CHAPTER 7

TRIAL BY INFLATION

It is scarcely surprising that poverty-ridden masses in countries which have recently gained sovereign independence—but little else to improve their people's welfare—should unquestioningly accept the trials of deliberate inflation, on top of the trials their ancestors suffered, in exchange for promises of economic growth and better times. But the relationship of identity drawn in industrial democracies between inflation and economic growth needs analysis. For it is a mythical relationship. It is not logically necessary. It is irrational. Yet it is certainly politically useful in industrially advanced democracies, both to lazy, shortsighted or timorous governments of the Centre and Right, and to those of the Left who are all of that and also perhaps subtly farsighted. This explains the easy acceptance of the no-growth-without-inflation myth among almost all sections of Western Europe's industrial democracies (save only the German and the Swiss).

The no-growth-without-inflation myth, so widely disseminated and accepted in all political parties and social groupings, accounts for most of the rapid rates at which, and the high peaks to which, post-war inflation was allowed to go in these West European democracies. The myth took control of all democratic party politics between 1944 and 1957-59. It even took precedence over the age-old differences between, say, Conservatives and Socialists (as in Britain). Both parties lent themselves willingly to the myth.

In those democracies at stages of decline (if not decadence) following the second exhausting World War within twenty-one years, the further social discipline and effort needed to found recovery and growth upon sound money seemed a superhuman requirement. To the Germans, who had suffered and endured even worse things and had been left with little for the second time in a generation, sound money seemed logically and imperatively the foundation for the most necessary, most rapid and most enduring economic growth. To the Swiss, who had watched belligerents and safeguarded neutrality throughout that troubled generation of wars without being directly involved in them, growth-without-inflation seemed natural. Thus all West European democracies after the war, save only Germany and Switzerland, slipped easily into inflation as a policy, no matter which party, parties or ideologies governed them.

They were rather like 'underdeveloped countries' in their mood: war-ravaged, impoverished, aware of vast needs of new capital, at their wits' end to see whence new savings might come. Though still democracies, there was tacit agreement between their nominally opposed politicians that 'forced savings' from their masses and classes alike, coupled with State controls, rationing, licences, etc, could alone bring about swift enough economic growth and recovery. None of them showed, in public opinion or political life, the bold vigour of Germany under Dr Erhard in 1948 in stablishing a new currency and keeping it as a sound foundation before all else was built upon it.

In the event, post-war growth and recovery only came to the West European democracies—Germany included—from America. The European Recovery Programme and the Organization for European Economic Co-operation were both offspring of the Marshall Plan of June 1947. They rescued European democracy. By 1949 the inevitable devaluations of the leading European democracies' currencies followed. Not even thereafter, however, was the no-growth-without-inflation myth abandoned as an all-party affair. The devaluations of 1949 placed more inflationary fuel at the disposal of the stokers. These stokers, drawn from nominally opposed political parties, fed the furnaces for a further eight years, during which the pound sterling lost a further 30 per cent of its purchasing power. Inflation was not abandoned in Britain until the courageous resignation of the Conservative Chancellor of the Exchequer, Mr Peter Thorneycroft, in 1957—over about £50m. in a Budget of over £5,000m., but on a monumental principle. For he resigned in protest against his own Prime Minister's, Cabinet's and Party's long-standing policy of national economic growth with inflation as an instrument to secure it. The last of the four major sterling crises after 1945 occurred largely as a result of his resignation. So did the new, anti-inflationary Conservative monetary policy which that fourth crisis forced his successor at the Treasury to deploy, for the first time in a dozen post-war years. The soaring of Bank Rate to 7 per cent at the end of 1957—a peak unattained for twenty-five years—marked the end of 'cheap money'. It was Thorneycroft medicine, administered by a *locum*.

