XII: INFLATION

We may now consider inflation - a bugbear of modern society.

An Anomaly

Inflation exists when the price of goods and services is persistently rising. It is an anomaly - because in industrialized societies the price of goods, at least, should be steadily coming down.

Automation and mechanization lower production costs by allowing workers to produce more goods. When that happens, prices should fall. So if prices are going up, in a progressive society, the currency is being diluted or debased - so we need more of it in order to buy the same quantity of goods or services.

A Complex Matter

Currency debasement is a complex matter. However, it presents itself to most people as rising prices. We may therefore begin a study of inflation by considering the factors that affect the price of goods and services.

Production Costs

No one can make a living by selling everything below cost. So the first thing that affects prices is production costs. These include:

wages paid to the workforce,

land costs - including money exchanged for land titles, site rent, land taxes and rates,

interest charges,

dividends paid to shareholders,

machinery costs, including depreciation,

expenditure on electricity, oil and other sources of energy,

the cost of raw materials,

managerial expenses,

insurance, freight, transport and telephone charges,

licence and/or registration fees paid to governments for one reason or another, and:

other taxes including company tax, payroll tax, sales tax and income tax.

Any or all of these expenses may fluctuate from time to time. As they do so, they will raise or lower production costs - either for particular items or for a range of goods and services.

Competition

However, variations in costs do not necessarily affect prices. Prices are also influenced by the degree of competition in the industry concerned.

When many different manufacturers produce similar goods or provide similar services, then competition amongst them keeps prices down. Under these circumstances, cost savings are often passed on to the consumer, while manufacturers and distributors absorb at least some proportion of any increase in costs.

By contrast, when monopolies exist, then cost increases usually emerge as higher prices, and reductions in costs tend to benefit only the producer.

It seems, therefore, that consumers fare best under conditions of open competition, and that

prices reach their lowest level when the market is free and unrestricted.

Are Conditions Ideal?

However, while that may be true in an ideal situation, the fact of the matter is that today's conditions are far from ideal. Nowadays, some producers have an advantage over their competitors. When that happens, a free market will always favour the producer with the lowest costs. He can undercut his competitors' prices and (if he is so inclined) he may eventually eliminate all competitors and obtain a virtual monopoly.

We see the effect of unrestricted competition in the automotive and electronic industries. Here the Japanese possess a cost advantage, which they achieve through using automation as much as possible and by paying lower wages, per hour, than their Australian, American and European competitors.

Japanese manufacturers use their advantage to increase their share of the market for cars, calculators and computers - all over the world. The increasing share of the market allows them to use even more automation - so their advantage tends to increase progressively.

Competition Amongst Farmers

A similar effect occurs in farming, where world wide markets keep the price of primary produce down.

Competition amongst farmers is almost world-wide. As a result, all farmers tend to receive much the same price for their produce, even though production costs per unit may vary considerably from farm to farm. (Depending upon the size of the farm and the amount of machinery used.)

This gives some farmers a greater income than others, and allows a fortunate few further to increase their profit margin by buying more land and machinery and further reducing their production costs. Competition amongst these may cause prices to fall still further - thereby adding to the difficulties of farmers whose holdings of land and machinery are limited. These are then told to "get big or get out". But their chances of getting big are negligible and if they get out they may have nowhere else to go.

Balancing Competition

Such happenings soon negate the benefits of competition. Therefore, most nations try to balance matters by restricting competition in various ways, or by aiding producers who are struggling to compete. They may do this by:

stockpiling produce when it is plentiful and releasing it onto the market during the off season - to limit the quantity on the market and to maintain prices at or above a pre-determined level;

subsidizing incomes - to allow an average producer to make a decent living after paying his production costs (thereby, at times, providing above-average producers with an unnecessary income boost);

adding tariffs to the price of imported goods - to allow locally manufactured articles to be sold at a reasonably profitable price;

fixing minimum wages in industry - so workers cannot be made to bear the brunt of any cost-price squeeze, and to prevent wages in Australia (for instance) being ground down to levels applying in poorer countries;

regulating the number of persons engaged in certain industries or occupations to (hopefully) limit competition amongst them so they can all make a reasonable living;

applying quotas to individual producers or importers so no one producer can obtain an unduly large share of whatever market exists;

applying quotas at colleges and universities - again in the hope of keeping the supply of doctors, dentists, chemists, lawyers, architects, surveyors, accountants, economists, engineers, etc., in line with the anticipated demand for their services;

licensing plumbers, electricians and other tradesmen and inspecting their work - to protect tradesmen and consumers from anyone who, might cut costs and prices and perhaps do shoddy work;

making tax concessions of various kinds;

providing low interest loans through rural finance or soldier settlement schemes, and:

making government-owned land available to selected persons at lower than average rents, or even selling it to them below the market price.

