THE RECENT DEVELOPMENT OF INFLATION FROM THE ANGLE OF SMALL COUNTRIES

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A foreword for the 25th anniversary of this Journal

«SPOUDAI» has developed within its 25 years — this volume is to celebrate its 25th anniversary — into an important Greek economic review. All those interested in economics in Greece read same with both pleasure and profit. Many papers published there thus secure a great publicity. Their authors become so known to all Greek economists. This would have not been possible if their papers were not included in «SPOUDAI». When asked to contribute to this volume I accepted with pleasure but did not make a decision on the subject to be treated for some time. I chose later the recent development of inflation from the angle of small countries on which I was working for the 2nd International Congress of Cypriot Studies to be held in Nicosia from the 15 to the 21 September 1974. This paper was to be delivered there and the Author expected to enrich same on the basis of the discussion to follow in the congress before publishing same in the Volume to honour the 25 years SPOUDAI appears. Unhappily the 2nd International Congress of Cypriot Studies (the first was held in 1969) had to be cancelled owing to very unfavourable developments due to the Turkish invasion of Cyprus on July 20, 1974. The latter led to a spectacular destruction of the country, of its organisation, of its economy and of its resources. Rehabilitation and reconstruction will need a long time and great efforts. Of course the latter will start only when the Turks will have returned to their homeland according to the decisions of the Security Council of the United Nations. For the time being the decisions have not been respected by the Turkish Government despite official statements by the latter's representatives to the contrary. Let us hope that the pressure of the nations of the world and particularly of those two which could have prevented all this misfortune on Turkey will prevail. Turkish invasion of Cyprus made about two hundred thousand prosperous and happy people both miserable and unhappy not to mention those who got killed or crippled for life.

In the effort to approach economic theory to reality one wonders if inflation does not show particular aspects in the case of small countries. Small countries are those whose population does not exceed 10 or 12 million inhabitants but of course the difference between Liechtenstein and the Netherlands or even between Cyprus and Greece is worth mentioning and influences very much the way problems show up and the methods applied for their satisfactory solution. I intend to deal :

— in the introduction with the increased intensity of inflation,

— in Part One with the reasons of the appearance of special problems connected with inflation in small countries,

— in Part Two with inflation problems in small countries, both developed and developing.
The Conclusion will follow.

Introduction

Inflation gets gradually stronger all over the world, particularly in the last two or three years. This is caused :

1. By the expansion and by the intensification of the inflationary mentality with the result that those influenced and conducted by same are continuously increasing their claims and contribute so to the strengthening of inflationary pressures.

2. By the rising tendency of all wages independently of the rise of productivity to the level reached in those trades where the rise of productivity is the greatest as otherwise labour would shift out of the branches where productivity and so wages did not rise; there is no danger worth mentioning of remaining unemployed with full employment or even overemployment.

3. By the increase 200 % of the oil-price which has pushed upwards of course in a different degree all costs and all prices.

4. By the deficits of the overall budget practically all over the world inasmuch as they are not covered by genuine savings.

5. By the develuation of the dollar of the United States of America in terms of both gold and many currencies even if in the latter case the abolishment of all obstacles to the free flow of goods and services from country to country ought to precede.

Part I

The reasons of the appearance of special problems connected with inflation in small countries are :

1. The impossibility for a small country to prevent imported inflation through

both its imports and exports as long as developments in the outside world cannot be influenced by the small country at least under normal circumstances. This is so important as exporters are keen to exploit to the utmost the upwards tendency of prices and that importers have to accept the conditions of their suppliers abroad without being able to influence same. Imported inflation is considered so important by Sir R.F.Harrod that he attributed to ted inflation is considered so important by Sir R. F. Harrod that he attributed to same the bulk of the price increases in the United Kingdom in the first decade or so following world war II[1]. If this is so in that country it is easy to judge the importance of imported inflation in countries smaller and less influent than the United Kingdom in the late fifties.

2. The small bargaining power of the corporations, of the firms, of the inhabitants and of the whole economy of small countries as they may most easily be replaced in the frame of the world economy by the suppliers or customers without any disturbance or at least change for anybody except those replaced or those succeeding. It may be said that the small country handles and is handled under conditions approaching those of free competition.

3. The extent of the opportunity cost incurred by a small country if retrenching herself from the world economy and from the advantages of the international division of labour in order to avoid the repercussions of imported inflation. In view of the certitude that imported inflation cannot be avoided the efforts undertaken in order to curb inflation due to internal factors are not very systematic nor very intensive inasmuch as imported inflation engenders as a rule a general upwards tendency of all economic aggregates. The opposition of those who will, at least temporarily, be unfavourably affected by the efforts to curb inflation will of course be strong and governments as a rule have the tendency to yield is as much as they know that the chances of succeeding to curb inflation will be meagre when imported inflation is unavoidable. The example of Switzerland in the last two decades can be mantioned despite the latter's impregnable monetary condition. I mean from the technical point of view.

