Appendix A: Bruce Beetham, “A + B Theorem Revisited and Revived”.

I. The causes of inflationary pressure

We will discuss inflation of two distinct types: commodity inflation; and asset inflation - exemplified by the booming property market, but also including share certificates and debt securities.

COMMODITY INFLATION

Commodity inflation is measured by an upward movement in the consumer price index and can be caused by monetary, income or cost pressures. Monetary and income inflation are generally known as demand inflation.

Monetary inflation is always associated with an increased availability of money – as a cause. An increase in the money quantity – as a result – is often associated with income inflation, but stems from an excess of investment funding that has been made available through bank credit (new money), supplementing the savings already available.

Investment in the construction of real assets (commercial or social) generates income that is not associated with any cost payment – which is the standard way of generating income. (The extent to which savings are, or are not, invested in ways that result in income being generated can have a minor influence on income inflation.)⁴

Demand Inflation

Democrats for social credit do not consider excessive demand for goods and services to be the main cause of inflation. Demand Inflation can arise when total income levels run ahead of the value of production available. With too much income about people will tend to try to buy more goods than are produced and this could result in retailers putting up prices to meet the market. This does not happen to any marked degree in New Zealand because relative shortages have to appear before prices can be put up and increase retail profits. These profits in real terms are not excessive nor have they increased at a greater rate than price increases.

New Zealand periodically experiences times when income levels do run ahead of the value of goods locally produced. The local shortfall in production is made up with imports which for a time can be paid for with money borrowed overseas. Rising income levels have a marginal influence on increasing local prices, but by enlarging effective buying power have a serious effect on our balance of payments situation.

When New Zealand does borrow overseas it is imperative that provision is made to repay those debts. This is possible only by ensuring that future overseas earnings are high from increased export earnings. If this is not done and exports fall away the only other way to pay off debts is to sell New Zealand assets and land to overseas interests.

It is therefore critical that income equals value locally available including that of imports. The value of imports should balance with that of exports.⁵

Cost inflation

Cost Inflation is the basic cause of modern inflation. It is the continual rise in costs which are being imposed on business and which cause a continual upward movement in the price of goods in the shops. This is much more important than demand inflation which arises because of too much income or new money chasing too few goods. In New Zealand inflation

⁴ Les Hunter, "Courage To Change", Ch. 15 p. 195

⁵ Les Hunter, "Inflation and People", p. 12-13

will not be controlled merely by seeing that spending money in people's pockets is the same as the total of prices of goods available for sale.

Prices must rise when costs increase. Competition reducing profit margins, keeping a lid on wage and salary increases or minimising staff numbers can only be taken so far. In the end cost increases must be passed on to the consumer if the business is to survive.

In order of importance the causes of cost inflation are as follows:

- Compounding financial costs imposed on production through growing and more expensive commercial debt.
- Efforts to increase prices in order to maintain profits in real terms.
- Wage increases in excess of productivity gains.
- Rising direct and indirect taxation.
- Increasing prices paid for the imported components of production. (Imported items can also have a decreasing effect depending on exchange rate movements)⁶

Commercial Debt

The Democrats for social credit believe that the driving force behind all forms of cost inflation is the interest charges which are now paid by industry for working funds. Commercial debt has grown and the costs to it compound, as industry is denied access to the cheapest source of working funds – bank credit.

The rising amount of debt in the productive sector, and the rising cost of that debt are responsible for cost loading on goods and services. It has become a vicious circle: the manufacturer, the wholesaler and the retailer each borrow and charge the cost of interest to the next stage of production. Prices for goods and services carry all these debt costs, and the consumer needs to borrow to fill the gap between income and the price of goods.⁷

Governments and the Reserve Bank, in applying orthodox policies have seen a reduction, at source, in the supply of money traditionally available to industry, to finance current production. Les Hunter in his book "Courage to Change" shows that prior to the imposition of monetarist policies in the mid-1960s, using M1 money supply and GDP data, the velocity of circulation for OECD countries was 3.6. Throughout the 1950s no – unexplainable – exception can be found. This empirical approach suggests the optimum M1 money supply should be some 28% of GDP.⁸

The M1 money supply to GDP ratio in New Zealand, as of March 2007 was 14.18% - a velocity of circulation of 7.05. Our basic money supply M1 has got scarcer and has to turn over at least 7 times to enable our goods and services to be purchased. This money is the main source of working funds for business and industry and because it is in relatively short supply a price is being paid for it. This is a cost which is continually added into prices.

"The first priority for money within industry is for working finance because wages and all other running costs, including raw materials, have to be paid for if a business, and industry in general, is to operate at all. Investment in replacing plant or expanding production does not

⁶ Les Hunter, *ibid*, p. 18

⁷ See Appendix A: Bruce Beetham, "A + B Theorem Revisited and Revived".

⁸ Les Hunter, "Courage To Change". P. 81, Sec 7.5

require the same critical use of money because these decisions can be deferred. Like oil, when working money is scarce the increased costs which must be paid for its use put up prices.

