12. Inflation

'The inflation bug is contagious. More and more of the world's consumers are trying to live with annual price increases in double figures. It took Ghengis Khan years of rape and pillage to achieve the chaos to which inflation has brought the world's economies by stealth in a bare eigtheen months.''

The Economist; 19.10.74.

Having indicated, it is hoped, a reasonably clear path through the labyrinth of misconceptions about money, and exposed the political nature of its debasement and manipulation in the interests of sectional power, it is necessary to consider more closely the modern phenomenon of world-wide inflation and to ascertain how important a role the management, — or mismanagement — of money plays therein, and to discover whether any other factor has a contributory, or even an equally fundamental, part in its cause.

There can be no doubt that the simple debasement of a currency is almost as old as the institution of money itself. What we are today confronted with is a situation in which practically every country in the world, apart from those with so-called 'communist' governments (the significance of which will be discussed later) is exhibiting all the symptoms of what has now become identifiable as a disease of epidemic proportions given the genetic name 'inflation'.

The condition used to be variously described as 'cost inflation', or 'cost-push inflation', 'demand-pull inflation', 'wage-induced inflation', and one aspect of it is still being described as 'imported inflation'. All these terms have had their sponsors among the economists attending the suffering patient; but nowadays a general consensus appears to have been reached on the single, all-embracing title of 'inflation', since it is recognised that all the features originally studied as aspects of the disease are almost universally present wherever it is active.

Having reached agreement on the nature of the disease, the obvious next step for the professionals in attendance is to consider its cure. And there is ample evidence in the libraries and the public print, not to mention the sound and vision waves, around the world, of the widespread search for this. Unfortunately, there also appears to be little evidence of real progress in the search; the conclusion seems plain that this is due to failure fully to understand the condition and, in particular, its true cause. There is also evidence of a general reluctance to apply certain remedies on the score of their predictable political unpopularity.

A brief look at recently recorded statements by economic experts gives a scintillating view of the latest thinking in the rarified air of academic cloisters. J. K. Galbraith, in his latest visit to Australia, when interviwed by *The National Times* in October, 1974, gave an entertaining performance of his usual iconoclastic originality in delineating cause and cure of inflation. The best specific he could offer was higher taxation. Professor Colin Clark, writing in *The Bulletin* in September '74, advocated a drastic reduction in government spending and "with the savings handed back to the people in the form of large reductions in both direct and indirect taxation". He added an original touch by suggesting that State Governments should be made to rely on a surcharge on Commonwealth income tax to replace their existing dependence on subventions from the Federal Treasury. He also, rather daringly, advocated "massive reductions in employment in government departments and universities."

Then there was the debate about 'indexation', in both Australia and the U.K., amounting largely to discussion on measures for living with inflation without too many tears. Professor Arndt, of the Australian National University, an economist who has usually displayed support for socialistic policies, declared in September, 1974 that 'indexation' would inevitably increase inflation. On the other side there was Professor Nevile, of the University of New South Wales, with Dr. H. C. Coombs and others strongly favouring this, admittedly, temporary doorstop.

One sensible reminder was injected into the debate around this time by the Economics Editor of the *Australian Financial Review,* P. P. McGuinness, who said: "It is pretty clear that the main reason why economists and economic theory have such difficulties in coping with modern inflation is that the real cause of inflation is no longer a relatively manageable matter of cost-push or demand-pull; it is the product of a conflict over the division of the social product."[1]

Then there was the extraordinary response recorded to the publication of a book entitled *You can profit from a monetary crisis,* by the American financial escapologist, Harry Browne, whose policy, in the words of *The National Times* reviewer, is: "Get out of the stock market, get into gold and silver, put your money into a Swiss bank, and find a place in the country where you can barricade yourself against the looting, short-sighted masses who will rise when the end comes."[2]

It is the contention of this present book that there are indeed several contributory causes of the disease but that they may collectively be described as *bad government,* and it is the purpose of this chapter to delineate these contributories and indicate the overall cause.

There is no real difficulty in defining the contributory causes of infation. They are (1) government deficit budgeting, involving currency inflation and the arbitrary expansion of credit; (2) government control of the banking system; (3) the ever-rising national debt; (4) welfarism; (5) monopoly

trading and the downward rigidity of wages; (6) tariff policy, import controls, subsidies, etc. (Dr. Einzig's 'physical controls'); (7) taxation; (8) the growth of the bureaucracy; (9) the traffic in land values.