Predisposing to Inflation

Subsidies, tax concessions, low interest loans and handouts of cheap land all help to bolster incomes without increasing prices. Government stockpiling may smooth out price fluctuations but probably adds little or nothing to prices overall. So these measures cannot be blamed for inflation.

However, tariffs, minimum wage laws and measures that restrict competition all maintain wages or prices above the levels that could otherwise apply in today's conditions - wherein unemployment is plentiful and goods and services are often hard to sell.

These measures predispose to inflation if they:

(a) increase the price of a wide range of goods or services, or:

(b) increase the price of widely used or essential items.

The Cost of Living and the Consumer Price Index

When either of these things happen, then the following events tend to occur:

1: The average cost of living increases.

2: The offending price rises are recorded in the Consumer Price Index or CPI - which records changes in the Cost of Living by comparing the price of equivalent goods and services, quarter by quarter and year by year.

3: Persons who can do so increase the price of whatever goods or services they supply - to keep their incomes in line with the CPI.

4: Wage earners approach the arbitration court and ask for wage increases - so they, too, can catch up with the cost of living.

5: Pensioners and others who receive benefits from the government ask for their payments to be increased as well.

Money Changing Hands

Possible alternatives, and their consequences, will be discussed later. Here we note that the above-mentioned events cause more money to change hands each week, in shops and factories. As a result, consumers and employers must withdraw more cash from banks or keep additional funds on hand. That, in turn, forces the banks to ask the government for additional currency.

If additional currency were not supplied, then prices and wages would probably fall again - eventually. In the meantime, some banks may be unable to supply enough cash to their clients - or some payments could be deferred until the existing supply of money had time to circulate.

Because of this, additional currency is usually supplied, once wage and price rises become widespread. In that way:

(a) buying and selling and working for wages can go ahead at the usual rate, and:

(b) payments need not be deferred because of a shortage of currency.

Currency Debasement

The additional currency dilutes the money already in existence and reduces its purchasing power. It therefore causes nearly all prices and wages to rise eventually - for reasons given on page 120.

In this way currency debasement largely negates the price rises that started the sequence in the first place. Consequently, while certain groups in the community may benefit from tariffs, or from measures that restrict competition and lift wages, these benefits are often short-lived.

Once price rises affect the CPI they almost invariably bring government action that leads to inflation. In this way they tend, largely, to defeat themselves.

Productivity, Wages and Currency Volume

We should note, in passing, that increases in wages and/or currency volume are not always inflationary. Both wages and currency volume can be increased, in line with increases in productivity, without the currency being diluted or debased.

Two Non-Inflationary Methods of Coping with an Increase in Productivity

A nation may deal with an increase in productivity, without causing inflation, in one of two ways. These are:

1: Allow prices to remain more or less constant when productivity increases, but grant wage rises so the average worker can buy more goods and services, or:

2: Maintain wages at a constant level and allow prices to fall as per capita outputs rise.

If the second alternative were chosen, then increases in productivity need not be followed by an increase in currency volume. An increase in productivity would increase the quantity of goods and services being produced and bought and sold, but prices would fall while wages remained steady. Therefore, more money would not be needed in shops and warehouses and factories. The volume of the nation's currency could remain the same.

This method would allow people on fixed incomes to share in the increased productivity. It

would spread the benefits of prosperity throughout the community, and eliminate the need for a periodic upgrading of pensions and of other incomes that are relatively fixed.

Workers Prefer a Wage Rise

Nowadays, when productivity increases, most workers seem to prefer a wage rise to a fall in prices. When this alternative is chosen, increases in productivity must be accompanied by an increase in the money supply. Under these circumstances, more money is needed in factories (to pay the higher wages), and more money is needed in shops, offices, professional premises and warehouses - to finance the buying and selling of an increasing quantity of goods and services, with the price of individual items remaining as before.