“Orthodox financial policies do not differentiate between the monies businesses require for investment in future production, and that required as working funds to finance current production. Restricting the money supply in a blanket manner, in which interest rate rises have been used to reduce demand inflation, has been based on an economic myth and thus it has not achieved the desired result but instead, has initiated severe cost inflation.

“Reality shows that interest paid on any investment must be related on a percentage basis to any increased value produced because of that investment. The degree to which the rate of interest paid exceeds the rate at which value is increasing equals cost inflation.

“In practise and given time, the rate of modern cost inflation, as a percentage, will equal the average interest rate paid over all investment monies, minus any percentage increase in productivity, applying over the whole country. The only mitigating factor which will slow the rate of cost inflation will be to the degree that sections of the community absorb a drop in their real income”⁹ – as actually happened in the early 1990s with the unemployment surge.

The money which is required by business to pay current expenses does not involve an investment function which will increase available value. What it does do is to allow current value to be consumed by placing spending money in the hands of people in the form of income. **The economic yield of money used by business for working finance is zero. Because of this the interest rate which should be paid for working funds should also be zero.** (This is not saying that a service charge should not be paid on this money.)

Today, the extent that interest is paid on working funds is a severe cause of cost inflation. Commercial debt is rapidly growing through the sale of various financial instruments by which working finance is obtained at fixed, and in many cases, compounding interest charges.

To eliminate this basic cause of cost inflation it will be necessary to isolate from each other the use of money as working finance and the other use as a means of real investment.

DSC recommends:

- That the Reserve Bank be the only institution which has the power to create, issue and cancel New Zealand money;
- That the Trading banks be denied the function of creating credit and thus the right to create money;
- That the Reserve Bank of New Zealand have the sole right to create credit;
- That the Trading Banks continue with their vital role in providing cheque and accounting services to business and people;
- That the Trading Banks act as agents for the Reserve Bank;
- That the Trading Banks be permitted to advance to their customers only that money made available to them by the Reserve Bank;
- That the Trading Banks be permitted to charge a service fee for funds from the Reserve Bank that they on lend to the customers, which may be an interest rate;

⁹ Les Hunter, “Inflation and People”, p. 19, 20.

- That the money advanced to Trading Banks, from the Reserve Bank, will be at a service charge only;
- That the Trading Banks no longer be permitted to recycle money which is regarded as savings and is to be used for investment purposes;
- That specialist savings institutions be charged with serving the investment needs of New Zealanders and not the profit of overseas shareholders

Comment:

These recommendations are designed to separate and institutionally isolate the function of money as a medium of exchange from its other function as the means of realising real investment.

DSC also recommends:

- That the Reserve Bank manages the supply of money in such a way that industry does not have to pay charges for the use of working funds because money has a scarcity value;
- That the Reserve Bank be charged with the responsibility to manage the creation of credit so that the money supply is in equilibrium with the needs of production; and
- That the money supply should not be so plentiful that the risk of demand inflation arises.

Comment:

Historical evidence suggests that the money supply available to industry as working finance should be at equilibrium when it represents about 28% of the national income.

Profits and Cost Inflation

“The greatest and most serious financial cost which is forcing prices upward is the requirement of company management to maintain the value of shareholders’ funds against the inroads of inflation. This is not the most significant cause of cost inflation but is by far the most serious result.

“When prices move up, the buying power of savings goes down by the same percentage. Saving invested in company shares will fall in potential buying power unless compensation is achieved by increasing the payout, or asset backing of shareholders’ funds. This compensation must initially come from increasing the level of profits. Profits can be increased only by lifting prices at a greater rate than other costs increase, and the pressures to do this are causing an enormous upsurge in the price of goods sold to the public. The upward movement of prices requires further compensation and the result is further impetus to the spiralling action which is so typical of modern cost inflation.

“The total amount by which prices must increase in any year to compensate for the fall in buying power of shareholders’ funds can be measured as a percentage of the book value of the total of net assets employed in New Zealand industry. This net value of assets, which represents shareholders’ funds, is not known but must be in the order of [billions] of dollars.

“As an example of the extent of this process, let us take one year when the average return on shareholders’ funds in money terms has been 8%. In the following year, inflation has

increased at a further rate of 4%, by increasing at an annual rate of 6% to 10%. The return on total shareholders' funds must now go up to 12% if full compensation for inflation is to be achieved, and this spread over [billions] of dollars worth of net assets. Under these conditions an increase of 4% requires an increase in profits of 50% for full compensation to be achieved. In practice this cannot be done...

"Attempts by company managers to increase prices and so be able to compensate shareholders for past inflation is reaction to a problem and not the fundamental cause of it. This fundamental cause stems from the multiplying effect of rising interest rates on commercial debt being transferred across onto the investment side of business operations. Production cannot proceed unless companies have access to adequate working finance. The need for this money comes first, and the price of it must be met and paid. The second need for money is for investment purposes to increase productivity and to replace worn-out and obsolete plant...

"The interest which must be paid on commercial debt regulates the interest or dividend which business must pay on investment monies. Any investment money is made available at risk, because the return on it comes from the sale of future production. Lending money as commercial debt involves almost no risk, because the returns won from this practice are included as costs by way of fixed interest charges against current production.

