INFLATION

THE post-war economies of practically all countries are riddled with the disease of inflation. The disease is of course present in a much more acute form in the belligerent nations than in the non-belligerent, but the epidemic is world-wide. It is to be seen at its worst in the European nations where war damage was most extensive and the capacity to produce most seriously weakened. In fact, the whole task of European reconstruction, on which the stability of the world so largely hinges, has been disastrously complicated and prolonged by the disorganisation of the normal means of exchange. (Before the new currency provisions were introduced, it was estimated that in the Western zones of Germany over 50 per cent. of business was conducted through barter arrangements.)

Inflation replaces confidence in the future with fear and uncertainty; it breeds disrespect for the law; it distorts production and diverts it away from purposes essential to reconstruction; by destroying competition between men for jobs and businesses for markets it weakens incentive; and finally it makes it imperative to continue into the post-war period an irksome structure of controls in order to preserve some semblance of economic stability and order. Inflation is a destroyer of men and morale as well as values; it has been well remarked that one of the most typical figures of ou times is the black marketeer.

Inflation, inflation on the grand scal was of course an inevitable consequence c total war. It could not have been avoide by any practical means known to economi and political science. Inflation is simply disruption of the more or less norma balance between the supply of goods an the supply of money. War, unavoidabl drastically reduces the former and greatl enlarges the latter. The colossal sum spent on production for war purposes ar paid away ultimately in the form of wage salaries, profits, interest and rents, an represent income to individuals or bus ness organisations. But these incomes ar balanced by no expansion, indeed, are ac companied in most cases by a severe con traction, of the supply of peace-tim goods and services. During war peopl continue to receive money income, bu much of this income is not matched b any corresponding production of goods o which it can be spent. When war cease people and businesses are left with vas accumulations of purchasing power, bu the supplies of goods coming on to th market are quite inadequate to meet th demand at any reasonable level of prices It is this situation, the inflationary pres sure of a great quantity of money on an insufficient quantity of goods, which enders certain controls essential in the ›ost-war period.

nflation Compels Controls

It is necessary to stress this close inter-:onnection between inflation and controls. nflationary pressure compels controls and :ontrols can only be safely eased as the nflationary pressure is reduced and when goods and money again bear some reason-.ble relationship to one another. The uccess of a government in dealing with he problems of the post-war transition nust largely be judged by the effects of ts policy in reducing this pressure. One f the greatest mistakes in the post-war olicies of Britain and Australia has been o suppose that all the evils arising from nflation can be prevented by a system of ontrols, of which price control is the rux. This has led to a concentration of he control aspect of the problem and a omparative disregard for the inflationary ondition itself. The tendency has been to hink that an excessive amount of money eed not be a serious drawback provided he controls are present to keep down osts of living, to stop a runaway increase n prices and, in effect, to prevent con-umers and businesses from spending heir surplus money. But suppressed in-lation leads to evils little less injurious o the health of the economy than those vhich would ensue if the inflation were llowed to take its natural course.

'he Disadvantages of Price Control

Price control of itself does nothing to orrect inflation. It operates on the ymptoms of the disease, not the dis-ase itself. It keeps the temperature f the patient from rising, but does nothing to cure the illness from which he is suffering. Moreover, as with all the other controls, it tends to conceal the existence of inflation and thus to delay the application of the basic remedies. The patient may feel reasonably comfortable, but all the time his illness may be growing worse.

Furthermore, price control is in several ways inconsistent with the actual cure of inflation. The mere fact of holding prices down perpetuates and intensifies the inflationary pressure by maintaining the purchasing power of the money held by the public. Because it reduces the real value of incomes there is nothing like a price increase to mop up surplus purchasing power—so long as money incomes do not rise proportionately. This is, of course, no argument for a runaway increase in prices—that would be a case of the cure being worse than the disease. But it is an argument against over-rigid and over-conscientious control of the price level. An easing of price control—not the complete and sudden removal—is one of the indispensable remedies for the cure of inflation.

In addition, one of the chief means for correcting inflation is to raise the efficiency of production. But controls, and price control in particular, tend to work against this desirable objective. They weaken the incentive of the efficient producer and enable the inefficient to remain in production.

Finally, price control has in practice tended to concentrate mainly on essentials such as food, clothing and housing and on such basic materials as coal and metals. While this policy had justification during

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the war, in the circumstances of today, where control of labour and materials has been relaxed, it has had two unhappy results. First, it has encouraged the production of the inessentials such as luxury goods and services where price supervision is not so strict. This brings about an undesirable diversion of labour away from the most pressing needs of the economy into fields which are relatively unimportant. This fact need not be elaborated here. It must be said, however, that the most vital and intractable problem confronting the Australian economy at the moment is that of getting labour and resources into the fields where they are most necessary. It is an ironic commentary on post-war economic planning that the number of people now engaged in housing, primary production and coal and steel are little or no greater than in 1938-9, where by contrast there has been a considerable increase in the numbers employed in the provision of entertainments, cosmetics and jewellery. Second, the fact that prices of essential commodities are rigidly controlled in an endeavour to keep down the cost of living, means that people have much more money to spend in other directions—more, for instance, for amusements, tobacco, liquor, the minor luxuries. This, of course, both tends to aggravate the general inflationary pressure and to further divert production into the least essential channels.