It was also the beginning of the end of the no-growth-without-inflation myth. Within twelve months of the end of 1957 the Fourth Republic fell in France. By 1959 sterling and a new franc were riding 'high, wide and handsome' on an unfamiliar wave of worldwide confidence. The industrial democracies of Europe were staging a rate of economic growth-without-inflation which impressed Americans. America and Germany in their turn had become menaced by inflation, and were now the chief industrial democracies fighting the no-growth-without-inflation myth.

Political Causes and Economic Effects

This brief tour of the post-war democratic horizon raises intriguing questions. First, if the United States and Germany were able to keep out of the inflationary race from 1948 to 1958, why did they get into it in 1959 when the others got out? In the case of Germany, the answer could be 'over-full employment': by 1960 the fifteen-year-long flight of Germans from Communist East to democratic West had practically ceased; the labour market was overstrained; and trade unions were pressing hard—in a strong bargaining position for the first time—for big increases in wages. All German resources were strained at once by a boom which threatened to turn into inflation in default of appropriate restraining action by the authorities on Dr Erhard's successful lines. If this is right, inflation in an industrial democracy is ultimately due to the organized power of the workers to take more out of the National Income (*a*) than others can, (*b*) than they themselves put in, or (*c*) than the democracy can withstand.

But nothing of the kind was true of the American economy. There was unused industrial capacity and unemployed manpower in America. Consumption trades boomed; but capital goods trades did not. Certainly trade unions in both sectors of industry—and outside industry altogether—pressed for higher wages than the rise in productivity (either in the industries or occupations concerned or on the average in the country) justified. But this had long been true in the American economy—for a century in fact—and new capital equipment and its management had offset the rise in labour costs. Why did it go wrong in 1959? In both democracies, America and Germany, all costs pressed prices up and the monetary authorities sought to counter the inflation by damping down the boom.

Secondly, however, *how* did 'the others'—in particular the leaders, Britain and France—get out of the 1948-58 inflationary race? And could they hope to stay out if America and Germany got into a new one? Britain and France had at long last managed in 1957-59 to call a halt to inflation by time-honoured but drastic discipline of their monetary systems. But their currencies remained fixed in official rates or relationships with the US dollar (based on gold at $35.00 to the fine ounce) and through that with German marks, Swiss francs, and all other currencies in fixed exchange rates with the dollar.

So, thirdly, if the price-levels in America and/or Germany for things in normal demand rose faster than those of France and/or Britain—*i.e.* if dollars and/or marks depreciated in purchasing power faster than francs and/or sterling—trade would turn away from things priced in dollars and marks, and it would increase in things priced in francs and pounds. If the countries' price-levels were not kept in line with the fixed exchange rates between their currencies—*i.e.* if each government did not keep the relationship between money and things in its country (its price-level) broadly in step with that relationship in the other countries—the fixed, official exchange rates between those countries' currencies could not possibly be maintained. If American or German prices in general soar, while British and French prices don't, world traders will buy in Britain and France the things which all four countries can offer, rather than in America or Germany. So to keep trade for their own industries and workers the Americans and Germans will have to cheapen dollars and marks: will have to devalue them, to quote more of them than before to sterling and francs. That is what Britain, France, and all other former inflaters had to do earlier in the post-war period.

And so, fourthly and finally, since Britain and France earlier, and America and Germany later, seem to run headlong into such difficulties because of inflation, is it not probable that the causes lie not in mere monetary matters but rather in politics and society? Is it not more probable that the monetary *manifestations* of inflation—soaring price-levels, rising interest rates, flights from fixed-interest bonds into variable (and hence rising) dividend-yielding equity shares, and so on—are really symptoms of a disease to which democracies seem peculiarly prone? Is it *because* they are democracies?

The currency relationships and arrangements established at Bretton Woods in 1944 between the leading, world-trading, industrial democracies ensure one thing at any rate. Inflation continued as a policy in any of them must either draw the rest along, or force the inflater to devalue his own currency as against all the others. So many democracies have (*a*) followed inflation as a policy since 1945, (*b*) at differing national rates, (*c*) have consequently had to devalue their currencies (many of them more than once in a decade), (*d*) ending up with America and Germany (long the soundest) threatening to go the same inflationary way, that (*e*) we may well suspect some cause built into democracy itself, or at any rate into modern industrial democracies run by representative governments elected by universal adult suffrage.