Increases in Population

More money is also needed when the population increases, if output per capita and wages remain about the same.

If the number of persons in the community increases, and each receives and spends the same amount of money each week, then the nation as a whole requires more currency than before.

Non-Inflationary Increases in Currency Volume

An increase in currency volume will not be inflationary if it merely balances an increase in population or productivity. New currency issued in these circumstances is a necessary addition to the money supply. It will not dilute the money already in existence or affect the Consumer Price Index - as long as it merely balances the increase in population or productivity.

TABLE 8: RETAIL PRICE INDEX NUMBERS
SIX STATE CAPITAL CITIES COMBINED, 1901 TO 1971
BASE YEAR: 1911 = 100

YEAR	INDEX NO.	% INCREASE	YEAR	INDEX NO.	% INCREASE
1901	88		1937	145	2.8
1902	93	5.7	1938	149	2.8
1903	91	-2.2	1939	153	2.7
1904	86	-5.5	1940	159	3.9
1905	90	4.7	1941	167	5.0
1906	90	0.0	1942	181	8.4
1907	90	0.0	1943	188	5.0
1908	95	5.6	1944	187	-0.5
1909	95	0.0	1945	187	0.0
1910	97	2.1	1946	190	1.6
1911	100	3.1	1947	198	4.2
1912	110	10.0	1948	218	10.1
1913	110	0.0	1949	240	10.1
1914	114	3.6	1950	262	9.2
1915	130	14.0	1951	313	19.5
1916	132	1.5	1952	367	17.3
1917	141	6.8	1953	383	4.4
1918	150	6.4	1954	386	0.8
1919	170	13.3	1955	394	2.1
1920	193	13.5	1956	419	6.3
1921	168	-13.0	1957	429	2.4
1922	162	-3.6	1958	435	1.4
1923	166	2.5	1959	443	1.8
1924	164	-1.2	1960	459	3.6
1925	165	0.6	1961	471	2.6
1926	168	1.8	1962	469	-0.4
1927	166	-1.2	1963	472	0.6
1928	167	0.6	1964	483	2.3
1929	171	2.4	1965	502	3.9
1930	162	-5.3	1966	517	3.0
1931	145	-10.5	1967	534	3.2
1932	138	-4.8	1968	548	2.6
1933	133	-3.6	1969	564	2.9
1934	136	2.3	1970	586	3.9
1935	138	1.5	1971	621	2.6
1936	141	2.2			

Balance Exceptional!

Unfortunately, balance in this matter is the exception rather than the rule - if one can judge from Table 8[21]. This lists the Consumer Price Index in Australia for the first seventy-one years of this century. It shows:

1: Prices only fell or remained steady for seventeen of those seventy-one years,

2: Since 1945, a steady upward march of prices has been arrested only once - in 1962, and:

3: Australia's longest non-inflationary period in the twentieth century was four years - 1930 to 1933!

No Improvement!

The situation has not improved - as can be seen from Table 9[22]. This shows that inflation is still with us, and that it has been particularly troublesome in recent years.

Steep inflations, such as those of the past few years, need special discussion. The inflation under discussion up to here is rather milder, but it appears (and re-appears!) with distressing frequency.

Wrong-Headed Governments?

Some economists blame all inflation onto wrong-headed governments. However, in Australia inflation has occurred under governments of many different shades. It has also occurred in peaceful times and when the nation was at war. Finally, it was only checked for four years during the great depression of the early 1930's.

TABLE 9: CONSUMER PRICE INDEX
SIX STATE CAPITAL CITIES IN AUSTRALIA
1964-65 TO 1978-79

YEAR	INDEX NO.	% INCREASE
1964-65	94.0	
1965-66	97.4	3.6
1966-67	100.0	2.7
1967-68	103.3	3.3
1968-69	106.0	2.6
1969-70	109.4	3.2
1970-71	114.6	4.8
1971-72	122.4	6.8
1972-73	129.8	6.0
1973-74	146.6	12.9
1974-75	171.1	16.7
1975-76	193.3	13.0
1976-77	220.0	13.8
1977-78	241.0	9.5
1978-79	260.7	8.2
1979-80	287.2	10.2

Therefore, inflation is a very persistent or recurring phenomenon. It must perform some seemingly useful function or we would, surely, have less of it.

INFLATION INSTEAD OF LAND TAX?