Measurement of Inflation

Under price control the movement in the price level ceases to be an accurate gauge of the extent of inflation and needs to be supplemented by other measures. One of the best is probably the extent of the labour shortage, that is, the numbe of jobs offering for which workers cann be found. Another measure is the rel tionship between the amount of potenti spending power in the hands of the publ and the volume of output of goods an services. Potential spending power i made up of current and fixed deposits i the trading banks, savings bank deposit and cash in the form of notes and coi held by the public.

These three measures — prices, th volume of money and the labour shortag —taken together give a fairly good pictur of the magnitude of the inflation in Aus tralia brought about by the war. At th end of the war retail prices as measure by the "C Series" cost of living index wer roughly 25 per cent. above the 1938- level.* Wholesale prices, according to th Statistician's index, were about 40 pe cent. above the pre-war level. The volum of money was more than double—£612m in 1938-9, £1356m. in 1944-5. Productio of peace-time goods and services was o course at the end of the war greatly belo pre-war production — probably by abou 20 per cent. On the basis of trade unio returns 9.3 per cent. of all wage an salary earners were unemployed when th war broke out. At the end of the wa there was virtually no unemployment except of a seasonal or temporary nature

*There is a great deal of misunderstanding abou the "C Series" index of retail prices. This does no measure, nor does it purport to measure, the averag of retail prices in general. It measures only th changes that take place in the prices of a selecte group of commodities and services which ente largely into the consumption of the basic wage earner. There is no index published by the Com monwealth Statistician attempting to measure th average of retail prices in general. If an averag could be taken of the increase in all retail price since the beginning of the war it would certainl show a far greater rise than that shown by th "C Series" index number.

ation Since the War

'he two years following the war saw ıe improvement in the inflationary ition. Retail prices rose by another er cent., wholesale prices by only 2 per t. The volume of money in the hands the public increased from £1356m. to 37m., an increase of about 14 per cent. the other hand, as peace-time produc- ı again got into its swing the output nany kinds of goods and services again ieved normal proportions and probably reased in a much greater ratio than ential spending power. Up to the end 1946-7 it could be said that the in- ionary position had not only been held, that some improvement had been omplished.

erioration

ince then a disturbing deterioration occurred. From June, 1947, to the t quarter of the current year, retail es increased by 9 per cent. and whole- prices by 21 per cent. These increases pare with 5 per cent. and 2 per cent. pectively for the two preceding ncial years. The volume of money, ch, in June, 1947, was £1537m., had n to £1600m. by March, 1948. The our shortage has also certainly become ch more pronounced over the last nine nths.* Thus, while by the end of 6-7 there may have been some grounds hope that we were getting a grip of inflationary tendency in the Aus- ian economy, nine months later the ition had deteriorated quite consider- y. This deterioration was brought about by two main causes—one external, one largely internal.

During 1946-7 a spectacular increase occurred in overseas prices for our main exports abroad. Because of its effects on the incomes of primary producers this resulted in the infusion into the Australian economy of a great quantity of additional purchasing power. The value of exports rose from £196m. in 1945-6 to an all-time record of £309m. in 1946-7. This unprecedented increase in export income came at a time when Australia was being seriously embarrassed by rising internal costs and has greatly complicated the difficulties of restoring stability. Unit costs of production have taken a sudden upward turn in recent months, because of a rising wage level, the 40-hour week and higher prices for imported materials.

There is little doubt that it was the unprecedented boom in export income and the anticipated increase in costs of the 40-hour week that caused the Commonwealth Government early this year to reverse the policy of reducing price subsidies which it had apparently accepted toward the end of 1947. At that time subsidies were budgeted at £20m. for the financial year 1947-8 and the Government had announced that they would be rapidly reduced during the ensuing months until entirely eliminated. A month or so later, early in 1948, this policy was completely reversed and the budget estimate for subsidies was doubled to allow for an expenditure of £40m.*

*bout the middle of last year it was estimated uthoritative quarters to be about 100,000. Over last few weeks a senior member of the Cabinet been suggesting that it is now of the order of 00 to 250,000.

*As an outcome of the prices referendum the Commonwealth Government reverted to the policy of reducing subsidies. This action was quite inconsistent with the decision earlier in the year to greatly increase subsidy payments and with its warnings during the campaign preceding the referendum on the evils which would follow from the removal of price control.

