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EDITORIAL

INFLATION—FACTS AND FALLACIES

THE people of this country are not being told the whole truth about inflation; indeed from many quarters they are being manifestly misinformed. Nor is it any help for the people to listen to the voices of sectional interests, insisting as they do on blaming each other or the people generally for something they themselves cannot understand.

The Government assumes an innocent air. Hiding behind a smokescreen of clichés and unsure of what measure to adopt next, it implies that forces outside its sphere are responsible. Nothing could be further from the truth. It has been spending beyond its means, literally creating its own money. Only the Government has the power and the opportunity to do this, and only the Government can halt the process. Has it the courage to face the political consequences of doing so? Or will it supinely stand aside, allowing runaway inflation to plunge the country into the worst economic disaster it has ever known ? Up to now it has preferred to rely on superficial and ineffectual measures. As if hypnotised by the stream of money pouring off the printing presses, it may hope to stave off the effects of the hangover by further doses of the drug. History testifies to the fatal folly of following that course. No government has ever succeeded in printing its way out of bankruptcy.

The cause and the nature of inflation is simple enough to grasp. Its adverse effects on the economic life of the country is less easy to understand. The situation is bedevilled because these *effects* are commonly believed to be the *causes* of inflation—as though by analogy the spots on the child were the cause of its having measles. This has led to the word "inflation" being used in so many different senses, many of them contradictory, that its real meaning is generally overlooked. Moreover it has been qualified further by such a variety of adjectives that there now appear to be numerous special "inflation problems," as well as inflation itself, awaiting solution. As an instance one writer has listed no fewer that fourteen different varieties of inflation !

Where there is such obvious confusion and bias the appeal to some impartial referee seems advisable. Any reputable dictionary will make clear the nature of the problem under discussion. *Fowler's Concise English Dictionary* defines inflation as:—

"Resort to inflation of the currency; raise price artificially; abnormal increase of the currency by the issue of inconvertible legal-tender notes."

The significance of the words "resort to" and "artificial" is apparent. They emphasise that inflation is deliberate not fortuitous, planned not accidental, artificial not natural, and the definition demonstrates that inflation arises when —and only when—the supply of inconvertible promissory paper money is increased. Logically it follows that when notes are convertible and may be exchanged on demand for a stipulated amount of wealth (gold, for example), inflation is not possible—impossible that is without a rush to convert the paper to gold.

Precise understanding of the nature of inflation (in the true sense) is so essential that, at the risk of seeming to labour the point, we quote from extracts from recent public statements made by people who are not afraid of speaking in unambiguous terms:—

SIR OLIVER FRANKS, Chairman of Lloyds Bank: "The Treasury Bill (Government promise to pay in three months) has been used as the modern equivalent of the printing press or debased coinage . . . The Government has financed itself with a flood of treasury bills which have indirectly swollen bank deposits and increased the supply of money."—*January* 29, 1957.

CITY PRESS: "The full employment we see around us at this moment is maintained only by persistently increasing the volume of paper money in circulation. And as the volume of paper is increased so it becomes less valuable until the time will come when it will go the way of the German mark."—*March* 15, 1957.

COAL PRICE INCREASES

Do they cause inflation?

MR. JOHN JENNINGS (Conservative, Burton): "*Does not my right hon. Friend agree that the recurrent increases in the price of coal are the prime factor in the inflationary spiral? . . .*"

MR. REGINALD MAUDLING, Paymaster General: "*The Question whether rising prices cause inflation or inflation causes rising prices is one to leave, I think, to economists . . .*"—Question Time, H. of C. July 15.

LORD DOUGLAS OF BARLOCH: "Inflation is not a budgetry phenomenon; it is a monetary trouble. It arises if a Government, instead of raising the taxation which is necessary in order to meet its expenditure, expands the note issue. The Government possess ample powers to deal with these matters. They control the Bank of England."—*November* 1, 1955.

SIR ARNOLD PLANT: "One certain way to arrest the continuing inflation is for the Treasury to instruct the Bank of England that in any year from now on it must not increase the fiduciary issue note circulation above the peak figure for the previous year."—*June* 1, 1956.

