

14th March 1984

Dear Editors, "The Georgist Journal"

In the German magazine "Der Spiegel" No.31 of August 1st, 1983, appeared an interview with private banker Johann Philipp Freiherr von Bethmann, Frankfurt.

Because of the sensation that was roused when Bethmann sold the remaining half of his well-renowned, ancient, and wide-ranged family banking firm, "Der Spiegel" inquired him about the background.

Eight years ago, Mr. Bethmann sold half of the firm to Bayerische Vereinsbank, but found that he got too little influence for his viewpoints in his cooperation with this bank.

And now he feels that the development in economy has involved considerable danger for the banking systems as a whole, since the banks are giving loans far beyond what can be risked to the developing countries who have but poor chances of ever paying off the loans, as the banks must expect great losses on their international loan operations.

He mentions the still unsolved problem of inflation, and fears a global industry crisis which is in its heart a crisis of currencies.

He considers the present trade policy and foreign exchange policy quite mistaken, saying that the welfare of the whole world is heavily dependent on the money and currency policy of U.S.A., and that it may lead into a catastrophic situation as it becomes clear that the loans are unrecoverable, not only giving losses to the banks but also losses to the depositors, maybe not in the shape of direct losses, but as a devaluation of the money.

His opinion is that the note banks are given a much too strong significance, and adds that the note banks are not masters of the total money amount.

When asked how he invests his own money now, he gives the answer that with his skeptic view of the value of money he preferably makes investments in real estate. (- which attitude Georgists will recognize -)

These gloomy prospects gave me the occasion to send the following article to "Der Spiegel", which should be of vital interest to all Georgists, as it is a signal that Henry George is stepping into the picture at an urgent moment.

Sincerely,



Knud Tholstrup,
Denmark.

Article, as sent to "Der Spiegel" - translated:

"The interview in your No. 31 with Johann Philipp Freiherr von Bethmann reveals considerable new-thinking and a clear vision of economy, which mainly points out that the vast outstanding in Third Countries must be considered unrecoverable, especially because of the too high level of the rate of interest, which automatically increases the amount drastically, and the unsolved problem of inflation, which predicts a great global industrial crisis.

A development of such serious character must call for a counteracting solution - we simply cannot just stand back and look on.

During the years when I was building up my business, I was primarily involved with practical economy, but now after the change of generation I have indulged in the study of that part of economics which deals with inflation, however not so much based upon the known theories as upon practical experiences.

I have arrived at the same conclusion on the concept of money as Mr. Bethmann, that any piece of paper with an I.O.U., including private mortgage papers and all instruments of debt are included in the total amount of money.

Former Minister of Finance of the U.S., Mr. G. William Miller, agreed with me on this in a private correspondence when he was Governor of the Federal Reserve System. Realizing this fact is enough to agree with Mr. Bethmann that "the note banks are not masters of the amount of money". Thus, they are not able to force a reduction of either the rate of interest or of inflation, without the remedies employed in cooperation with the politicians hampering the free economic movement and thereby also production and employment in the home country and in trade partner countries, to the detriment of both.

Medicine can reduce the fever but kill the patient.

Monetarism is built upon a mistaken theory and can therefore not be successfully practised, on the contrary it will delay the economic improvement we are all hoping for.

All attempts up till now to fight inflation and its little brother, the high rate of interest, have been directed against the symptoms (wage and price spiral, high rate of interest) by introducing wage and price stop and credit squeeze, instead of being directed against the source of inflation by preventing inflation from appearing.

To be sure, inflation was slowed in some places, but certainly through putting a brake on activity itself, causing unemployment.

Mr. Bethmann talks of the "other face" of inflation. I would like to point to the two effects of inflation which balance each other. It gives losers as well as winners. It hits all consumers and savers but favours all real estate owners, especially land owners, even in two ways. The value rises, and debts to mortgage holders is reduced. All attempts have aimed at mending the damage on consumers but without success.

We must therefore turn to the other side - the winners. Without winners, no losers, and without winners and losers no inflation.

I fully agree with Mr. Bethmann that high rate of interest more than any other thing makes Third Countries poor.

The yearly amount of interest added to the already immense loan sums carry the main responsibility for the foreign debts of Brasil having reached \$85 bill. and growing automatically by 8,5 bill. at a rate of 10 % interest, though at a 5% rate it would only increase by 4,25 bill. Here we have the main reason for the claims of the banks becoming un-recoverable.

There is great reason for thanking "Der Spiegel" and Freiherr von Bethmann for pointing to the serious character of this problem, and Mr. Bethmann's thoughts should rouse the greatest attention so that we might again get interest down to a fair level.

Mr. Bethmann says the problem of inflation is still unsolved, which must be understood such that he expects and wishes it to be solved.

First condition is to know the source of inflation. In this area I have made several indicative discoveries through the years.