Economic Convulsions in Democracies

Democracies are now confined to Western Europe, North America, and to isolated industrial societies elsewhere, like Japan, South Africa, and Australia. All of them, without exception, have shown—most of them show—the same inflationary manifestations. All of them are supposed to concert their monetary policies in order to keep up a steady rate of growth in international trade (full employment), to maintain a general international stability of prices, and to preserve their currencies' mutual official values in other currencies (the exchange rates) through the international institutions of the United Nations and of the International Monetary Fund set up in Washington after the conference at Bretton Woods in 1944.

Remarkable, in view of world events since 1945, as has been the general level of success in the international achievement of these aims, success inside each separate industrial democracy has not been so remarkable. And in, and therefore between, all of them inflation has taken tolls, caused devaluations, and been pursued as a policy at varying national rates. The effects upon the different industrial democracies have consequently varied; but the combined effect of so many varying national inflations on the economic development of the free half of the world has been to make its progress spasmodic, convulsive and unreliable.

The turnabout of the United States between 1949 and 1959 is sorry testimony—from the confident, freely-trading, generous, stable, economic saviour of the democratic half of the world, to the apprehensive, more protectionist, more careful, more inflationary, economic portent to the other democracies today. Almost as sad testimony is borne by Germany. She is now—like America—so much richer than in 1949, and possessed of so much of the gold and other reserves which America has meanwhile lost, yet fighting (like America) the same built-in inflation at home, but behaving in the foreign economic field in no way like the good American creditor of mankind a decade earlier.

Alongside these, which are two of the strongest economic systems among industrial democracies, we can range Britain, France, and the others whose post-war progress for a decade and a half has been one long inflation punctuated by crises and devaluations. As the 1960s opened, neither they—nor any other democracies—showed much disposition to face the international problem of continuing national inflations: some causal, some consequential, all of them carried along together, none of them stopped.

In the free half of the world alone vestigial democracy, representative government, consumers' and producers' choices, private enterprise, and personal freedoms remained. But instead of facing the unfree, authoritarian half with steady, co-ordinated, economic growth, progressive yet settled societies, and dependable co-operation between them, the leading, free nations contrived to present a social and economic picture almost as arbitrarily convulsive and spasmodic as that presented by the Communist half of the world. Whereas the Communist half produced its convulsions by lack of fundamental freedoms and by authoritarian plans for the future, the free half produced its spasms by unco-ordinated inflations and consequent interferences with the working out of those freedoms. There was more than met the eye of each half-world's system in the other.

Democracy's Economic Advantage

'But surely,' the innocent non-economist will object, 'all you are saying about inflation in and by modern industrial democracies amounts to advocacy of totalitarianism: an extraordinary argument by a freedom-loving, libertarian individualist.' Neither true; nor extraordinary if it were. First, because if it were true, a lover of truth more than liberty (if those were ever by their nature opposed) ought to tell it, as he sees it, though the heavens fall. And secondly, because Communist, Socialist and other 'totalitarian democracies' (Professor Y. Talmon's phrase) do *not* successfully avoid inflation and its real burdens upon a people. They are only very successful in the masking, redistribution, and gerrymandering of those real burdens. At least as long as any democracy endures, the effects of inflation can be seen and acted upon.

The remaining democracies must still allow certain facts to come to light. They must still leave a sector of the economy to free and competitive private enterprises. Personal, private and corporate possessions of money and other property are still not 100 per cent controlled by State authorities. Foreign trading is still open. So despite all State controls over and interventions in the economy, natural prices and costs for most things, reached by the free and competitive 'higgling of the market' (Adam Smith), come to light. The democratic State can nationalize this and that industry, set up monopoly after monopoly, clap many trades and economic pursuits in State-tailored strait-waistcoats, and so rig demands and supplies and markets and prices. But money itself remains, and can be privately exchanged for goods. Some indication of 'natural' values, of costs and prices therefore remains, relating to all kinds of goods and services. So the effects of inflation on all of them emerge and can be traced and talked about.