"To obtain investment money, interest must be offered [which has a margin above] that being obtained from commercial debt. Given time, a condition of access to all investment money will be that high fixed interest charges are attached to it, and if these are not committed in advance, the money will not be forthcoming...

"Companies are being forced under the dictates of orthodox policies to pay fixed interest charges on more and more investment money. These, as multiplying and compounding costs will continually drive prices upwards and nothing will stop this type of inflation except financial reform.

"The level at which cost inflation will permanently increase at a compounding rate is directly related to the average interest rate paid on all money invested in industry. This [is] mitigated only to the degree that sections of people are forced to accept a drop in real incomes. This is how the inflationary spiral closes back upon itself.

"Management by [the Reserve Bank of New Zealand] of the costs attached to working funds and the policy of bringing the scarcity value of these to zero will force interest rates down. To eliminate cost inflation, interest must settle at a rate which is equal to the average productivity gains, expressed as a percentage pertaining over the whole country.¹⁰

DSC recommends:

- That industry be required to obtain investment money to the largest degree possible by way of the issue and sale of equity shares.

Wages and Inflation

"Wages are direct costs, and do not have a multiplying effect within the inflationary spiral in the same as do the interest charges on working funds. However, leapfrogging wages gains by one section of people tend to have a ratchet-like effect on all other wages, which eventually all move up and follow the front runners... When wages are increased, prices must rise by the full gross amount, unless other cost components of production are reduced...

¹⁰ Les Hunter, "Inflation and People" p. 23 - 25

“When the price of goods increases in the shops, take-home pay must also increase by the same percentage if family living standards are to be maintained [which in turn leads to price increases, and so on]. **Only financial reform and a break with conditioned orthodox economic thinking will change this situation.**¹¹

DSC recommends:

- That emphasis should be placed on reducing income tax at the lower levels, in preference to increases in gross remuneration.
- That when inflation is controlled, wage increases should be based in a more direct relationship to productivity gains.
- That the Reserve Bank accept the specialist role of management of investment monies required for low economic yield, social investment and the effect the spending of these loans has on income and prices.

Comment:

The provision of interest-free loans for local body infrastructure, low-interest loans for housing and the funding of free health and education will go a long way to supplementing incomes.

Taxation and Inflation

“Most forms of taxation eventually appear as costs, and the degree to which taxation increases, initiates pressures which will eventually force prices upward. This applies equally to direct and indirect taxation...

“The cost-thrust of indirect taxation is not a major cause of inflation. Because constant indirect taxation moves revenue up at the same rate as prices, this does not in itself increase prices. Increasing the rate of indirect taxation would immediately push up prices by the same amount, and give the government access to more of available goods and services at the expense of other sectors of the economy. However, reducing the incidence of indirect taxation would give immediate relief against inflationary pressure when other costs are rising. Reducing the tax on diesel fuel, used for transportation and production, would lower costs.

The major cost-thrust now comes from direct taxation because of the ‘cat chasing its own tail’ effect which the graduated income tax scale has on widening the gap between gross and net incomes. Wage and salary earners are forced to seek compensation with pay rises for increased income tax continuously, if net pay is to be sufficient to maintain family living standards. This cannot be done, because prices must increase by the full gross amount of a rise, whilst more tax continually reduces the proportion of take-home spending money to that gross amount. This is a major factor which makes stability impossible between wages, taxation and prices within the modern inflationary spiral.

“Increased taxation, which reduces personal buying power in any way, will contribute to cost inflation no matter how it is collected. This inflationary pressure is equal to the amount by which government revenue increases as a percentage of the national income, mitigated to a very small degree only by any gain in the country’s productivity... The only equitable way in which the cost-thrust of increased taxation can be removed from within the inflationary spiral is a policy of fixing government revenue as a constant percentage of the national income.

¹¹Les Hunter; *ibid* p. 27

“The same principle of cost-inflation involved in interest payments applies with government debt. Everybody is taxed and their money is transferred as interest payments to the financial institutions who own the debt. [DSC] sees it as unnecessary for the government to obtain revenue money by accumulating debt which the taxpayer is called upon to service.¹²

DSC recommends:

- That any borrowing the government may require to fund national infrastructure requirements or a short-term need for deficit financing should be funded interest-free from the Reserve Bank.

Imported Inflation

It could be said of recent times that we are importing deflation, as the country has been flooded by cheap goods produced overseas. Our manufacturers have had to compete with their overseas peers who benefit from “slave labour” pay rates, little if any environmental protection standards and virtually zero social or compliance costs. It has not been a level playing field and has resulted in a huge overseas debt. The never-ending run of trade deficits should lead even orthodox economists to look for new solutions.

The floating exchange rate system on its own does not produce rates which bear any relationship with the actual value of goods bought and sold. The values set are more related to the huge movements of speculative currency flows chasing short term investment returns. The benefits gained by having cheap goods reducing New Zealanders’ cost of living is but a short term illusion which can be shattered overnight with a large drop in the value of the kiwi dollar.