My starting point is, 1: that we have inflation when the growth in the amount of money (same definition as that of Mr.B.) is faster than the growth in production. The same fact is said by Milton Friedman but without telling us from where this surplus growth in the amount of money comes. 2: If purchasing power, wages and profit, could only be obtained through production, there would be balance between the goods produced and the payment obtained thereby, the purchasing power, and thus no extra money with which to press up prices, and thus no inflation.

We need not search for long to find the source of the surplus purchasing power coming in to press up prices.

In Switzerland the biggest rate of inflation ever was experienced in 1973 when the country was in a building boom. During the period before there had been a busy purchasing of building plots, far beyond the needs.

The table below shows development which clearly indicates when a lot of surplus purchasing power came out of sale of land and entered into the turnover, and how inflation fell as soon as the purchasing of building plots practically came to a halt.

| | NUMBER OF HOMES BUILT | INFLATION % |
|------|-----------------------|-------------|
| 1968 | 53.140 | 2,2 |
| 1969 | 57.280 | 2,3 |
| 1970 | 63.590 | 5,4 |
| 1971 | 65.248 | 6,6 |
| 1972 | 73.612 | 6,9 |
| 1973 | 81.865 | 11,9 |
| 1974 | 73.691 | 7,6 |
| 1975 | 54.899 | 3,4 |
| 1976 | 34.158 | 1,3 |
| 1977 | 32.297 | 1,3 |
| 1978 | 34.464 | 1,0 |
| 1979 | 37.813 | 3,6 |
| 1980 | 40.876 | 4,0 |
| 1981 | ? | (est.)6,0 |

In U.S.A., during 1977-80, big purchases of real estate especially land took place, paid with Arabian oil money, entailing high rises in land prices. In Oregon building plots went up from \$8000 to \$13.000 within one year, just for an example. Inflation in U.S. developed as follows:

| | | | |
|------------|-------------|--------------|--------------|
| 1977, 6½%. | 1978, 7,6%. | 1979, 11,3%. | 1980, 13,5%. |
|------------|-------------|--------------|--------------|

When recession came and home building was halved, the U.S. rate of inflation fell again (1981, 10%. 1982, 6%. 1983, 3%.) However, inflation must be expected to rise rapidly again in 1984 due to the land value increments that were a consequence of an 80% higher home-building activity. Therefore a reduction of the rate of interest cannot be expected now.

The development in Denmark is an object lesson on the cause, effect, and methods to abolition of inflation.

The actual trade value of land increased from Dkr. 17 bill. in 1960 to Dkr. 320 bill. in 1981, equal to 19 times double, while wages rose 9.7 times and price index 5 times. The amount of bonds increased by more than Dkr. 300 bill, viz. from 14.4 bill. to 356 bill., 24 times up. It is precisely this increment of the amount of money which, according to Mr. Bethmann, is outside the power of the note banks.

Thanks to good experiences in Denmark, we are also able to prescribe the remedy for stopping inflation and that high rate of interest which always follows. After election in May 1957, a coalition government was formed of Social Democrats (Danish "labour" party), a free enterprise party, and the Georgist party called Justice Party, who all agreed on stopping land value rising through a levy on the surplus land value increase, the revenue of which was to be used to lower income taxes. A law to this effect was to come into force as from 1964 based upon the regular land assessment that was due in 1960. I, as a Member of Parliament, promised that this law would stop inflation and lower the rate of interest. In fact, all land speculation - the intended as well as unintended - came to a standstill, and my promise came true already the first year after. Inflation went down from 6 pct to only 1 pct per annum, the rate of interest from well above 6 pct to 5 pct the year after. These events entailed a long cavalcade of other advantages: The deficit in balance of payment was converted into surplus, foreign debts were brought down by three-fourths within 3½ years, no new taxes were introduced, on the contrary a few were reduced. By and by production developed, so that 100.000 more people had employment, and the real value of wages showed the biggest rise ever.

But alas ! In the election campaign of 1960, land owners staked the highest sums ever spent in an election campaign in this country, the against this very law. They won, and presently managed to have the law cancelled just as it was to come into force. Immediately, land prices soared again, inflation increased feverishly and in 1962 reached 8 pct. Also the rate of interest increased.

By unintended land speculation I mean the acquisition of real estate either for use or as a hedging against inflation, just as Mr. Bethmann says he is investing his own money after selling his bank and firm.

There are other kinds of unearned income, but they are quite insignificant as compared to the fortunes gained on land value rising, and thus without much interest in this connection.

The increase in productivity sometimes may cover up the actual size of inflation, as it has a counteraction effect upon the price risings which we are using in the concept of inflation.

Having clear indications of the cause of inflation, and knowing a method of abolishing it — a method which does not violate the concept of ownership, and which brings down income taxes by the same revenue amount that is levied on land value increment — should we not take into use this new knowledge so that also the rate of interest may be reduced (the necessity of which Mr. Bethmann in his interview stressed quite clearly) — and thus avoid a new and maybe more serious international economic crisis, and the awful misery entailed by it?"

To emphasize it is an urgent matter. It is an urgent matter that Henry George is coming into the picture of to-day.

Knud Tholstrup
Denmark.