DR. J. E. HOLLOWAY, South African Secretary of Finance, Economic Adviser to the South African Treasury (from 1934 to 1937): "Paper money by itself gives the public who have to store their savings no protection whatever . . . Inconvertible paper money is the worst and most dishonest money . . . The public call it 'a rise in the cost of living.' They can see from week to week the process of money of account becoming money of less account."

These brief extracts and the dictionary definitions suffice to indicate the cause, nature and cure of the problem. But our task is not only to show what inflation is, but what it is not. Let us examine some of the most frequently encountered notions.

THE COST OF LIVING

The constantly rising cost of living is commonly mistaken for inflation. Now while it is true that the cost of living inevitably and invariably increases whenever a new supply of paper money is pumped into circulation—the price of *all* goods and services rising—there are many other factors that can and do raise prices. Among these are increases in direct and indirect taxation, and increases in the cost of labour and raw materials. It is quite wrong to describe these as "inflationary." For the sake of example, imagine that the Government increased the purchase tax on bicycles, and the import duty on watches and that workers in the textile industry were given a wage increase. Each of those particular items, bicycles, watches and textiles would be dearer, and to that extent the cost of living would rise. But the volume of money in circulation would not be increased. The housewife who paid more for these goods would have less to spend in other ways. In short, rises in the cost of living merely *transfer* purchasing power from one individual to another or from one section of the community to another. What one section of the community loses another gains. In the case of inflation however everyone holding money is affected whatever he may spend it upon.

TRADE UNIONS AND WAGES

Repeatedly one sees the all-round wage increases secured by Trade Union action blamed for causing inflation. In fact, the opposite is the case. Debasement of the currency reduces the purchasing power of money wages, and redress is sought by wage earners who are getting less wealth in exchange for the services they are giving. It is irrelevant that some Trade Unions have secured wage increases which more than offset the effects of inflation. Those who blame the Unions for causing inflation contend that general increases in wages necessarily involve an increase in the volume of money. This is as false as it is superficially plausible. If Governments issue money merely because more has to be paid out in wages, to whom do they give it? They certainly do not make gifts of notes to employers for this purpose! In fact, money is *spent* into circulation by the Government issuing notes to pay for some of the goods and services it requires. It alone has the power to command wealth merely by printing promises (which are never kept); the rest of the community have to give goods or services in exchange for money.

Post-war increases have in the main been hollow victories. They have merely kept pace with rising prices. And examination of the increase in the volume of money during the same period shows, in turn, how prices have steadily risen as more and more money has been printed. The picture is complete.

In 1939 there were 580 million pounds of un-backed paper money in circulation. This has increased steadily year by year until to-day it stands at 2,050 million, the latest increase of 50 million being as recent as 3rd July this year.

FULL EMPLOYMENT

Inflation is also being deliberately used in obedience to J. M. Keynes's famous "full employment" theories. Therefore it is widely held that a slump or unemployment would be caused if inflation as an instrument of policy were abandoned. This may be true but it would not be

GUILT-EDGED

From Hansard, July 23, col. 222.

Mr. Lewis asked the Prime Minister whether he is aware that, since October, 1951, the market value of gilt-edged securities has fallen by more than £2,000 millions, that the cost of living has been continuously rising, and that the £ sterling is now worth less in purchasing power than at any previous time . . .

Aptly (but presumably inadvertently) the Question is headed: *GUILT-EDGED SECURITIES.*

caused by a return to an honest currency. Incipient unemployment would merely be permitted to show itself. The migraine sufferer deprived of further aspirins could not reasonably argue that his headache was *caused* by the absence of drugs. The underlying factors responsible for unemployment are present in the system which leaves the monopoly of natural resources in private hands.

The relation between a "full employment policy" and inflation manifests itself in steadily rising prices. The Government, armed with its bogus claim on goods and services (this newly created money) enters the market and begins to compete with existing money for goods and services. This gives an impetus to production and creates the false prosperity of which we have had so much. Demands for goods and services means demand for employment and so long as inflation continues so is trade artificially stimulated. The theories of J. M. Keynes work out well in practice, but it is a sharp practice and the effects of the "cure" are as bad as the disease, and obscure the real remedy.