DSC recommends:

- That the Reserve Bank of New Zealand be made responsible for the availability and flow of working funds necessary to facilitate trade with other nations;
- That the Reserve Bank of New Zealand ensure that the money made available by each nation for trade would be backed by the real value of goods and services;
- That the Reserve Bank of New Zealand would facilitate an exchange of equivalent value with no undue influence from the currency and other speculators;
- That a Financial Transaction Tax (FTT) be applied to all New Zealand money transferred off shore or exchanged for other currencies.

Comment:

We must cut out the middlemen, remove the money changers from the temple, and negotiate reciprocal trade agreements between ourselves and other nations. New Zealand would not then be dependant on the world’s reserve currency – we would utilise our own trading credits managed through the Reserve Bank. A bilateral form of trading, on equal terms between nations, will enable us to trade on a fairer basis with all, and that includes those countries that desperately need our goods but under the current system cannot afford them.

Speculative movements of money will cease – FTT will erode any margins made. Money made from FTT could be used to reduce internal taxation and a proportion used to progressively pay back our debt. These new trading recommendations will see the risk of imported inflation removed and will allow us to deal with internally generated inflation.

¹² Les Hunter; *ibid* p. 32 - 34

ASSET INFLATION

Asset inflation is exemplified by the booming property market, but also includes share certificates and debt securities.

“Asset inflation is independent of commodity inflation, and therefore can be evident when commodity prices are either falling or rising at a much lower rate. Commodity inflation is affected by asset inflation only when assets are sold at an inflated price – cashed in – and the money (M1) coming to hand is spent on consumer goods or services. Asset inflation is closely involved with the creation of money, by the fractional-reserve banks, as they provide funding to sustain the practice.”¹³

It is clear that current monetary policy considers excessive demand to be the main cause of inflation. The rising personal debt burden is thought to be evidence of this, and most instruments have been designed to curb borrowing by raising interest rates, in order to reduce demand and therefore inflation.

The Reserve Bank Governor's use of the Official Cash Rate (OCR) as a tool to reduce domestic demand is misplaced. Increasing interest rates has not dampened demand. New Zealand's money supply (M3) has increased by some \$25 billion over the last 12 months while GDP grew by about \$3 billion. The excess has obviously been used to facilitate the buying and selling of existing assets at ever increasing prices.

DSC recommends:

- That the Reserve Bank Governor be instructed to implement a low interest rate policy.
- That demand be managed by using the “Repayment Term” factor instead of the “Interest Rate” factor; i.e. loan demand managed by increasing or decreasing the loan term.

Comment:

A low interest rate policy will have the effect of removing demand from overseas investors chasing returns from our high interest rates. A side benefit of these actions will see the exchange rate move down to reflect a true value relationship between the exchanges of goods and services and less to the pressures of speculation.

The OCR “Blunt Instrument” Effect

As set out in this submission, inflation has two aspects – commodity inflation and asset inflation. The OCR is a blunt instrument, as it cannot be targeted to one or the other. It may have beneficial effects in one area and devastating effects in another. For example, raising the OCR may reduce the speculative demand for housing (a moot point), but definitely dampens or hinders the growth of the productive sector.

¹³ Les Hunter, “Courage To Change” Ch. 15.1 p. 191

II. Effectiveness of current monetary policy in controlling inflation

New Zealand's monetary policy is, in the main, effective at controlling inflation *as measured by the Consumer Price Index (CPI)*,

BUT:

New Zealand's monetary policy is **not effective at controlling cost inflation**, the basic cause of modern inflation.

New Zealand's monetary policy is **not effective at controlling asset inflation**, as evidenced by the massive increase in property prices.

The Reserve Bank of New Zealand Act specifies that the primary function of the Reserve Bank shall be to deliver "stability in the general level of prices" and, through the separate agreement between the Minister of Finance and the Governor of the Reserve Bank (Policy Targets Agreement), sets out specific targets for achieving and maintaining price stability.

Inherent in New Zealand's monetary policy is the belief that by delivering price stability, it can set a predictable background against which businesses and households can make the most effective decisions and by that, contribute to maximising sustainable economic growth for New Zealand.¹⁴

The *Democrats for social credit* are adamant that **the inherent objective should not be as narrowly focused** as "maximising sustainable economic growth for New Zealand."

The *Democrats for social credit* are also adamant that achieving that target is not necessarily desirable for New Zealand.

In fact the maximising of sustainable growth needs to be looked at in itself. The current myth-based financial system is necessarily hooked on to growth for growth's sake, just to keep the wobbly economic bicycle going. The compounding debt structure necessitates growth of any sort whether or not it is beneficial for human beings and the planet.

The shortcomings of the present monetary policy and the expansion of its narrow focus will be discussed under the next section, "The interaction of monetary policy with other elements of the economic policy framework."

¹⁴ www.rbnz.govt.nz - Fact sheet No. 3, May 2007

III. The interaction of monetary policy with other elements of the economic policy framework, including fiscal policy

The two main tools of government for influencing the overall level of economic activity, monetary policy or fiscal policy and the balance between the two, have always generated controversy.