Of these, deficit budgeting, control of banking, monopoly trading and the traffic in land values may be considered the main contributories; the remainder are inter-related and consequences of the others. The ever-mounting national debt, for instance, a natural consequence of deficit budgeting, inflicts on the community a huge and increasing burden of interest which, while it is self-balancing from the point of view of the nation as a whole — in terms of 'macro-economics' — benefits a minority at the expense of the many. Welfarism is a consequence of the harmful effects of currency inflation (depreciation of the value of money) and the consequent rise in prices, taxation policy, monopoly trading and all the 'physical controls' covered by item (6), growth of the bureaucracy (part of the vicious circle of which welfarism is itself mainly the cause), and — fundamentally important but little understood — traffic in land values. Conversely, of course, welfarism, plays a large part in the creation of the national debt.

The downward rigidity of wages, on which von Mises and his followers place so much emphasis, is itself the consequence of the absence of true competition in trading operations, the spread of restrictive practices and monopolies, to which unionism with its disastrous strategy of strikes and wage blackmail is simply a response.

Tariff policy and all the other apparatus of 'physical control', part of the monopoly structure, benefiting those fortunate enough to be successful in the political lobbies at the expense of the consumer, directly contribute to the upward trend of prices and, in consequence, unrealistic wage increases.

Taxation, on which this book will later concentrate for its profound importance in the general picture of *bad government,* is obviously interwoven with all the other factors, including of course the over-growth of the bureaucracy..

There can be little doubt of the important role 'money management' plays in the general condition. Indeed, inflation, in its limited sense as applied to the issue and control of a currency, is an actual tool at the disposal of the managers; this is clear to any student of banking procedure and of the role of the Treasury. As Paul Einzig point out[3], there was no sign of 'runaway inflation' before the time of his writing (1951). But the process had definitely begun, as he indicates in the first paragraph of his chapter (2) on 'The British Monetary System': "In spite of the similarity between the fundamental characteristics of the present system and that of the 19th century, there are considerable differences between the role of money in our economic and social system then and now. This is largely because the ends and means of monetary policy have undergone far-reaching changes. The instrument is fundamentally the same, but it is now used for different purposes and in different ways."[4] He could have said 'misused', for this accords with the facts.

The preceding chapter, on Money, devoted considerable space, including extensive quotations from Paul Einzig's book on the subject, to the effects of 'money management' on the general condition of the economy practicing it. Stemming largely from the theories of Lord Keynes and the macro-economic school, while induced mainly as a measure with which to deal with the problems resulting from involvement in two world wars, it gradually became acceptable policy throughout the Western world, as its special advantages to both the wielders and the seekers of power became more obvious day by day. These advantages were recognised by both 'right' and 'left' elements in the societies. This is illustrated by the utterances of the leader of the Australian Trade Union Movement, Mr. Bob Hawke, whose speeches are full of the macro-economic jargon he learned as a student of orthodox economics, just as well as those of professional economists and economics writers and of Big Business chairmen; though there is mounting evidence that more and more of the latter, together with some leading bankers, are beginning to express doubt about the efficacy of such 'management', especially when practiced by governments like the Whitlam Labor Government of Australia.

Among the millions of words flowing from the presses of Australian Journals these days on the subject of economics, these from an article by Jack Wright[5], for twelve years an adviser to the governor of the Reconstruction Bank of Australia, indicate a realisation of the overall effects of 'money management' especially when inexpertly practiced: "Over-using monetary policy measures to reduce effective demand in the face of expansive fiscal policy had no net beneficial effect on demand pressures but further transferred resources from productive sections of the economy to non-productive purposes." The 'policy' he refers to merely indicates the lack of cohesion and clear-sightedness within the government and its hordes of bureaucrats and advisers, in particular as between Cabinet and the Treasury. Writing in *The Bulletin* on November 23, 1974, Peter Samuel refers to "the whole elaborate machinery of data collection and analysis by more than a thousand economists and statisticians in the Treasury, Reserve Bank and Bureau of Statistics complex" which, he says, "is reduced these days to virtual insignificance", presumably by reason of the government's lack of expertise and decisiveness, its pragmatism and proclivity for ad hoc policy making.

On the effects of 'money management' in the international field, a very good statement was contained in a letter to the editor of *The Bulletin*[6].