In my opinion, low levels of inflation are a compensatory phenomenon. They stave off the unemployment that occurs when a nation fails to tax its land. I base this opinion on the following arguments.

Variations in Production Costs

As noted on page 92, production costs include land costs and interest, as well as wages, taxes, licence and registration fees, the cost of raw materials and sundry other expenditures.

Any or all of these may vary enormously from one nation to another. However, in most cases they do not all vary in the one direction. Thus, while producers in some countries have access to cheap labour, their overseas competitors may cut costs by using more sophisticated machinery. Likewise, while land costs may be low in some areas, they are often offset by a shortage of raw materials, or by the need to import an expensive source of energy.

Nevertheless, there are some products for which one nation has a definite net advantage over its competitors. This occurs with cars, radio or television sets and other electronic equipment made in Japan, and with Asian textiles. It explains why the manufacturers of these items can easily undersell their Australian competitors, and why Australia sometimes uses tariffs to protect her local industries.

Internal vs. External Variations

Australia can do little or nothing about production costs in other nations. But this should not blind us to potentially curable imbalances within our own economy. Such imbalances certainly exist. They are responsible for a great deal of internal trouble and unemployment.

The Biggest Variable

In Australia, wages, taxes and other expenditures tend to uniformity in any given industry. Therefore, variations in these costs do not ordinarily give one Australian producer an advantage over others.

But this is certainly not the case with land. At present, land taxes in Australia are woefully inadequate. As a result, land is a costly item, and some producers must rent land instead of

buying it. Others buy land on terms or burden themselves with heavy mortgages in order to obtain a site.

One-Sided Competition

Tenants and debt-ridden purchasers must compete against producers who fully own their sites. This competition is somewhat one-sided, but it is not the only ill-effect of untaxed land.

When land taxes are inadequate, then even landowners are not all equal with respect to land. Some people own immensely valuable sites, while others own marginal land of little worth. And, of course, a whole range exists between the two extremes.

Producers who own the best sites in the nation clearly possess an advantage over the owners of less valuable sites. And so on - down the line.

Cost-Price Squeezes

These differences allow many producers to ensnare their competitors in a cost-price squeeze. Thus, people who own land can put a cost-price squeeze on tenants and on anyone who is mortgaged heavily, or who is buying land on terms. Similarly, the owners of valuable city sites can put a cost-price squeeze on the owners of suburban or country premises - as the city businessman has access to a larger number of customers than does his country or suburban counterpart. Finally, the farmer who lives close to a city can put a cost-price squeeze on the farmer whose transport costs are higher because he lives further out.

Disappearing Jobs

Under these circumstances, the owners of valuable land can literally swallow their competitors.

In the process they gobble up job after job.

Big business naturally aims for cost-cutting and efficiency. So the bigger any business becomes, the more it tends to replace men with machines.

Therefore, unbalanced competition causes jobs to disappear progressively, as it concentrates production and distribution into fewer and fewer hands.

Non-Renewable Resources

This constant replacement of men by machines is not always associated with a really necessary increase in productivity.

Big businesses aim for the maximum possible output at the minimum possible monetary cost. To do this, they sometimes use non-renewable energy and raw materials in place of readily available manpower - often with only a marginal saving in operating costs. Therefore, company mergers are not always in the best, long-term interests of society.

GOVERNMENT AID

Imperilled producers do not always succumb without a fight. Instead, they seek government aid - as tariffs, subsidies, quotas, restrictions on competition, tax relief, aid to decentralized industries or price-support mechanisms.

If aid is granted, then it gives an upward push to prices and to the Consumer Price Index. This adversely affects the nation's wage earners, who can then buy fewer goods and services with their pay.

Alternatively, if tariffs and other price-support mechanisms co-incide with an increase in product-

ivity, they prevent the fall in prices that should normally occur. That also affects wage earners, by causing their standard of living to lag behind their productivity.

In either case, unions soon approach the arbitration court and ask for wage increases. And who can blame them? Workers are entitled to a reasonable standard of living, and to a share in any increase in national productivity. They should not be victimized by someone else's cost-price squeeze.

Forcing the Government's Hand

A government cannot easily resist these pressures.

If, for instance, the government rejects the producers' requests, then unemployment would worsen as more and more producers were forced out of business by their competitors. Likewise, if the unions' requests were ignored, then unemployment could worsen because consumption may be checked.