DSC firmly believes that the correct monetary policy must be in place first, and that it provides the foundation for sustainable fiscal policy to operate on. Playing with fiscal policy alone is just tinkering around the edges.

Monetary policy

The vital elements which make monetary policy – the source or ownership of our money supply, the quantity of money, the rate of interest and the exchange rate – should all be managed by the Reserve Bank of New Zealand. In addition, the Reserve Bank should be answerable to Parliament.

DSC recommends:

- That the Reserve Bank be responsible for ensuring that money will be created according to the needs of the community;
- That the Reserve Bank recognises that the main purposes of money are: to help bring together what is needed to produce goods and services, share them out and buy them so they can be consumed;
- That the Reserve Bank issues new money needed for production to the Trading Banks at cost;
- That the Trading Banks will only be able to charge service costs when they on-lend the new money to their business customers;
- That the issue of new money by the Reserve Bank will be limited by the resources that are available, and used to increase production in different parts of the economy;
- That the distribution of new money among different parts of the economy will be governed by the Reserve Bank by adjusting the repayment periods for the loans instead of by methods that cause cost inflation.
- That the Reserve Bank is responsible for ensuring that what is socially desirable, improves the environment (or at least does not harm the environment), and is physically possible, is also financially possible.

DSC also recommends: That the Policy Targets Agreement should include:

- That the nation's money supply should directly relate to the value of goods and services it produces;
- That the total value of goods and services leaving the country will equal the total value of those entering it.
- That the people of New Zealand will be able to buy what they produce without, as a nation, going into debt to do so.

Fiscal policyDSC recommends:

- That taxation or government expenditure levels should not be the main tools used to increase or decrease aggregate demand;
- That the Financial Transaction Tax be used to control speculative demand;
- That the government should run a balanced budget;
- That the government should only borrow to pay for important capital works.

IV. New Zealand economy's capacity for non-inflationary growth and how it can be improved.

DSC believes that under the current financial system “non-inflationary growth” is impossible, as all growth is dependant on borrowed money which incurs interest, which must then be added into prices. Thus the price of money contributes to cost inflation.

Whether the economy has been managed in a monetarist way or a fiscal way, the boom/bust cycles continue to occur. Until the issue of ownership, distribution and cost of new money is dealt with, cost inflation and ever increasing debt burdens will continue.

In addition, the use of Gross Domestic Product (GDP) as a growth indicator is another “blunt instrument” that inadequately reflects the genuine state of the New Zealand economy. GDP lumps negatives such as massive storm damage with business success as part of the same “growth”, while other activity such as volunteer work and the contribution of the environment go unrecorded. A raft of new measurement tools need to be applied in order to accurately record both positive and negative aspects of the economy, the society and the environment.

DSC recommends

- That growth should not be limited by money or its cost but instead by the availability of labour, technology and materials, and by environmental impacts.
- Any planned economic growth should be toward achieving a carbon neutral status for New Zealand.
- That Reserve Bank Credit at cost be made available to fund businesses, territorial authorities and other groups who grow and expand their activities in making the transition to a carbon neutral status for New Zealand.
- That the government actively promote economic growth in areas that help to achieve a fossil-fuel free status for New Zealand.
- That new measurements of progress be employed, Genuine Progress Indicators (GPI) that track social, economic and environmental progress, in order for funding to be provided in areas that need assistance.

Comment:

DSC since its inception has advocated reform of the monetary system, not as an end in itself, but to realise social, economic and environmental justice.

Measuring the market value of economic production tells us very little about the broader health of the community or the environment, and nothing about the social costs of what has been produced in the economy, or about its usefulness or sustainability.¹⁵

¹⁵ Mike Salvaris, “Community and Social indicators” p. 5

V. The role of productivity in the economy, how it can be improved and the constraints upon it

DSC Recommends:

- That the government recognises that the proper purpose of industry is the production of goods and not the provision of employment.
- That the government recognises that the proper purpose of production is consumption.
- That the government recognises that the opportunity for self-development and the enjoyment of leisure is the true purpose of labour-saving invention.

Comment:

With all of the previous funding recommendations in place, business requirements for research and development, use of new technology along with new and improved local and national infrastructure (roading, public transport, power, health, education, and telecommunications) New Zealand's productivity rate will greatly improve.

VI. The recommendations from recent examinations of monetary policy, including the joint Treasury and Reserve Bank of New Zealand's report entitled Supplementary Stabilisation Instruments

The six options evaluated in the "Supplementary Stabilisation Instruments" merely tinker with the status quo, and provide no real solutions.¹⁶

DSC recommends:

- That the "Limit on term of mortgage finance" option in the appendix be implemented in place of the OCR.

Comment:

The reservations expressed in paragraph 175 are easily overcome.

The concern that loans would be specified with a single large payment due at the end of (artificially shortened) life of the loan, which would in turn would be financed with a new loan is a simple matter of regulation to mandate even repayments over the life of a loan.

The reduction in loan term need not disadvantage low income borrowers to any greater degree than does an interest rate rise. The reduction in average loan term of a lender's portfolio is what needs to be achieved. This leaves flexibility for the lender to manage individual loan terms within their portfolios, i.e. a low income earner's loan term could be longer than a high income earner's.

