Addressing global inflation

One of the repercussions of the current international monetary crisis is global inflation. Chances are it could even be hyperinflation. Malaysia surely would not be spared from the effects of this imported inflation. The seriousness of the current crisis is something to reckon with because many, particularly those from the middle and low-income group, will be significantly affected by the ensuing decline in living standards brought about by the ever-decreasing purchasing power of money.

There are at least six main reasons for this global inflation. Generally, the main cause of inflation in almost all countries is the structure of the monetary system itself. Here, the problem is due to the mismatch between the growth in monetary aggregates and of the real economy. A common phenomenon is total money supply and debt growing exponentially. This is primarily due to the effects of fiat money, fractional reserve banking and compound interest, which are the key features of today’s monetary systems.

Inflationary pressure sets in because the real economy is not able to match the huge growth in monetary aggregates, hence prompting governments to control the prices of basic necessities like rice, floor, sugar and cooking oil. In Malaysia, money supply grew at about 15% per annum on average while the economy grew only at about 8.5% at its peak. The difference, of course, is what shows up as inflation.

However, the current drastic rise in food prices globally is significantly due to the US dollar crisis, where the value of the greenback has been falling relative to other currencies for about a decade now. Since the prices of commodities in major markets are priced in dollars, accordingly, the prices of all these commodities, including grain, have been generally increasing.

Everyone now knows that gold and silver prices are rising. Indeed, any item priced in dollars will face this inflation due to depreciation. The table provides the prices of some basic commodities in January 2002 and a decade later in January 2012. Note that the price of rice has increased 183% — almost tripled — in the last decade while the price of petrol has gone up five times. It is government subsidies that are keeping local prices affordable to most people.

The fact that the dollar is an international reserve currency is also adding to inflation. Many businesses and even central banks are now moving away from the dollar, diversifying into other major currencies. The velocity of the dollar’s circulation has increased because of this, contributing further to inflation. The international reserve currency status of the dollar, therefore, exports inflation globally.

Indeed, velocity is responsible for the hyperinflation of the rouble in the early 1990s (when the Soviet Union collapsed), the Zimbabwe dollar in the last decade and even the duit pisang — the currency issued by the Japanese during their occupation of Malaya in the early 1940s. The root cause of such inflation is the loss of confidence in the currencies. The dollar is currently going through a similar phase but unlike those currencies, its effect will be global.

On top of all this, the US has been pumping huge amounts of dollars into the system through its quantitative easing — QE1 and QE2 — exercises to mitigate a biting recession. However, due to the low returns on the stock and bond markets, a significant amount of this new money will find its way into the commodity and property markets worldwide, prompting further increases in already inflated prices. QE3 is also possible and deemed necessary to keep the US economy afloat, although its effect would be temporary. In my opinion, QE3 would trigger immediate hyperinflation worldwide, causing the dollar to plunge.

The derivative market presents an even bigger threat. Huge amounts of fiat money are now being parked there and there exists a real danger that financial markets would go through a turmoil due to a continued global monetary meltdown. A quadrillion dollars, that’s a thousand...
trillion, are estimated to circulate in the derivative market.

To put things in perspective, a trillion dollars is where one can spend US$1 million or about RM3 million a day for about 2,700 years! And we have a thousand of that in the derivative market. In the wake of the global financial crisis, it is very likely that some significant portion of this money will find its way into the commodity market because unlike financial assets, commodities are for real. Imagine what the pressure would be on commodity prices if this happens.

Finally, there is also a cause for global inflation from the real sector — global warming and climatic changes. Severe droughts, floods, hurricanes and tsunamis have all contributed to reduced global food and agricultural production. In all, we see a compound effect on global inflation with devastating effects on global standards of living, particularly of the middle-income and low-income groups. Countries that import food products would be severely affected.

Since inflation due to monetary reasons, like the ones discussed earlier, actually involves a transfer of wealth from the low-income to the high-income group, the latter is indeed a beneficiary of the inflation. Hence, inflation due to monetary reasons is a zerosum game unlike inflation caused by the real sector, which is borne by all.

The question now is, what can people and the government do to mitigate global inflation and its effects on the standards of living in the country? Indeed, there are some short, medium and long-term measures that we can take to address this issue.