"The present economic and industrial unrest is caused by government interfering in the market-place. The most damaging is the arbitrary fixing of the price at which the currency of one country can be exchanged for that of another. WITH FIXED RATES: (a) inflation in one country in relation to others increases costs, making it impossible for producers to compete against imports or on the export market. Further interference in

the market-place can not stop the inevitable recession and unemployment that brings the value of the local currency back into line at the fixed rate. (b) inflation induces an inflow of capital from investors financing increased imports and seeking to profit from high interest rates; with inflation at 10 percent and interest at 15 percent, the foreign investor, on recalling his investment, gains a threefold greater real return than the local investor in the same security. WITH RATES DETERMINED IN THE MARKET-PLACE: (a) inflation increases the flow of imports but the increased demand in the market-place for foreign currency will change the exchange rates, making imports dearer and increasing the price received for exports. (b) inflation will induce an outward flow of investment, with the investor seeking to safeguard his money and profit from the change in the exchange rate at the time of its recall. Movements of investment with exchange rates determined in the market-place stabilise an economy by moving money out in time of inflation and bringing it in when the economy is deflating. With the fixed exchange the movement is in the opposite direction and adds to instability. A free exchange removes the conflict of interest between labour and management. An overall forcing of wages up or down does not alter the value of reward each receives. The reward for labour and management depends on the value of service each renders. It makes possible labour participation in management and full employment without inflation."

On the dangerous trend towards totalitarian government visible in Australia, as elsewhere, today, another letter in the same issue of *The Bulletin*[7] well expressed the process by which this occurs:

"Many people seem surprised that the present government has done nothing to quell the inflationary spiral, and that the last 'mini-budget' *boosted* inflation. The reasons are not hard to find. The socialists know they would never win an election or a referendum on the straight-out issue of nationalisation of all the means of production, distribution and exchange. However, with the present inflation they don't have to. As everyone is pushed into a higher and higher income bracket, we are now approaching the point where the government, by a combination of taxes, takes 80 percent of the money that everyone earns and gives us back in allowances just enough to live on. This means that soon only the government will have any cash to invest, so only the government will be able to develop anything. Having absolute control over all capital will give the government absolute control over industry and all the people connected with it, employers and employees."

On the breakdown of macro-economic thinking among the less orthodox of the present generation of economists, an article by Malcolm Crawford, economics editor of the London *Sunday Times*, headed intriguingly 'Time to Bury Keynes?', expresses the situation in the U.K. "There is more profound debate about the operation of the U.K. economy" he says "now than at any

time since . . . a decade ago, when economists deliberated over how to make Britain grow without inflation."[8]

"The decade that followed was one of profuse experimentation in economic policy. Despite an acceleration of growth . . . during that time it fell far short of the hoped for economic miracle. Disillusionment over this, compounded by an explosion of inflation unprecedented in peacetime, has made the public more confused. Ten years ago it thought that either politicians or economists . . . knew the answers. Today it is openly sceptical. Now, as economists try to discover what went wrong, the Expenditure Committee of the Commons has tried to pull together some of the main strands of this specialist debate in a coherent way. At the same time, quoting Talleyrand's well-known saying about war being too important to be left to generals, it shares the public's doubts."

The article proceeds to discuss the report (the ninth) of the Expenditure Committee, which rejected, among other things, a proposed 'permanent statutory prices and incomes policy' as "politically both impracticable and objectionable." 'Demand management' appears as the main subject of discussion with consideration of the merits of 'fine tuning' and 'medium-term targets' while the Committee's main concern, according to Crawford, was "over the use of public expenditure as a counter-cyclical device." Which exposes as well as one could wish the basic lunacy beneath the whole boiling of macro-economic theory — that the purpose of 'economic management' is 'economic management', not the interests of human beings within a society concerned with their own well-being and their economic relations with one another in the pursuit of a living. Public expenditure is not to satisfy an agreed public need — such as an undertaking too large and complex for the capacities of any group of individuals to organise (difficult as this is to conceive of in any truly free society) — but for such purposes as 'counter-cyclical control', in other words for the satisfaction of theorists playing with models. Crawford ends his article on a despairing note, despite its suggestive title:

"I see no sign though that the basics of economic management in the U.K., which is firmly rooted in the system devised by Lord Keynes, are about to be overturned here, as has happened to a large extent in the United States. Are we, as Keynes said of his own generation, enthralled in the teachings of economists long dead? Some would say we are."

A random selection of articles and letters to the editors of journals concerned with economic discussion, between October 1974 and January 1975, exposes the depressing state of affairs that macro-economic myasma still dominated most of the thinking, despite the breakdown of theory staring its protagonists in the face. (This will be found in Appendix A at the end of this chapter.)

Reference was made earlier to the fact that the escalating inflation of Western countries was not experienced in those countries with so-called

'communist' governments. In those countries, where governments exercise complete control over the economy, production conforms to fixed plans, consumption is dictated not by consumer choice but by management policy, prices are not flexible, wages likewise, unemployment does not exist, and international trade is reduced virtually to barter. In such closed and fully controlled economies, inflation, as the West knows it, does not exist.