4. The great influence of monetary fluctuations and disturbances abroad on the balance of payments, on the structure of the economy and on the rate of inflation in small countries contributes further to weaken their efforts against inflation and so to strengthen same particularly if inflation lasts for decades.

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1. Cf. Sir R. F. Harrod, The fight against inflation, New York 1958.

Part II

The problems connected with inflation present themselves in a somewhat different way according to the degree of development in the small countries concerned.

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They are in the seventies of the twentieth century as far as those developed are considered :

a) The increased intensity of inflation all over the world which is very much felt in developed small countries. The latter have to be open to the outside world as otherwise development would have been impossible, I mean without the advantages of the international division of labour. This gives them the possibility to secure the benefits of progress all over the world and of the exploitation by themselves of the chance of supplying only those commodities and services where each of them enjoys the most comparative advantages.

b) Small developed countries have as a rule strongly developed secondary and tertiary sectors without avoiding to make the best in order to keep a very intensive primary sector whose importance is particularly felt when for any reason international flows of commodities are restricted. This development cannot be secured nor maintained without the import and the export on a great scale of combustibles, in our days particularly oil, raw materials, foodstuffs, manufactured and semi manufactured commodities. The Leontieff paradox has not to be forgotten nor do we have to forget first that the internorwegian trade in fishes is substantial despite the fact that all areas produce fish not of course of the same type, second that the world trade is mainly the turnover of manufactured commodities between developed industrialised countries.

c) The prices of agricultural commodities and of raw materials have the tendency in both prosperity and inflation to advance more sharply and more quickly than those of manufactured commodities with the result that small developed countries undergo in the interlude a deterioration of their barter terms of trade and a strengthening of the repercussions of imported inflation which cannot be neutralised for the reasons exposed in Part One.

d) Small developed countries have as a rule a substantial amount of both invisible receipts and expenses in their balance of payments. These flows in both directions are influenced very much but in a different degree and at different time by inflation in the world economy and in the small country concerned. They lead as a rule in the latter to the intensification of inflation constituting another type of imported and thus unavoidable inflation.

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When the small country concerned is developing the following points may be made as far as inflation problems are concerned :

a) Small developing countries are as a rule, at least as far as their exports are concerned, countries of monoculture which get very much influenced by the inflations' repercussions on the prices and on the demand of the single or the few commodities they export. In a phase of upwards price tendency incomes and so demand may surge which in colonial times induced metropolitan governments to impose compulsory saving in order to secure finance for infrastructure development or for the satisfaction of vital needs in the future when prices of the export commodities will have dropped.

b) Capital in-flow in order to finance development projects will act in an inflationary way as far as it will

   aa) be spent within the country and not for the import of machinery, spare parts, raw materials, semi manufactured commodities and know how from abroad,

   bb) those securing incomes or an increase of those they already have will not hoard same or will not be prevented from spending them.

c) Inflation abroad will increase the receipts from the invisible items of the balance of payments but will also increase invisible expenses by the inhabitants of the developing country as long as those willing to undertake some will not be prevented by law or by decision of the authorities concerned to do so.

d) The substantial income's increase in the developing country caused by one of the factors mentioned under a, b, c of this paragraph will most probably, except it prevented by exchange control, induce those securing income increases they are not ready to spend, to invest or to borrow in the developing country to capital transfers abroad. They will be induced to do so :

first by the fear that investments or loans within the developing country itself will prove a source of loss, particularly if the boom, engendered by inflation abroad and by the substantial improvement of the barter terms of trade, subdues,

second by the desire to participate in the profits from price increases, even only in nominal terms, abroad as a consequeance of inflation,

third by the rational desire to divide risks and even more when in the past the developing country had had recourse to devaluation, exchange control, moratoria or nationalisation the latter without paying quickly adequate indemnity.

The transfer abroad may create problems in the balance of payments if the outflow is important in comparison with the receipts from abroad and in comparison with the gold and the foreign balances of the central bank. On the other hand it will weaken the impetus of inflation in the developing country and contribute so to the preserving of the equilibrium of the country concerned.

Conclusion

Inflation as a rule is more intensely felt and less thoroughly fought in small countries. It has as a rule unfavourable repercussions except the reduction of the burden of debts at home and abroad. This lighting however is matched by the diminution of the purchasing power abroad of claims and of balances. If these claims are payable abroad and if the balances are held there that diminution constitutes a pure loss for the country concerned. On the other hand if these claims and balances have to be paid within the country it faces only a transfer. It is not known in advance if this transfer is from the macroeconomic point of view advantageous or not. The cost for a small country to avoid inflation is prohibitive and cannot be considered as a practical solution at least with modern priorities between the aims of the economic policy of any country.