EXPORTS AND IMPORTS

Inflation, as we have seen, raises the prices of all goods and services within a given national economy. But it cannot be exported. This is because the overseas buyer has alternative markets open to him. No problem would arise if currencies were allowed to find their own level in terms of all other currencies. As the value of a given currency fell at home in terms of goods, so would it fall abroad in terms of foreign currencies. For example—if there were inflation in Britain and none in Germany, a German importer would be able to buy more pounds for the same number of marks, and British goods would be no dearer *to him* although their price in pounds would be higher. But the Government has tampered with the scales by fixing exchange rates at arbitrary levels so that this automatic self-adjustment is no longer possible. Thereby each new bout of inflation increases the price of British products abroad as well as at home, and overseas sales are falling as a consequence. British goods are being priced out of foreign markets.

PUBLIC AND PRIVATE SPENDING

Drastic reduction in government expenditure is highly desirable, on many grounds, not the least of which is that it would remove or reduce resort to the printing press. But it is a mistake to think, as do many of those now calling for retrenchment, that the mere act of spending (by the Government or by private individuals) causes inflation. Indeed the Government could *increase* its present level of expenditure without causing inflation—*if,* and only if, it first increased its tax revenue. The volume of money in circulation, and its value in terms of wealth, would not be affected although obviously the more that the government spent, the less the general body of taxpayers would have to spend! It is for this reason that national savings may be considered "anti-inflationary": the public voluntarily surrenders (temporarily) part of its purchasing power and places it at the disposal of the Government which, otherwise, would, unless it reduced its expenditure, either have to increase taxation or resort to further inflation.

COSTLY LETTUCES

Do they cause inflation?

"*Is the Minister aware that we are still paying* 1*s. in Newcastle for a head of lettuce? Is he aware that this applies not only to vegetables but also to fruit and that we are paying 7d. each for apples? Does not the right hon. Gentleman agree that this sort of petty profiteering right through the economy is one of the major causes of inflation?*—CAPTAIN E. W. SHORT, Labour M.P. for Newcastle-on-Tyne, Central, at Question Time in the Commons, July 22.

Lest we be misunderstood we should perhaps emphasise that we are not in favour of increased governmental expenditure; we wish to see such spending reduced, for it to be met entirely from taxation (and for taxation to be levied on the rental value of land). National Savings partially counteract the effects of inflation by transferring purchasing power from the public to the Government. Paradoxically the public's reward is the diminished value of those very savings which are supposed to defeat inflation!

INFLATION AND PRODUCTION

It is widely held and advocated (not least by the Government) that the way to halt inflation is to increase production. That is not so. If more goods were produced, prices (except for the products of monopolies) would tend to fall accordingly, and so the cost of living would be lowered. But as we have seen, inflation and the cost of living are not synonymous terms. There is absolutely no guarantee (or reason to believe) that the Government would switch off the printing presses as soon as production began to increase. The ease with which money can be issued compared with the difficulty of creating wealth illustrates the absurdity of pinning hopes on industry to solve the problem of inflation.

There is a further consideration, although perhaps it is not strictly germane to the present discussion. That is that if the Government stabilised the currency so that increased production did in fact lead to a general lowering of prices, the benefits would be reflected in the rental value of land. The people at large would derive an immediate, short term improvement in their condition but the inexorable march of rent would be hot on their heels as it has been throughout history.

Inflation must be brought to a halt. But it is not sufficient merely to stabilise the currency. The fountain of all production, the land, must be thrown open for all to use on equal terms. There must be no question of valuable land being under-used or held idle. Every holding must be freely available for whatever happens to be its best economic use, whether for agriculture, housing, industry, commerce or any other purpose. Trade, which is simply a process of production, must also be set free. Restrictive practices must be abolished, and the countless special privileges bestowed by the Government on sectional interests must be withdrawn. Then, with the brakes taken off production, and with the cost of government met from the rent of land, there could be real prosperity for all.

V.H.B.