Now, there is one significant element which, apart from all else, has a predominant influence in this situation, and that is the fact that the whole of the land of the country, in every case, has been 'nationalised', as a consequence of which rents are no more negotiable than prices or wages; they are, in the case of private dwellings and accommodation, fixed by government decree, and, in respect of industrial or commercial sites, are either not assessed at all or are merely a book entry in the accounts of the particular undertaking, of no real significance since the government is the recipient of both the gross and the net proceeds. The real importance of this lies in the fact that the economic rent, the surplus return over and above wages and interest arising on sites above the margin of production, which in Western countries swells the profits of those producers occupying prime sites — necessitating public expenditure on amenities and services, paid for by cost-inflating taxation — flows automatically, if un-noted, directly into the national treasury, providing a perpetual fund of income massive enough to offset the consequences of the worst excesses of inexpert economic management.

Marx was well aware of the importance of this factor in the socialist economy, although his dedication to the Theory of Surplus Value and the 'class war' obscured his vision of the true significance of Rent in the concept of wealth distribution. This is clear to anyone who takes the trouble to disentangle the confusing and confused discussion which Marx conducted in *Das Kapital* with Ricardo on the laws of Rent and Value. (Henry George, in *Progress and Poverty* and *The Science of Political Economy,* made redundant all the long pages of tautological absurdities Marx expended on this subject, by his own irrefutable logic in which, starting with the foundation of political economy by the French Physiocrats, he proceeded to demolish the theories and sophistries, and to expose the aberrations, of all the great names in the calendar of economic discussion and teaching up to and including those of his contemporaries.)

The importance therefore which Rent assumes as a share in the distribution of wealth has a clear bearing on an understanding of the cause of inflation. Succeeding chapters of this book will be devoted to the elaboration of this theme; but at this point the following statement of the primary cause of inflation is offered as a definition:

> Injection into the economy of excessive money and credit based on artifically boosted land values, unrelated to production, causing the diversion of investment from production to channels of real estate

speculation, creating purchasing power, or demand, vastly in excess of supply. This in turn, together with the burden of taxation consequent on the failure to collect the 'surplus product' as national revenue, restrictions on the free flow of trade and a policy of downward rigidity of wages, creates the upward price spiral.

The picture which emerges in this proposition is that, whereas in 'communist' countries economic management is total, the effects are mitigated by the fact that the economic rent is not the subject of private exploitation; in the rest of the world the private appropriation of the economic rent has led to the adoption of a form of economic management short of totality, producing the economic absurdity of the 'mixed economy'. This necessitates the imposition of taxation, with all its attendant evils, followed by the disastrous spread of government power and intervention and the general growth of monopoly, including unionism; leading, ironically enough, by all the signs, to the despotism of the totalitarian countries.

To summarise, it may be said that inflation is the direct outcome of 'economic management' which is itself the consequence of ignoring natural economic laws and the substitution of controls and 'guide-lines' for the operation of the free market. The leading, most visible weapon in the armoury of the 'managers' is money manipulation — currency control and control of credit. The less visible, but more fundamental one is the institution of taxation as a substitute for the proper public revenue, the economic rent.

An excellent pamphlet, presenting conclusions similar to the foregoing, and containing a description of the events in the years 1957-1960 in Denmark during which a successful application of the ideas here advocated produced significant results in the Danish economy, is *Economic Liberalism* by Knud Tholstrup.[9]

APPENDIX A

Here are a few examples of the bewilderment that accompanies the cerebration of intelligent people watching the destruction of values, and the deepening morass into which governments are floundering in the clueless struggle against the inflation their own policies have induced.

1. A letter to *The Economist*[10], using all the cliches in the 'macro-economic' book — "the level of domestic aggregate demand", "the rate of growth" to be determined by "the shares obtained by the domestic industrial and commercial sectors" in the world markets for their goods, the latter (never again) looking to the government as being "the prime determinant of the level and growth of demand." The writer concludes that "major assumptions underlying economic policy since the war have been invalid".
2. An article in *The Economist*[11] entitled 'Borrowing money that isn't there', discussing the effect of the British Government borrowing from "the Arabs instead of the banking system", thus turning "a 4 billion

overseas deficit'' into a ''cash flow deficit for companies''. Money supply, it reported, was rising more slowly than prices, posing a threat of mass unemployment — to which the T.U.C. responded by calling for government subsidies for companies faced with bankruptcy and ''regulations to prevent industry from making men redundant.''

