

Australian Adam Smith Club (Melbourne)

President: Timothy Warner, Editor: Mannie Gross, P.O. Box 950, Hawthorn, 3122

Princes and sovereign states have frequently fancied that they had a temporary interest to diminish the quantity of pure metal contained in their coins; but they seldom have fancied that they had any to augment it. The quantity of metal contained in the coins, I believe, of all nations, has, accordingly, been almost continually diminishing and hardly ever augmenting.
Adam Smith (Wealth of Nations, 1776)

Dr Peter Jonson on Great Crises of Capitalism: Central Bankers - friend or foe?

**The Adam Smith Club will host a meeting on Wednesday the 25th of May 2011,
at the Hawthorn Club, 627 Glenferrie Road, Hawthorn.**

Peter Jonson is founder and editor of Henrythornton.com. A former chief economist at the Reserve Bank of Australia, Dr Jonson has worked in the private financial services sector, as a company director and as a professional writer with a regular column in *The Australian*.

Dr Jonson's new book *Great Crises of Capitalism* provides an overview of four centuries of economic history, for which unfashionable work Peter was recently commended by Quadrant editor Keith Windshuttle. More controversially, the book draws lessons for how capitalism works and proposes remedies including ways to limit the scary increase of financial instability which Peter largely blames on weak American central bankers. His proposals for reform include a global central bank, for which he was recently taken to task by the Hon Peter Costello, AC.

Attendance is open to both members and non-members. Those desiring to attend should complete the attached slip and return it to the Club no later than Friday the 20^h of May 2011. Tickets will not be sent. Those attending should arrive at 6:30pm for dinner at 7:00pm. The cost is \$40.00 per head for members and \$45.00 per head for non-members (see next page for explanation of arrangements and for electronic booking details).

**Enquiries to Hon Secretary, mob. 0408 321 948
or email: asmith@adamsmithclub.org**



detach and return

The Secretary,
Australian Adam Smith Club (Melbourne),
PO Box 950, Hawthorn, Victoria 3122.

Please reserve place(s) at \$40.00 dollars per member andplace(s) at \$45.00 per non-member for the May 25th meeting of the Australian Adam Smith Club. I enclose the amount of \$..... in payment for the same.

NAME (please print):

ADDRESS:

.....

SIGNATURE: TEL:

LAISSEZ FAIRE ON THE WEB

This newsletter has an address on the web: <http://www.adamsmithclub.org/laissez.htm>. The Club's web site can be found at <http://www.adamsmithclub.org/>.

ELECTRONIC PAYMENTS

By popular demand, the AASC now offers electronic booking and payment to dinner meetings. Bookings can be made by emailing the number of members and non-members attending to twarner@adamsmithclub.org; a reply email from the club will then be sent with a link to PayPal where the payment can be made by Mastercard, Visa, AMEX, Diners or PayPal Account. Bookings made after Friday 20th of May will not be accepted online. FEES - a \$2 card fee will apply for the transaction.

MARCH MEETING

The March Meeting had Katy Barnett speaking on 'The Limits of Law' – it was a very interesting paper, which is available for download from [adamsmithclub.org](http://www.adamsmithclub.org). The psychological status of legality, and how over regulation and silly laws tend to destroy law abiding cultures was particularly appreciated. The question time was robust, with plenty of participation.

The Curry Club Cafe gave us their usual good fare, as we farewelled the Bollywood Lounge. The Lounge has been home to almost half our meeting in the last five years, but due to re arrangements at Curry Club our future functions there will be upstairs in the larger function room.. TW

ALTRUISM AND BUSINESS DON'T MIX

John Kinghorn was one of the darlings of the boom, pre GFC – global financial crisis. He floated the company he built from nothing, RAMS Home Loans, and cashed out most of his shares weeks before financial markets crashed, making a profit of \$600 million. Whether it was the result of sheer luck or the result of insight bordering on genius - or a combination of the two - no-one will ever know for sure. At the time, Kinghorn was much criticised for getting out when he did, but he can hardly be blamed for taking a well-earned profit or for successfully predicting an event almost no-one else did.

Although RAMS shares were virtually valueless after the GFC, they have now recovered somewhat. Kinghorn now wants to take RAMS private and delist it from the stock exchange. This has annoyed the institutional shareholders and also the small-time punters who bought into the company hoping for a quick profit, which they have indeed gained.