The implementation of DSC's submission, recently made to the Inquiry into housing affordability in New Zealand, will see the degree of difficulty for low income earners to be a non-issue.

¹⁶ Peter Bushnell et al, "Supplementary Stabilisation Instruments", 10 February 2006

VII. Additional measures that could enhance monetary policy in New Zealand

The application of monetary policy in New Zealand could undoubtedly be enhanced by employing economists and advisors who have a skill or a thirst for seeking knowledge, and who have the ability to question the foundations of what they do and believe in. This is a profession made up of people who are usually only wise after the event.

Current economists have a belief structure that has at its foundation an assumption on which they build model economies. They use these models to manage an economy made up of real people. If the assumption is flawed, how dangerous is that?

The Assumption: “Provided it is agreed that income is equal to the value of current output ... all of which is conformable to common sense and the traditional usage of the great majority of economists.”

It must be pointed out that “common sense” once dictated the earth was flat, and “traditional usage” was doctors prescribing calomel – a highly poisonous mercury-based concoction – to cure influenza and other fevers.

DSC Recommends:

- That the Universities of New Zealand be urged to impartially examine the validity of those imported economic theories and doctrines taught to students of macro economics;
- That the New Zealand Universities be requested to establish chairs in macro economics with the specialist function of examining and developing modern social credit theory for application in New Zealand.

Summary

As long as the creation of money lies in the control of commercial banks, the current monetary policy as applied by the New Zealand Government will not be effective in controlling inflation. **It is, however, effective in creating a society of increasing social injustice, economic injustice and environmental devastation.**

This is because the current monetary policy has no control over the quantity of money, the source of money or the exchange rate, and relies solely on influencing interest rates, using the OCR – a “blunt instrument” as discussed earlier.

This is a world-wide problem, with governments abrogating their right and their duty, to own and manage their nations’ money supply, to private “for profit” banking interests. These private banking interests have facilitated the huge, compounding growth of debt that burdens us all. One way or another, we service that debt as taxpayers and consumers.

The 95% of world currency movements have nothing to do with buying and selling of real goods, but have everything to do with speculation. Our current high-interest-rate monetary policy is attracting these speculators like bees to a honey pot. They win, our exporters miss out, and the necessary opportunity is again lost to reduce and eventually repay our overseas debt.

More and more existing assets – land, businesses, water and the like – will need to be sold to overseas interest. Calling the sell-out of New Zealand a “capital inflow” is a euphemism for an inability to pay off debt.

The citizens of New Zealand are, increasingly, tenants in their own country.

It is long past time for a change.

Appendix A:

**SOCIAL CREDIT STATES ITS CASE:
(The A + B Theorem revisited and revived – a discussion paper)
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Useful and all as the Economic Summit may have been in a number of respects, it is a tragedy that such a grouping of interests could come together to discuss, for three whole days, the nation's problems and still fail to identify the fundamental flaw in the economy which results in the twin evil of inflation and unemployment.

This failure, however, is not really surprising. All the interest groups represented have been so steeped or brainwashed in financial orthodoxy (the false Keynesian assumption that total incomes equal total prices) that they, like the National and Labour Parties, are incapable of doing anything other than devising economic strategies and policies upon this basis. In short, they are incapable of any worthwhile lateral thinking on economic management. The most of which they seem capable is movement in the direction of what is currently fashionable but still highly orthodox – free market and monetarist theories. These have been shown both in the distant past and in recent times (e.g. in Britain under the Iron Lady) to leave gross inequalities and social injustices in their wake.

The fundamental flaw in our economy – and we won't get any solution to our predicament until we recognise and act upon it – is that, in the course of producing consumer goods, industry does not generate and release enough purchasing power to enable all of the goods produced to be consumed without heavy consumer indebtedness. In other words, total incomes never automatically equal total prices as they should. There is a gap between total incomes and total prices which should be filled in special ways. Instead it is either not filled, in which case recession results, or alternatively it is filled in ways that produce inflation and unemployment.

With inflation now rising again to compete with unemployment as the country's most pressing problem, the time is ripe for social credit to release a modern form of the original Douglas A + B theorem to prove once again the existence of the gap or deficiency in purchasing power – that money placed as income in the hands of people involved with production is less than the total prices of goods produced for consumption. And, in view of the complete failure of conventional economic thinking to find a solution to our problems, I believe the time is also ripe to challenge once again the orthodox economists, or anyone else, to attempt to prove the theorem is wrong, in the terms in which it is stated in this paper, instead of resorting to derisory remarks as in the past. Feeble derision is no substitute for attempted refutation.

In the course of producing consumer goods, in any one working cycle of production, the manufacturer normally draws money from his trading bank to buy raw materials, pay salaries and wages and meet other direct costs. In using credit in this way he generates income for others equal to these direct costs. At this point income generated equals costs met – that is, income equals value. But these direct costs (let us call them A costs) are not the price at which he can sell his product because he has other indirect costs (e.g. interest charges on his overdraft and depreciation on his plant and equipment) which are not covered by any money put into circulation at this point. In addition, he has to make a net profit. Let us call these indirect costs B costs. The manufacturer's selling price must therefore be A + B and no accountant can balance the manufacturer's books until the manufacturer receives payment equal to A + B.