As long as a fair amount of personal and corporate freedom remains to do as one wishes with one's own money and other private property, people will eye the trend in the purchasing power of money and all other trends dependent on it, and dispose of their money and property to what they deem their best advantage. Hence the awareness of inflation's effects in democracies. Hence, too, the problems created by the economic activities of property-owning persons, which inflating democratic States increasingly try to bring under controls. And hence, finally, the compulsion upon an inflating democratic State to undo democracy.

The Totalitarian Economy

But in a 100 per cent Socialist State or Commonwealth the production, distribution, exchange and uses of everything—manpower, materials, machines, transport, work-space—are decreed, and compelled to occur as closely as possible 'according to plan'. The calculations and measuring are done by money and credit because that is the only way to run a modern, highly capitalistic industrial society effectively (if not efficiently).[1] But prices and costs for everything in money do not openly emerge in free markets by competitive enterprise. There is neither producers' nor consumers' choice. The plans and their execution are actually conceived in *non*-monetary terms, almost in those of primitive barter: so many thousand tons of this, so many thousand man-hours necessary to a task, so many freight carloads, so many houses—and all (naturally) of standard kinds to achieve the plans.

Accordingly when production does not work out, or quality and standards fall—as they do for both human and superhuman reasons in the life of a nation or of many nations, due to bad harvests or new discoveries or epidemics or cussedness—the execution of the totalitarian State's original plans, supervised by a large and costly bureaucracy watching every detail, must still appear to ensue. It cannot be allowed to appear to fail, as that would mean a continuous scrapping of plans: planning to be unplanned. Consequently arbitrary, forceful alterations have continuously to be made to the various human or material ingredients, and to the standards or qualities as well. Thus, the 100 per cent totalitarian Socialist State achieves its plans not always, but mainly, on time; but certainly not up to standard, specification, quality, or durability.

[1] See Chapter 4, p. 55.

A massive rigidity and cumbrousness are caused by planning and undertaking important economic operations in real terms by State bodies. But the people do not know the relative values of things. The massive bureaucracy need not publish its money-accounts, as long as the plans appear to be fulfilled. The true costs of production, the true costs of errors, need never be published. Only crises occur within the bureaucracy.

Not leaving such decisions and operations to free enterprise, public markets, and the automatic measuring and registering of results in money costs and prices, necessarily does away with democracy and freedoms. It gives the State the power to inflate, to force savings from the masses and to make them produce and consume what they are told to, for the good of the State's plans. It gives the State, therefore, the power to cover up the real costs of inflation. They are covered in the general, massive loss of efficiency, or slower rate of consumers' progress, or social and political tensions, or absence of many things the consuming masses would prefer to what the State produces. But it also does away with the priceless democratic boon of the finest, most accurate, most sensitive and automatic economic measuring instrument for all values: the natural costs and prices of everything in free and competitive markets.

Great as is the rate of growth in the scientific and material achievements of 100 per cent totalitarian States, they have not been achieved by inflation as a policy. On the contrary—and the significance of this fact alone should be realized by all democrats—the published discussions among economists and other technical experts in totalitarian States show that their advice has ever been to avoid inflationary effects, although those effects would only work out in real and not in money terms, in the private world of bureaucrats' statistics and not in public, and unperceived by the masses of consumers. Most significantly, the political rulers of Russia have consistently tried to follow their advice. They realized their achievements, plans and aims depended alike on the highest possible efficiency.

It is a pity that an even higher degree of economic efficiency—that of finer calculations by sound money, free markets and competitive enterprise—was impossible for the totalitarian rulers because their political doctrine ranked above it. It was also a pity that the political rulers of democracies strove so hard to copy the totalitarians' means of massively covering up the effects and costs of inflation, without making sure they avoided the thing itself as well as the totalitarians avoided it.