But what does Kinghorn owe the minority shareholders? The small punters did little more than place an order with their brokers and perhaps attend the statutory meetings. The institutional shareholders have a duty to their stakeholders to maximize profits from their investment. In both cases, they are the legal owners of the business. If the business thrives, they benefit, if it fails, they lose. That's the risk they accept as owners.

Kinghorn, on the other hand, is both an owner and a manager. As a manager, he aims to maximize his returns while fulfilling his duties to the owners – the shareholders – of which he is one.

Reports in the press (see 'Like a ram to the slaughter,' AFR, 30 April 2011) seem to suggest that Kinghorn has some sort of altruistic duty to the minority shareholders. Kinghorn, as the manager, must fulfill the legal requirements involved in running his business. As for ethical conduct, it's a case of 'how long is a piece of string.' Ethics are culturally based and subject to varying interpretations. The fact is Kinghorn is no worse – and in many ways a great deal better – than others who have taken out minority shareholders.

Take Warren Buffett. Buffett, 'the Sage of Omaha' is possibly the most successful investor in the history of the world. He has always taken pride in his reputation for ethical conduct, which has recently been tarnished by an insider trading scandal, which, though inexcusable, an auditor would describe as 'not material.' But Buffet has never made a secret of the fact that in his view altruism and business don't mix. That doesn't mean he is not generous with his money – he is. He intends leaving most of his multibillion dollar fortune to the charitable foundation run by his best friend, Bill Gates. It's just that Buffett thinks that altruism and business are two different things. JRB

VENUE ARRANGEMENTS

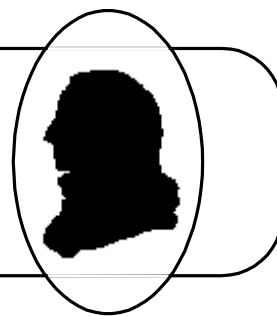
The Hawthorn Club is on Glenferrie Rd, just south of the Burwood Rd intersection. It is 300m from Glenferrie Railway Station and the Number 16 Tram stops at the corner of Glenferrie and Burwood Rds. Car Parking is available on the street or in the large car park behind the Hawthorn Town Hall.

The Venue room is to the left on entering the Club - we have the Bistro area for our function. There is no BYO. Drinks are at bar prices. Coffee & Tea are included.

We hope these arrangements do not cause inconvenience and we welcome your feedback.

Laissez Faire

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THE INTERNATIONAL MONETARY FUND

Since the advent of the GFC in 2007 there has been a resurgence of activity and interest in the IMF, which, in the years previously, had seemed to be in danger of becoming irrelevant.

The IMF is an organization affiliated with the United Nations based in Washington DC. Its membership is comprised of most of the world's national governments. Its mission has expanded over the years since its inception and now includes surveillance and monitoring of economic and financial developments, the provision of policy advice to members, particularly crisis-prevention advice, the making of short term loans to nations in financial trouble, the provision of training and technical assistance, and the setting of economic and financial codes and standards.

The Managing Director of the IMF since 2007 is a French one-time communist and former Minister of Economy & Finance, Dominique Strauss-Kahn. He is expected to retire in 2012 and run as the Socialist Party's candidate for the presidency of France. Predicted to replace him is the former British Prime Minister, Gordon Brown, who is known for selling off Britain's gold at US\$300 per ounce, effectively the bottom of the present bull market in gold.

The IMF was created in 1944 at Bretton Woods in New Hampshire, at an historic meeting held by representatives of the allied nations. It was one of a trio of organizations formed at that time, the other two being the forerunners of the World Bank and of the World Trade Organization. Under the influence of J M Keynes, the famous British economist, the representatives planned and formulated an economic and financial design for the post WW2 world. The 3 organizations were intended to stabilize the world's finance and currency systems, promote trade, and provide aid for developing nations.

Prior to WW1 developed nations had operated on a gold standard, whereby gold coins were minted as money and so-called paper money was freely and fully redeemable in gold. This had the effect of constraining individual government's ability to create money. Along with many other things, the gold coin standard was destroyed by WW1.