3. A letter to *The Economist*[12] by a satirist who suggests that the best way he can ''assist his country'' is to cash his 'special deposit' and burn the notes. He points out that the Chancellor of the Exchequer ''would gladly attend the bonfire.''
4. A letter to the same[13] suggesting that we are ''approaching an era when paper money is no longer a practical method (sic) of exchange'' and pointing out the almost certain universal return to a system of barter.
5. An article in *The Economist*[14] titled 'The squeeze-easy cycle', sub-headed ''Old-fashioned stop-go has been replaced by a new-fangled squeeze-easy as the Chancellor manipulates financial flows instead of demand. As long as he is powerless to limit consumption, the squeeze-easy cycle will intensify inflation.'' Under the cycle, says the writer, ''the Chancellor first takes from industry to help consumers, as in pre-election March, and then from consumers to help industry, as in post-election November.'' In this new cycle ''output and employment hold up well for a time until the whole house of cards comes crashing down . . . Bottlenecks and shortages can co-exist with weak demand. There is great distortion to the productive process . . .''
6. An article in *The Bulletin* (Australia)[15], 'Business in real trouble' by Peter Samuel, in which he refers to estimates by the Melbourne Institute of Applied Economics for the coming year and praises its ''Attempt to adjust corporate earnings for the distorting effects of obsolete accounting conventions and inflation . . .'' concluding that ''non-finance companies are this year trading at a loss, after tax, of $115 million in aggregate compared with a profit of $1 billion in each of the three previous years. Real replacement-cost depreciation will be almost $3 billion this year, a 50 per cent increase on that of two financial years back and almost three times that of 1969/70. Illusory stock appreciation is up almost eight-fold and taxation wrongly levied . . . on these paper profits is due to reach $540 million this financial year, three times that of 1972/3 and eight times that of 1969/70. Capital gains taxes to be introduced next year will have to be devised so that they tax only real gains, not the illusory money gains which inflation produces. Otherwise the capital market will be effectively destroyed.''
7. A letter to *The Bulletin*[16] on 'Shrinking Salaries', dealing with 'indexation', says ''The loss of relativities (and purchasing power) . . . is obviously made far worse unless taxation scales are also indexed . . . this loss for those on more than the average wage will naturally lead to unions seeking large increases outside the 'indexation' system. Thus the

whole purpose of indexation in keeping wage rises on a par with the rate of inflation will be lost."

8. Finally, *The Bulletin*[17] devotes four pages to 'A Master Plan for Australia' in which the author (described as 'the leading Australian economist') attempts the role of economic forecaster for 1975 and offers a schema of methods by which the Australian Federal Government is to control the situation. He is said to have been "a stern critic of economic management in Australia for some time"; but, instead of advocating a cessation of this madness, he simply offers his own brand of management, which is only slightly more imaginative than that of which he has been critical. He does at least recommend tax cuts to reduce prices but approves 'indexation', proposes a government 'joint economic council', a substitution of subsidies for certain tariffs, a corporations and exchange commission, a 40 per cent 'constant marginal' tax rate on incomes over $3,000 a year and 'negative income tax' for "all individuals, including children, with incomes below $3,000", an annual wealth tax of one per cent on personal wealth of $100,000, and the adoption of a national superannuation scheme, a new national health insurance scheme, and an Australian Economic and Social Research Organisation — a super bureaucracy to supervise the functions of existing Bureaux (statistics, et al.) plus three new ones!

NOTES FOR CHAPTER 12

1. *The Australian Financial Review*, 20.8.74
2. *The National Times* (Australia), Aug 5-10 '74
3. Paul Einzig: *How Money is Managed*; Penguin Books, London, 1954.
4. Ibid; p35.
5. Article in *The National Times* (Australia) (?) (1974).
6. J. F. Gordon, Armidale, NSW; *The Bulletin* (Sydney); 31.8.74
7. A. Temesvary, Tottenham, NSW; Ibid.
8. *The Sunday Times* (London), 18.8.74
9. *Economic Liberalism* by Knud Tholstrup, Copenhagen, Denmark; 1975
10. D. F. Lomax, Claygate, Surrey, Engl; *The Economist*, 26.10.74
11. *The Economist*, 26.10.74.
12. L. J. Blumenthal, London, N.S. *The Economist*, 16.11.74
13. J. O. H. Lobley, Maidenhead, Berks; *The Economist*, 16.11.74
14. *The Economist*, 16.11.74.
15. *The Bulletin* (Sydney), Dec. 21-28 '74.
16. Denis J. Maclaine, Howrah Tas.; *The Bulletin*, 4.1.75.
17. *The Bulletin*, 11.1.75.