This payment is usually made by a wholesaler who uses credit from his bank to buy the product. In doing so, he pays the manufacturer his A + B costs (which then become the initial part of the wholesaler's A costs) together with his own normal direct A costs, including

wages to warehousemen and commercial travellers. The amount by which he draws down his working funds will have to cover this total sum.

The manufacturer is now able to repay his overdraft (his A value) to his bank, which must now cancel this created credit out of existence. Income has, therefore, now been generated and paid out to the level of the manufacturer's A + B value, plus the wholesaler's own additional A costs. The wholesaler still has to recover his indirect B costs, including wholesale sales tax and his net profit, for which so far no credit has been released and no income has been generated.

At this point the retailer buys the product with credit from his bank. He pays the wholesaler's A + B costs (which now becomes part of the retailer's A costs) together with his own normal direct A costs (e.g. rent, wages, etc.) The overdraft the retailer negotiates will have to cover this total amount. The wholesaler is now able to repay his overdraft (his A value) which will now be cancelled.

Income has now been generated to the level of the wholesaler's A + B value plus the retailer's own additional A costs. But the retailer still has to recover his indirect B costs, which include interest charges, retail sales tax and net profit, for which no income has been generated in this production cycle from manufacturer to consumer. The price of the goods is the retailer's A + B value, but the amount of money released as income for their purchase in the course of production is less than this necessary selling price. It is equal only to the retailer's total direct A payments which in turn equal the amount by which he has had to invade his working funds. Income equals A, but final value or price is A + B.

Income does not equal the value of current output and is, in fact, less than this amount. There is therefore an income or purchasing power gap, deficiency or shortfall which has to be made good if there is to be sufficient income to meet the necessary price level. Let me translate it into simple figures. If, on 100 articles selling at \$1 each, the retailer's A payments equal \$90 and his B costs are \$10, then income released in current production is sufficient to purchase only 90 articles. Unless there is an injection of \$10 into the system, 10 articles will remain unsold on the shop shelves.

It may be argued that the problem will be solved when the manufacturer extracts more credit from his bank to commence his next production run. That is a fallacy. In fact, if nothing is done to fill the gap in the right ways immediately, the problem is compounded because in the second production run the manufacturer with his overdraft cannot possible cover his own current A costs and the retailer's B costs (less the retailer's net profit when he gets and spends it) from the first round of production. At the end of the second run the gap will have become wider.

There remains therefore the continuing problem of a compounding income deficiency. The shortfall, of course, becomes even greater when savings are made and not invested in new capital goods. If the gap is not covered, an over-production and under-consumption situation will result, leading to massive unemployment and depression – the “poverty amidst plenty” scenario as in the 1930s. Normally the shortfall is covered by consumers drawing on savings (which means they will not be available for new capital investment and employment) and borrowing and buying on some form of credit. In short, savings and investment declines and consumer debt grows.

Today the main source of money to fill the deficiency is highly expensive consumer debt finance, either released and multiplied off a deposit and free reserves base or recycled at high speed by financial intermediaries (e.g. finance companies) at great profit to themselves. Both procedures amount to some form of credit creation. To this is added government deficit financing which is eventually recalled by extra taxation and by forced and competitive borrowing of private sector savings which should be invested in new capital. Both methods of closing the gap add inflationary costs, in the form of high interest rates, to the

whole system as well as produce a state of ongoing debt. The repayment of consumer debt, including the very high interest charged on this money, leads to demands for higher incomes. This automatically increases financial costs of industry. Additional cost inflationary pressures are, in this way, automatically built into the economic system. From that flows most of our economic problems, not the least of which is unemployment.

There are several ways out of the problem – that is, of closing the gap properly. One is to adopt policies which ensure that people's savings and reserve funds (mainly depreciation allowances) together with low interest loan moneys from the Reserve Bank, are invested in new capital goods (renewals and replacements of plant machinery and equipment) and public and community amenities (to the extent of materials and manpower available) respectively. Investment in new capital goods and assets in these ways releases equivalent additional income for consumption without immediately increasing the supply of consumer goods and can thus close the deficiency in purchasing power.

Another way is for the government, through the Reserve Bank, to make supplementary income, in the form national or citizen dividends, available to the point where incomes and prices equate; or to provide consumer credits (subsidies) to lower the price of goods to the point where they equate with incomes. To the extent, but only to the extent, that the base money supply can be increased at any one time without producing demand inflation, these options – citizen dividends and consumer credits – can be achieved by putting debt-free money into circulation. Beyond that point, money put into circulation in these ways can only be done so on an interest-free basis – that is, it must be able to be recalled and cancelled, as was the case with the sugar subsidy in the early 1970s, which was provided on the basis of a loan from the Reserve Bank of New Zealand to the government.