Following the end of the war, a modified gold standard was set up. This was the gold bullion standard. Gold coins were no longer issued, but paper money, at least theoretically, was redeemable in gold bullion. Since gold was no longer required for coins, this considerably reduced the constraint previously imposed on governments. But the Great Depression destroyed the gold bullion standard, particularly after President Roosevelt seized America's gold and banned individuals from owning it. By the time of Bretton Woods the world was in need of a new monetary system. What eventuated was the gold reserve system. During the time of the Great Depression and the lead-up to it, the world had been troubled by the lack of fixed exchange rates and the practice of countries manipulating their rates in order to gain a trade or other advantage. This was particularly the case with so-called competitive devaluations, where countries pursued policies intended to decrease the value of their currency and hence increase their exports. Bretton Woods set up a global system of fixed exchange rates to be overseen and protected by the IMF. It also provided a gold reserve currency, namely the US dollar. Due to Europe's self-destruction by 2 world wars, the USA at that stage possessed approximately 80% of the world's monetary gold. The USA agreed to back its Federal Reserve dollars with gold valued at \$35 an ounce, and to redeem from any foreign government, its notes, with gold at that price. The US dollar thus became the world's reserve currency. In return the USA was granted veto power over IMF decisions.

By the late 1960s, the Bretton Woods system had begun to fail. The USA had become involved in a number of costly wars, particularly in Vietnam, and was flooding the world with dollars. Foreign governments, particularly that of De Gaulle in France, became concerned about America's ability to redeem them all and began demanding gold. In the end the USA succumbed, and in 1971 repudiated its agreement to redeem with gold.

Since 1971, fixed exchange rates have virtually disappeared and been replaced by floating exchange rates which constantly fluctuate. This increases the

risk and complexity of world trade and investment. Almost by default of anything better, the world switched from the Bretton Woods, gold reserve standard, to a so-called US Treasury-bill, or dollar, standard. The USA has continued to live beyond its means and to flood the world with irredeemable paper dollars, to the extent that creditor nations with large dollar reserves are increasingly concerned that they will ever receive any real value for them. This has become even more so since America has seemingly begun purposely to depreciate its currency. Calls have arisen for reform

A number of proposed reforms of the world's currency system have been put forward, some of which involve a modified and invigorated IMF. One suggestion is that the dollar should be replaced as the world's currency by an IMF issued currency called Special Drawing Rights ["SDRs"], which would be

based on an expanded pool of funds to be provided it by its members. This would require much increased contributions from emerging nations such as China, India and Brazil. These countries object to doing so, however, without receiving an increased say in IMF affairs, which they see as presently dominated by Western governments, particularly that of the USA. This would also mean the IMF taking over the nominal role of the World Bank, which to a large extent it has done already.

Other reform proposals include rejecting use of the dollar in international transactions and instead increased use, on a bilateral basis, of other national currencies. Or perhaps even less desirable, a return to protectionism, including capital controls. Significant change in the short term in the world currency system now seems almost inevitable. *DBS*

VIVA FEDERALISM

Supporters of federalism as their preferred system of government are likely to point to its alleged superiority in encouraging and maintaining liberty as being the reason for their preference. Such a view of federalism has been endorsed by many among the learned and the great, such as Lord Acton, the famous British historian of liberty and, in more recent times, Sir Harry Gibbs, the former Chief Justice of the High Court of Australia.

The number and seeming popularity worldwide of federations and federalism continues to grow. Despite this, in Australia, as in the USA, federalism as an ongoing political system, has failed and continues to fail. It is of the essence of the claim that federalism promotes and protects liberty that it is competition between the states, which promotes liberty, and that it is the power of such states,

which provides a sanctuary for those who would seek it. However the centralization of power in the national government, and the commensurate decline and loss of power of the states and of their rights in both countries, have led many to question whether a federal system any longer exists therein. Large numbers, perhaps a majority, now support and call for the abolition of the states.

In both Australia and the USA, the highest courts in the land, (the High Court in Australia and the Supreme Court in the USA) have, as interpreters and reviewers of their respective nation's constitution and legislation, failed in the task of maintaining the federal balance. Many have asked why this should have happened. Perhaps the best answer is that given that each such court is a federal court, such result was inevitable.

Recently proponents of

federalism have begun to insist that judicial review is not the best or most appropriate method to maintain a federal covenant. They point instead to the remedies of secession and nullification. In the USA the right of a state to secede was rejected, with Northern victory in the American Civil War, whilst in Australia the Constitution itself seemingly excludes such right.

Nullification embodies the idea that legislation or an act of the federal government that exceeds the constitutional authority or power of the federal government is not lawful and that rather it is properly the role of each state to determine for itself whether such purported law shall operate or prevail within its own jurisdiction. If federalism is to survive, and it seems desirable that it should, then acceptance and application of nullification or some such similar measure seems to be required. *DBS*