thus be of the order of 15 per cent. At parity of exchange it would be over 30 per cent. Clearly, it is much easier to get an adjustment of 15 per cent. than one of 30 per cent. Despite a 10-per-cent. exchange rate, import prices have fallen in New Zealand currency. According to the index number published by the Government Statistician, import prices have fallen by 3 per cent. in New Zealand currency. This fall is due to a decline in the prices of imports of at least 12 per cent. in terms of sterling. It may be expected that the adjustment of the prices of secondary production throughout the world to the lower level of raw materials and foodstuffs will gradually increase this figure. As the sterling prices of imports fall, the cost of imports in New Zealand currency will tend to approximate to the 1929 level, despite a 40-per-cent. exchange rate.

Effect on Security Values.

78. A higher rate of exchange will sustain security values and ease the process of financial adjustment. The credit structure cannot easily withstand the shock of a sudden and drastic fall in all security values. As mentioned before, liabilities tend to be fixed in terms of money claims that are not easily adjustable to a rapid and heavy fall in prices. Assets, however, are vitally affected by such a fall. They shrink or become frozen, and it becomes difficult to meet obligations in terms of fixed money claims. Over a period of years an adjustment to a lower level of prices can be made without undue financial disturbance. This is not the case if the fall in prices is rapid and severe. The price level is, indeed, a central feature of the economic system. Any sudden disturbance of it transmits a shock to the whole system that may have serious consequences. A high exchange rate by preserving the higher level might prove economically beneficial.

Effect on National Credit.

79. There is the question whether a high exchange rate would damage the credit of the Dominion overseas. This is a question upon which opinion varies.* In the immediate future, the Dominion's credit abroad would be adversely affected, because the rise in the rate would draw attention to the gravity of the economic situation in New Zealand. This is a point for consideration in connection with necessary loan operations overseas. (Section XIII.) If, however, the situation was being met with courage and determination, and the country demonstrated its capacity to restore sound trading conditions and meet its external obligations, national credit would recover even if the higher rate be maintained and if the currency be devalued. (See Section IX.)

80 In present circumstances there is a net gain to the community from an exchange rate above parity.* The analysis of the problem given in this section may lead people to believe that a complete readjustment could be made through the exchange policy alone. This is a wrong conclusion. The mere raising of the exchange rate will not set in motion all the necessary adjustments. A very high rate might lead to lack of confidence in the currency and cause considerable financial disturbance. This would delay rather than expedite the process of economic recovery. It is therefore undesirable to place too much strain upon the currency and exchange mechanism. An exchange rate above parity should be associated with other economic adjustments. These are considered in Sections X to XIII. Even with a rate of 40 per cent., which has been taken for the purposes of illustration, some adjustments in fixed charges, rent, wages, and public finance would be required. At a 10-per-cent. rate the adjustments required would be greater.

Alternative: Primage Duty and Export Bounty.

81. The general effects of a rise in exchange rates might be illustrated by reference to a possible alternative method of attaining to a similar end. Supposing that New Zealand's payments abroad balanced with exports at £35 m., imports £25 m., and interest payable £10 m. These prices are in sterling, and sterling prices are beyond New Zealand's control. A 20 per cent. rise in exchange would add that proportion to all items in the balance of payments expressed in New Zealand currency. Exporters would receive £7 m. more; importers would pay £5 m. more, and £2 m. would have to be found by taxpayers to meet additional interest. Thus £7 m. paid by importers and taxpayers would be received by exporters.

82. A similar result might be achieved in another way. Let a primage duty of 20 per cent. be placed on all imports, to yield £5 m., and the extra £2 m. be raised from the taxpayer as under the higher exchange proposal. There would then be £7 m. available with which to pay a bounty on export. In these conditions all the effects would be similar to those caused by a higher exchange. The prices in New Zealand currency of export and import goods would tend to be 20 per cent. higher, taxation for interest 20 per cent. higher, the money value of the national income and the taxable capacity of the people would in the long-run be raised in similar degree, and the same transfer to exporters from other sections of the community would be made. The higher exchange has the advantage that it would be automatic, more certain in its working, and, if necessary, easily capable of permanent adoption by devaluation.* On this question see Section IX. The primage duty would be less certain, more difficult to administer, and open to political interference, but it would enable the bounty to be distributed according to need. If the primage duty were regarded as a temporary measure it might not sustain security values. But the far-reaching effects of allowing matters such as these to become the subject of political pressure points to the danger of deciding them on grounds of political expediency.

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* See Addendum by Mr. Park.