Democracy's Disadvantages

The weaknesses of a totalitarian State are great but concealed. Those of a democracy are perhaps not so great but paraded. On the whole the latter is the preferable State, for it is publicly remediable.

The built-in weakness of a democracy—and it has always been so—is its proneness to pressure from vested economic group-interests. These latter seek specially advantageous treatment from representative governments in return for their votes. The more equal the opposing political party forces in a democracy, the greater the temptation—the less resistible—to angle for the votes of these organized vested interests. Their votes, as in ancient Athens or Rome, go with their pressure. Their pressure is exerted on governments for their own specific, peculiar, particular, material gain. Taxes, tariffs, subsidies, rewards for public servants, costs of State services—these are the more obvious means of sectional material advantage. They are used to benefit such pressure-groups by weak democratic governments at the cost of the whole society or of those large parts of it who pay the enhanced taxes, tariffs, subsidies, and prices of State services.

Thus a great part of the national income—which is the national output—becomes a happy hunting ground for raids by democratic governments in favour of booty for privileged pressure-groups: and this at a time when the days of privilege and class are supposed to have been superseded by democracy itself. Such material corruption of the spirit of democracy, such perversion of its principles and practices alike, pervades the Left as much as the Right, agriculture as much as industry, management as much as trade unions, and officers of the State as much as ordinary citizens.

In all economic groupings—agriculture, industry, distributive trades, clerical and professional occupations, State industries and services, and the State's own bureaucracy itself—the corruption of political pressure for sectional material gain unites, rather than divides, the two older and opposed sectionalisms of employers' vested interests and those of employees. In the modern industrial democracy the political pressure of trade unionists as organized workers for their own sectional gain is more frequently and publicly expressed than that of employers' associations: to prevent free competition at home or abroad, to keep out (or discharge if it is 'in') any refugee or other foreign labour, to limit apprenticeship or training, to stop new machines or methods operating at their productive best (*i.e.* to stop their lowering of unit costs and prices). On the employers' side, collective arrangements to keep up prices, to keep out foreign competitors, to keep away home competition, and to secure sectional levies, tolls, or subsidies also exert pressure upon parliaments and parties. Often the employers' and trade unions' pressures on governments coincide, at society's cost; and when the State is the employer—as in all nationalized industries and services—they always coincide.

Such pressures need not be—often are not—overt, formal and deliberate. The weaker, lazier, more timid and more apprehensive the government and the parties opposed to it, the more naturally and automatically do they succumb to the temptation to buy votes, to give in to the pressure-groups before the latter even formulate demands, to make sure of electoral support from such sectional vested interests at the public's expense and to 'head-off trouble' by favouring them in advance, so earning their political gratitude ahead of any need to do so. Geographical sections of the country ply their sectional interests along with economic groupings. Whole industries and occupations seek material benefits at a weak democratic government's and opposition's hands. What the entire community, the society, does not see and can barely feel in economic terms is easily and speedily voted by such parliaments in favour of a clamant few who are loudly willing to 'stand up and be counted'. The costs are there, but are paid by the unorganized electors. They are so widely spread that they can be well concealed.

In this way the so-called Welfare State—the system of State-organized and distributed welfare at the forced expense of contributors and higher-tax payers—also becomes a happy hunting ground for political raids. Benefits, pensions, subsidies to families or other consumers tend to be decided with as much of an eye to the next election result as to what is sound for the national economy, or as to what is sound even for the beneficiaries whose marginal votes loom so large in the political arithmetic of timid or calculating democrats. Thus taxes and other State levies on individuals and businesses rise to penal heights but still fail to balance soaring Budgets. Budgets already overloaded by State expenditure are then nominally covered by inflation.