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The Banking Position

The effects of the colossal additions to export incomes and of rising internal costs are vividly reflected in the banking figures. Over the fifteen months from June, 1946, to September, 1947, bank deposits rose only by £12m. — from £698m. to £710m. In the same period the total volume of spending power, comprising cash and all banking deposits, increased by £22m.—from £1516m. to £1538m. But in six months from September, 1947, to March, 1948, bank deposits soared from £710m. to £785m.—an increase of £75m. Spending power went from £1538m. to £1600m.—an increase of £62m.

These movements, together with bank advances and bank lending to Governments, and the addition to or subtraction from internal spending power, as a direct result of overseas trading, are set out in the table below.

In the earlier period the effect on spending power of the increase in bank advances of £104m. was for the most part offset by the reduction in Government securities held by the banking system, brought about mainly by the redemption of Treasury Bills. But in the later period both bank advances and bank holdings of Government securities increased. At the same time there was a net addition to overseas funds of £31m.

It needs to be strongly emphasised the present inflationary condition is one of the classical text-book t brought about by the over-expansioi bank credit and marked by an unhea ratio of cash and liquid assets to l advances and a generally unsound structure. On the contrary, the pre liquid position of the banking syster sufficient to support a further vast ex sion of bank lending.* The percen ratio of advances to deposits for the quarter of the current year was 47 cent. Under pre-war conditions a r of 80 per cent. was generally regarde sound and healthy.

Bank Advances and Inflation

The large increase in bank adva: which took place over the two y 1944-5 to 1946-7 was necessary to as the reconversion and expansion of in try to peace-time purposes. Moreo part of this increase is to be attribi to the rising levels of values and cc which mean that producers and tra require additional money for worl capital to finance raw materials, sto debts and replacement costs. When c pared with the total of bank advai

*Not that this would be desirable.

	Cheque-paying Banks Deposits £m.	Total Spending Power £m.	Bank Advances £m.	Bank Lending to Govts. £m.	Overse Fund £m.
June, 1946	698	1516	259	630	202
Sept., 1947	710	1538	363	540	175
	+12	+22	+104	—90	—27
Sept., 1947	710	1538	363	540	175
March, 1948 . ..	785	1600	395	555	206
	+75	+62	+32	+15	+31

ore the war (1938-9—£288m.) the sent volume of advances cannot be arded as excessive. Latest figures sug- t that the rate of increase of advances lowing down. The recent aggravation the inflationary situation has little to with the expansion of bank credit. It es primarily from the higher unit s of production resulting from wage eases and the 40-hour week, and from abnormally high prices being obtained our major exports.

sent Shortages Not Direct ult of the War

nflation is at the present time the tral problem and the greatest danger he stability of the Australian economy. is the key to most of the other nomic problems. The economy is fering today not so much from the er-effects of the war as from the con- ued inflationary pressure. Today's rtages are in the main not the direct ult of the war, but of the excess of nding power which has been allowed continue since the end of the war. No itical party could have afforded to suddenly all controls whilst the im- ance between goods and money con- ued. The main point of criticism of the t-war economic policy pursued by the bour administration is not that up till ently it has retained a tight structure controls, but that it has failed to take quate measures to deal with the in- ionary pressure which rendered these trols necessary.

e Automatic Mechanisms

t is not easy to decide what should be e, for all possible alternative courses e their weaknesses and carry certain ks. Moreover, the whole problem is rmously complicated by the fact that ort to some of the main automatic mechanisms for correcting an inflationary position—for instance, interest rates and the rate of exchange—is virtually ruled out of account. An appreciation of the exchange rate would assist materially in the short term. It would reduce the purchasing power of the present immense accretions to the incomes of primary producers and it would lower the costs of imports in Australian money. But from the long-term viewpoint it has disadvantages. For one thing, the present extraordinary export prices are not likely to last — indeed, a severe slump in these prices is not beyond the bounds of possibility within the next few years. In addition, an appreciation of the exchange would weaken the long-term competitive position of many Australian industries. Powerful political pressure would certainly be brought to bear against any suggestion for appreciating the exchange rate and, for this reason alone, it does not appear a course likely to be adopted. If, however, the present Himalayan peaks for export prices were to continue for any length of time, it might be necessary to consider an appreciation of the rate of exchange.

A rise in interest rates would discourage borrowing and encourage saving, but it would probably have to be quite a large one to have any substantial effect on the present situation. Because of the immense public debt and its effect on the budget, the balance of argument would appear to be against any really worthwhile change in interest rates.

Remedies

Since we are apparently debarred, largely for political reasons (but less on economic grounds) from falling back on two of the main automatic mechanisms—the exchange rate and interest rates—for easing the inflationary pressure, we must look elsewhere. There is, however, one

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economic factor of the automatic kind which we should endeavour to restore to its natural role as soon as possible—that is, the commodity price level. The re-establishment of a free price market—paradoxical as it may at first blush seem—is fundamental to any correction of the inflationary tendencies and of all the evils to which they give rise. The mere fact of freeing prices would itself be a most powerful incentive to greater industrial efficiency by restoring in many fields a measure of price and quality competition.