The relationship between consumption and unemployment will be discussed in detail later. Here we note that governments which ignore the plight of voters do not remain in office for very long. Because of this, governments usually grant assistance to beleaguered producers, and courts increase wages in line with changes in productivity or in the Consumer Price Index.

Prosperity and the Price of Land

Tariffs and other price-support mechanisms provide job security for producers and their employees. High wage rates give an air of prosperity to the community.

People are attracted to a prosperous community. They want to live or work there, and to share in

the benefits of prosperity.

But no one can live or work in any community until he either owns or rents a site in the vicinity. Hence, prosperity (or even apparent prosperity) increases the demand for sites. It allows vendors to add to their "asking price". It increases the amounts workers and/or businessmen can pay for home, farm, shop or factory sites.

These changes - as noted on page 89 - are a normal response to prosperity, or to an increase in local or national productivity. If land costs remained in line with productivity, then no one would be harmed.

However - as also noted previously - land costs tend to run ahead of productivity when land taxes are inadequate. At the same time, an increase in prosperity usually brings land speculators and investors out in force. It also increases the number of persons who have spare cash with which to invest or speculate in land. Prosperity therefore provides land costs with a two-pronged upward push.

Land Prices and Interest Rates

The two-pronged push causes land prices to rise ahead of earnings. It therefore increases the proportion of earnings spent on land, and the length of time people must save in order to buy land. In this way it increases the size of mortgages and adds to repayment periods and to the amounts of interest paid.

Interest and Cost-Price Squeezes

Any increase in interest payments must tighten the cost-price squeeze on many producers. It also puts a squeeze onto producers who could survive, if lower land prices allowed for smaller

loans and shorter repayment periods.

Interest also cuts into the profits of farm or factory buyers, and reduces the number of goods and services home buyers can afford. Therefore, any increase in interest payments must drag down the standard of living for a large number of citizens.

No one likes to see his profits falling, or to find his standard of living going down. Hence, when people are adversely affected by rising land prices and interest payments, they soon approach the government for further aid, or seek still higher wages. The requests are usually granted eventually, and so the cycle repeats itself.

Other Causes of Inflation

Of course, rising land prices are not the only thing that predisposes to inflation. Sudden steep increases in oil prices exert a similar effect. The same applies to the high food prices that may accompany a drought, flood, bush-fire or similar disaster. All such events are reflected in the Consumer Price Index. If wage rises are granted to compensate for them, then further inflation is almost inevitable.

Inflation can also be initiated by any sudden upsurge in wages, whether this accompanies a series of good seasons in primary industry, a large trade surplus, or a vigorous and concerted trade union campaign. However, while wage rises and union demands are often blamed for inflation, in my opinion rising land prices are a far more potent cause.

Admittedly, wages can rise ahead of productivity and lift both prices and the Consumer Price Index. Nevertheless, land prices have a definite

advantage in this respect.

Negotiate or Withdraw From the Market?

Both wages and land prices are usually determined by negotiation and arbitration, but if negotiations break down, then one or more parties may withdraw from them.

Thus, if workers are dissatisfied with their wages or with wage negotiations, they can strike. If a landowner is dissatisfied with any offer made for his site, he can withdraw it from sale.

There is a limit to the length of any strike - because workers must be fed and clothed and housed. Therefore, no worker can withdraw his labour from the market indefinitely - unless he is prepared to starve.

The landowner is not constrained by any such limitation. Land is imperishable. In the absence of a holding charge it requires little or no expenditure on maintenance. Therefore landowners can (and often do), hold out for higher prices by withdrawing sites from the market for years and years and years - thereby restricting the supply of land and adding to its price in a manner that is simply not available to labourers. It seems, therefore, that land prices usually rise first, thereby increasing the size and duration of mortgages and the amounts of interest payable. Wage rises are then granted to compensate for these effects.

Chronic Inflation Has Chronic Causes

In other words, while sporadic bursts of inflation may follow an increase in the price of oil or food, or a sudden upsurge in wages, these things are not to blame for chronic inflation.

Chronic inflation has chronic causes. The most likely culprits are:

1: the undue upsurge in land prices that follows any burst of prosperity (whether real or apparent), and:

2: measures introduced to limit the unemployment that constantly spreads when citizens are not all treated equally with respect to land.