SITE VALUES IN LONDON

A TORY Cabinet Minister let slip a most interesting and valuable admission at question time in the Commons on July 9. Mr. R. R. Stokes, M.P., had asked the Minister of Housing and Local Government what was the rateable value of the St. James's Theatre, in London's West End, and what would be the value of the site alone if the theatre were demolished. Mr. Henry Brooke, said that the present rateable value is £3,283 and that the value of the cleared site was estimated at £250,000. And then, answering a supplementary question, he remarked: "I think that it is seldom that one finds that the rateable value exceeds the value of a site in central London."

Mr. Brooke is quite right and of course the same is true in the centres of other towns and cities. It is for this reason that in the central areas a rate on the value of the land *alone* is more productive than a rate of equal amount levied on the assessed value of the composite property, land and building. This goes far towards answering those opponents who suggest that a rate on site values would not suffice to meet the revenue needs of the local authorities. It also explains what is a paradox to people who have difficulty in reconciling the spate of new office blocks in London with our contention that development is retarded by the present rating system.

HIGHER TAXES ON FACTORIES

THE British system of local taxation is inequitable in its incidence and harmful in its economic effects. It fosters land speculation and slums, deters and fines development, and makes buildings of every kind needlessly scarce and dear. For these and similar reasons we believe that it should be swept away. The Conservative Government disagrees. In a White Paper* issued on July 10 it proposes three measures to "strengthen" the present rating system. Factories and freight-transport premises (which at present pay rates on only 25 per cent of their net annual value) will be "re-rated" to 50 per cent; the provisions for rating plant and machinery will be brought up to date; and new rating arrangements will be introduced for the nationalised gas, electricity and transport industries. Legislation embodying these rate changes and changes in the grants paid to local authorities will be introduced in the autumn and will come into effect in April 1959. No other rate changes are proposed.

"Re-rated" industry will pay about £30 million a year more to the local authorities and, as a consequence, about £15 million a year less to the national Exchequer in income tax, profits tax and surtax. This is because rates are allowable as a business expense. To offset this reduction in national tax receipts, the Government proposes to reduce by £20 million a year its grant aid to local government.

In broad outline this "re-rating" proposal will slightly increase the income and financial independence of local government (and place an extra £5 million at the disposal of the Chancellor). It will also increase production costs which manufacturers will tend to pass on in increased prices, and will tend to deter the improvement and extension of industrial premises. And this at a time when the Government is exhorting industry to increase production and to become more competitive! One can but hope that manufacturers will now examine more sympathetically the case for taking local taxation off buildings and levying it on the site value of land, especially as the Labour Party would fully "re-rate" their premises. Meanwhile it is to be noted that agricultural land, however valuable, and idle sites, are to remain totally exempt from local taxation.

The system of grants to local authorities is to be radically recast. The White Paper points out that the present percentage grants for specific services afford an indiscriminating incentive to further expenditure and involve an aggravating degree of central checking and control of detail. The grants for education, health services, fire services and nine others (totalling nearly £300 million) will be absorbed in one new general grant. Its size will be determined in advance for a short period of years and it will be distributed "by reference to objective factors (mainly of weighted population) which are readily ascertainable and afford a fair and reasonable measure of the relative needs of each authority." Seven sundry small grants (totalling £1½ million) are to be abolished. The Government will stipulate basic standards for grant-aided services and will exercise control at "key points," but the local authorities will be allowed the maximum possible freedom in their spending of their income. Various other grant changes are also proposed.

These proposals are a poor substitute for thoroughgoing rate reform and genuine financial local independence. But they are a step in the right direction. They will reduce the power of anonymous gentlemen in Whitehall to decide the level and the nature of local services and expenditure. Costly delays will be eliminated, or at any rate reduced, and a greater variety and flexibility will be possible. Local government will be less the agent of the central government and more the servant of ratepayers who may be expected to take greater interest in local affairs and to exercise a prudent restraint on expenditure.

EUROPE, BRITAIN AND THE FARMERS

THE treaty to establish the European Common Market was ratified by both Houses of the French and German Parliaments last month. Ratification by the other four countries—Belgium, Holland, Italy and Luxembourg—is expected to be completed by the middle of August. In that event, the treaty will come into force next January

* *Local Government Finance,* Cmd. 209.