The decision last June by the Commonwealth Government to abolish subsidies over a wide range of commodities, while unnecessarily sudden in its impact, is therefore, on the whole, a step in the right direction. The policy of reducing subsidies and relaxing price control will no doubt in the first instance lead to steep rises in the prices of some commodities, but other prices, in the absence of further cost increases, would probably fall.* In any case, we have nothing to fear from sectional price increases so long as the average level of prices does not get out of hand. A general easing of price control must not be regarded as an isolated measure, but as one instalment only of the anti-inflationary policy which the present situation demands. Taken by itself it could be positively dangerous. The elimination of subsidies and price control is a sound step, provided and only provided, it is accompanied by an anti-inflationary programme to reduce spending power and step up production. The time has come when it is no longer possible to countenance any large additions to money incomes. There is no case at the moment for any substantial increase in the average levels of wages, salaries or profits. The pegging of rents should of course continue. These things, as the British Government l been forced to recognise, are basic to t success of any policy to relieve the flationary pressure.

Moreover, the reduction and early eli nation of price subsidies, at present r ning at the rate of £40m. a year, wo mean a substantial cut in Government penditure. This, combined with t abnormally buoyant condition of Gove ment revenues, would in turn make p sible a really strong reduction in rates taxation, thus strengthening incenti and encouraging production. Through t reductions an increase in money incon can be achieved without imposing a burden on the cost and price structu The freeing of prices should thus r entail great hardship on any section the community, particularly as the low income groups are protected to some e tent by the automatic cost-of-living a justments.

The central objective of public finan should be to lighten the taxation burd and at the same time attempt to real a substantial budget surplus. The latter supremely important under present con tions, because it is by spending less th it receives in revenue in the form of tax tion and loans that the Government able to suck spending power out of t economy. These two objectives—that a reduction in taxation and a budg surplus — may seem at first sight to contradictory objectives. But under p sent conditions this is not so. For o thing, lower rates of taxation, as we ha seen over the last two or three years, not necessarily mean a loss of Governme revenue. By stimulating economic activi to a higher pitch, rates of taxation te up to a point to increase the total taxati yield.

Under the present conditions of seve labour shortage, and now that the reco

*Further rises in costs, however, seem certain, but price control could do little to prevent them.

ersion of industry to peace purposes has or the most part been accomplished, there hould be no need for a further large in-rease in the aggregate of bank lending. n pursuit of this aim the Commonwealth ank, in conjunction with the trading anks, should endeavour to hold advances t a point not greatly above the present gure.

Finally, this is a time when the business ommunity should be expected to exercise ne greatest restraint and self-discipline o far as its own price policies are con-erned. Wherever possible prices should e cut to the minimum consistent with a easonable profit. Increases should not be nade unless absolutely imperative. With-ut the understanding and co-operation f the business community no policy for orrecting the inflationary pressure can ope to succeed. The defeat of inflation emands a concerted effort by all sections f the community—all have a responsi-ility and all must play their part.

The essential elements in a financial olicy to cope with the inflationary posi-ion in Australia should therefore com-rise—

(a) The progressive reduction and early removal of price subsidies.

(b) An easing of price control over the whole economy with the complete removal of control on the large range of commodities of which the supply is now reasonably well adjusted to the demand.

(c) A strong reduction in rates of income tax on companies and personal incomes.

(d) The drastic pruning of Government expenditure.

(e) A substantial budget surplus.

(f) For the present, no further increases in average money rates of wages, salaries and profits.

(g) An endeavour to hold the total level of bank advances at a point not greatly above the present figure.

(h) Self-discipline on the part of the business community in fixing prices.

Disinflation Not Deflation

Lest there be any misconception, it needs to be emphatically stated that a policy to relieve the inflationary pressure is not a policy of deflation. As Lionel Robbins, the eminent English economist, states: "To remove inflationary tendencies is not to resort to deflation, that is, to a contraction of money incomes." When there is too much air in the tyres, the common sense thing to do is to let some of it out. But that does not mean that the tyre is to be flattened or left with too little air. Practically all the main weaknesses in the Australian economy at the moment are caused by an over-inflated tyre — under-production, the under-manning of the most vital industries, industrial inefficiency and poor quality of goods and services resulting from the absence of a worthwhile measure of competition, the constant pressure to bursting point on the tyre itself, the irritations and inefficiencies of controls, all these result from an imbalance between money and goods.

With the strong political pressure being exerted against the continuation of controls, the only practical alternative to disinflation at the moment is the old-time policy of "boom and bust." We can take our choice.

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