The first option, however, will not involve any subsequent government taxation or borrowing. Nor will it generate an new interest costs which would have to be built into the price of future consumption. That is why the Social Credit Party in recent years has tended to favour the greatest emphasis being placed on this solution, though it sees room for all of the above possible approaches to be used to varying degrees, depending on economic circumstances and social needs.

Indeed, with the impact of high technology now threatening to reduce our ability to get income from traditional work, people are going to have to receive compensatory income in some form. Social Credit sees this as being best achieved through individual worker shareholding in industry and through citizen shareholding in public assets. People will then receive dividend income, as of right, arising from their part ownership either of industry or the assets of their country, rather than in the form of what many would otherwise see as handouts from a patronising central government. This in fact would not be the case, since all citizens are co-inheritors of what has been achieved, but the “work ethic” is still so deeply ingrained in our national consciousness that, from a psychological viewpoint alone, this is the best approach, as well as the only viable one, long term, in relationship to the money supply.

The alternative to the Social Credit solution, which is what we have had and what we have got, is a continuous process of constantly enlarging debt, ever-increasing taxation, inevitably ongoing demands for higher wages, forever greater and greater costs for producers, and surging price inflation. In the end, high and rising unemployment results when governments decide that the inflation has to be artificially restrained through wage and price controls. The risk with this, as we can see quite clearly now, is that when the controls are eventually lifted, as they have to be to avoid business collapse, we finish up with the worst of both worlds – high inflation once again with still massive unemployment.

In recent times the cost of trading bank overdraft finance used as working funds at each level of production, and expressed in interest charges, has risen dramatically. This has lifted the proportion of B costs to A payments and increased overheads at all points in the

production chain. This has necessitated repeated rises in price levels as profits have had to climb above these rising interest rates.

Rising interest charges on bank-created credit (working funds) have resulted from a decline in the base money supply (MS1) relative to National income. This has occurred as governments have imposed restrictions, via the Reserve Bank, on the availability of overdraft finance to industry in the mistaken belief that inflation is caused by too much money chasing too few goods. Between 1955 and 1980 the M1 money supply, as a percentage of National Income, declined from 35.6% to 13.3%, a huge drop. The effect of this has been to turn money into a scarce commodity and, given any commodity in short supply for which there is a high demand, the price for access to it will rise. In the case of money, this is expressed in high and rising interest rates. High speed multiplying and recycling of existing savings by fringe banks then becomes necessary to substitute for the shortage of credit. This raises the interest rate structure even higher and attracts, for high return investment, savings which should be directly invested into new capital goods to help in closing the income gap.

The result is that the income gap is not reduced in an effective way. It is actually widened by the additional costs incurred by industry being obliged to compete with consumers for finance (in the case of industry "industrial finance" for both capital and working funds) from fringe banks at exorbitant cost. This has to be reflected in increased prices, which means that consumers then have to seek even more "consumer finance" from the same sources. This produces demands for higher incomes and greater costs for the production system, and so cost inflation spirals upwards.

Obviously, then, one obvious way to reduce overhead costs in production, and a further way of reducing the size of the income gap, is to increase the supply of the overdraft finance and lower its cost. In fact, doing the one will automatically achieve the other, as well as winding back the high cost and high velocity operations of the fringe banking system. In fact, this must occur at the same time as the M1 money supply is increased, and there is now so much inertia in the system that some degree of regulation may also be needed in the short term.

Social Credit also believes that, since money should be basically a means of exchange and not something that anyone should profit from in its original creation, the Reserve Bank, representing the people, should create and advance at low cost the working capital required for industry and production. The trading banks, representing mainly private interests, should not be able to pocket as profit the interest on credit created for the community's use. That is the prerogative of the people as a whole, and only they should be able to exercise it if they decide it is desirable to do so. The trading banks would be given the opportunity to be distributing agents for the working funds created by the Reserve Bank and be entitled to charge a reasonable fee to both the Reserve Bank and customers for the services they rendered as agents. Any interest charged would belong to society to be applied to whatever form of economic or social investment or benefit the people should, through their parliament, deem desirable.

BRUCE BEETHAM

Appendix B: Defining Money¹⁷

In a modern economy, money comprises “fiat” money, that is paper money, and indeed nowadays mostly “electronic” money (in the form of electronic records of deposits held at banks.)¹⁸ This means that any analysis of money in the economy is necessarily focused on the financial system, and the banking system in particular. It also means that when we talk about monetary expansion (or contraction), we are also talking about bank credit expansion or contraction.

The deposits, or money balances held with banks are the direct counterpart to the assets that banks hold on the other side of their balance sheets, namely their loans. When a bank makes a loan, it places the amount of the loan (which constitutes “credit”) in the borrower’s deposit account (which constitutes “money”), and the latter can be “spent”.

Hence an analysis of the role of money in the economy needs to incorporate the role of credit. Thus... money and credit will often be referred to together. Indeed, in many respects they are “different sides of the same coin.”

¹⁷ Sean Collins et al, “Defining Money and Credit Aggregates: theory meets practice” - Introduction

¹⁸ Fiat money is to contrasted with ‘specie’, i.e. money in the form of precious metals.

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