**Short-term solutions**

The short-term measures include giving immediate assistance to those severely affected by the inflation, particularly the low-income group. Food stamps are an option for this as they offer assistance only to those vulnerable to inflation. The cost for running food stamp programmes should, however, be financed by taxing the high-income group. Otherwise, the entire burden would be placed on the shoulders of the middle-income group because the high-income group is generally a beneficiary of inflation.

Another measure that has been in place for quite some time now is price controls. This is a powerful way to curb price increases. Unlike food stamps, price controls would benefit all parties, including the middle-income and high-income groups. Without government subsidies, the cost of price controls would have to be borne totally by food producers. Nonetheless, during times of high inflation, food producers and sellers sometimes hoard their products or sell them elsewhere where they can fetch better prices.

Hence, price controls without adequate subsidies could prompt protests from food producers or force them to find ways to evade the controls. However, it is worthwhile to note that price controls of basic food items would push money into other sectors and thereby prompt price increases in those sectors, like the stock and property markets.

Inflation can also be tackled through the real sector. An important option here is to increase food supply by increasing the number of smallholding food producers and processors. Government agencies (in Malaysia, there are numerous examples: the Malaysian Agriculture Research and Development Institute, the Federal Agriculture Marketing Authority, veterinary services and so on) and financial institutions like Bank Pertanian may work hand in hand to realise this.

Programmes aimed at getting new graduates to enter the agriculture business should be encouraged and assisted. An increase in food supply, accordingly, would suppress food prices and thereby counter inflation.

Monopolistic or oligarchic food production and distribution should be curbed because large food producers and distributors tend to dictate the price, type and quality of items produced and sold.

**Medium-term solutions**

As for medium-term solutions, the government could encourage the setting up of complementary and community currencies. These currencies, like coupons, complement the ringgit and foster employment and economic activity. Many towns in the US, UK, Australia, New Zealand, Japan and so on have complementary currencies working along with the national currencies. Complementary currencies ensure that there is no shortage of money in circulation.

Complementary currencies are best introduced to a cooperative structure where
they are applicable only to members. In this way, rules and regulations can be enforced.

The whole idea here is to net off as many transactions among the members as possible before settlement is done. This is also termed “mutual credit clearance”. Complementary currencies are non-inflationary because, unlike the present fiat money, they are created only when a good or service is exchanged.

Commercial barter exchanges also work in a similar manner as complementary currencies and mutual credit clearance. The establishment of such exchanges should, therefore, be encouraged. Currently, there are only about two barter exchanges existing in Malaysia, still in their infant stage.

Long-term solutions

One long-term solution to inflation and many other economic problems, including the problems of stability and sustainability, is to link the monetary unit to gold or other commodities — to establish real money systems. Indeed, it’s the removal of the link between the dollar and gold in 1971 that I would significantly blame for the many monetary crises in the last few decades — for the current dollar crisis and the precarious condition of the global socio-politico-economic-environment situation, which even threatens the world with a thermo-nuclear war.

In my opinion, the best form of money today is interest-free, gold-based electronic credit. Such money and a payment system would prevent a lot of today’s economic malaise from happening and bring about economic justice, stability and sustainability.

Nonetheless, I believe this is a long shot, given today’s political realities.

Such a credit-money system would prevent the shortage of money in circulation and attendant recessionary effects while being inflation-free. The availability of credit also encourages employment and trade.

It is advisable for countries, including Malaysia, to nationalise their banking system or go for public banking. By equating “virtual wealth” — money created out of thin air — with real wealth, the current banking system has transferred a significant portion of wealth, particularly land and resources, away from the indigenous community.

Hence to mitigate such problems and other imbalances, public banking is a promising solution. Ellen Hodgson Brown, the author of the bestseller The Web of Debt, also advocates public banking and established the Public Banking Institute to propagate banking in the interest of the public. North Dakota practises public banking and, indeed, it is the most solvent state in the US, if not the only one.

To put an end to shocks to the current global monetary system, a bold government should consider eliminating interest charges totally — abolish riba entirely from its monetary system. Interest is not return on capital. It exists because some quarters control the quantity of money in circulation. Currently, this power is a monopolistic one enjoyed by the commercial banks, through the central bank.

Dr. Ahamed Kameel Mydin Meera is head of the Department of Finance at the Faculty of Economics and Management Sciences in International Islamic University Malaysia in my opinion, the best form of money today is interest-free, gold-based electronic credit. Such money and a payment system would prevent a lot of today’s economic malaise from happening and bring about economic justice, stability and sustainability.