Rather than risk unpopularity in the eyes of any grouping and bring State expenditure and taxes down in parallel, leaving the citizenry to perform more welfare and other economic activities for themselves, democratic governments and oppositions alike prefer to cover gaps in State expenditure by inflation. So State spending can never fall. Similarly they prefer to find the extra money and credit in the same inflationary way to buy off threatened strikes in State industries, to enable whole private industries to pay any and every wage demand and keep up full employment, and to keep in profitable being even the inefficient firms by inflationary easy money for easy profits. It is little wonder that in face of such bi-partisan timidity and inflationary easy-goingness more and more electors in modern industrial democracies become more and more uncertain which is which—government and opposition, Right and Left. That has at any rate been the common experience of almost all West European democracies since 1945.

It explains those equally confusing reversals of traditional rôles in the democracies, due to post-war obsession with 'full employment policies'—the preference of trade unionists for longer hours (at overtime rates) rather than leisure, the raising under Socialism of the British tariff (with the support of trade unions and employers' associations) to one of the highest in the world, the use of other State controls to ensure work in established if obsolescent trades at no matter what cost (full employment) rather than transference to new trades, and the keeping up of all costs and prices by protectionism, subsidies, and other arthritic State artifices aimed at full employment, no matter in what direction or at what rate the stiffened economy might then have to move. The general democratic preoccupation with work rather than leisure, with sectional producers rather than the body of consumers, and with everyday expediency rather than sound principles, has led to such confusion in politics and economics that the very system of representative and parliamentary government has rapidly come into common contempt.

Symptoms of Inflation as a Policy

Such conduct by the State, under democratic governments of differing (and of all) parties, naturally results in the classic manifestations of perpetual inflation. We have described *indexisation* of government bonds in France and elsewhere—the guaranteeing of a *real* rate of future yield on the bonds if inflation proceeds (by tying the yield to the price of gold) instead of only a fixed nominal rate of interest. But in Britain and other usually more stable democratic societies even Conservative governments felt themselves forced, by the growing public distrust of the currency's future purchasing power, to introduce such unheard-of devices (to circumvent distrust of the fixed rates of interest on their bonds) as the offer of big capital bonuses on gilt-edged after seven years (free of tax) and 'Premium Bonds' based on a lottery (the premia drawn by lot being also non-taxable). They even felt forced in social fairness to change the laws governing investments in trustee securities (mainly 'gilt-edged' or their equivalent, at fixed interest). This was so that trustees, like other folk, could 'hedge' against perpetual inflation, by investing their beneficiaries' funds in equities yielding dividends likely to rise in the inflationary future, and therefore saleable in that future at higher prices for a capital gain (not taxable).[1]

All these and other all-party, official, belated actions in industrial democracies are really recognitions of inflation as a policy. Most of them have been brought in by Conservative, Centre, or Right-wing governments. Ready to stem too-rampant inflation for a year or so, they yet go thus far in admitting their inability—or refusal—to stem it, singly or together with other democratic governments, as a policy for the future. And to the Left of Centre in these democracies the apostles of collectivism and complete State *dirigisme* propose to do likewise, faster, but with even higher penal taxation, more personal and business unfreedom, and a capital gains tax to scoop into the hands of the inflating State the paper gains of all taxpayers, which might have helped to preserve their property and its original value. This latter tax thus becomes a capital levy by the State. It recognizes that inflation is running democracy's capital down, not building it up.

The limits of personal and corporate toleration in an inflating democracy are soon reached, as long as freedoms remain. Driven

[1] See Chapter 5, p. 75.

to bribe electors in one vested interest after another by fear of losing power, eager to seem beneficent with public money on all sides, but aware that its policies and practices have driven citizens beyond those limits and in so doing have begun to undo democracy, the government both inflates and tries to control inflation's results in despair. It is open confession that the arbitrary, inequitable, and massive 'forced saving' of inflation becomes inevitable in democracy if its governments are bankrupt of convictions and courage. It is open confession that democracy cannot endure under government by expediency; under government that coasts along on tides of bribery from the public purse. Under sound, bold leadership—even in the most critical times and predicaments, and even against wide unpopularity—democracy can endure, adapt, and spring back where authoritarian systems crack, collapse and are superseded. But it has never endured under followership.