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 worldwide. 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 our times is the black marketeer.

Inflation, inflation on the grand scale was of course an inevitable consequence of total war. It could not have been avoided by any practical means known to economic and political science. Inflation is simply disruption of the more or less normal balance between the supply of goods and the supply of money. War, unavoidably drastically reduces the former and greatly enlarges the latter. The colossal sum spent on production for war purposes is paid away ultimately in the form of wages, salaries, profits, interest and rents, and represent income to individuals or business organisations. But these incomes are not balanced by no expansion, indeed, are accompanied in most cases by a severe contraction, of the supply of peace-time goods and services. During war people continue to receive money income, but much of this income is not matched by any corresponding production of goods of which it can be spent. When war cease people and businesses are left with vast accumulations of purchasing power, but the supplies of goods coming on to the market are quite inadequate to meet the demand at any reasonable level of prices. It is this situation, the inflationary pressure of a great quantity of money on an insufficient quantity of goods, which
renders certain controls essential in the post-war period.

Inflation Compels Controls

It is necessary to stress this close interconnection between inflation and controls. Inflationary pressure compels controls and controls can only be safely eased as the inflationary pressure is reduced and when goods and money again bear some reasonable relationship to one another. The success of a government in dealing with the problems of the post-war transition must largely be judged by the effects of its policy in reducing this pressure. One of the greatest mistakes in the post-war policies of Britain and Australia has been to suppose that all the evils arising from inflation can be prevented by a system of controls, of which price control is the crux. This has led to a concentration of the control aspect of the problem and a comparative disregard for the inflationary condition itself. The tendency has been to think that an excessive amount of money need not be a serious drawback provided the controls are present to keep down costs of living, to stop a runaway increase in prices and, in effect, to prevent consumers and businesses from spending their surplus money. But suppressed inflation leads to evils little less injurious to the health of the economy than those which would ensue if the inflation were allowed to take its natural course.

The Disadvantages of Price Control

Price control of itself does nothing to correct inflation. It operates on the symptoms of the disease, not the disease itself. It keeps the temperature of 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
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 number of jobs offering for which workers cannot be found. Another measure is the relationship between the amount of potential spending power in the hands of the public and the volume of output of goods and services. Potential spending power is made up of current and fixed deposits in the trading banks, savings bank deposits and cash in the form of notes and coin held by the public.

These three measures—prices, the volume of money and the labour shortage—taken together give a fairly good picture of the magnitude of the inflation in Australia brought about by the war. At the end of the war retail prices as measured by the “C Series” cost of living index were roughly 25 per cent. above the 1938-level.* Wholesale prices, according to the Statistician’s index, were about 40 per cent. above the pre-war level. The volume of money was more than double—£612m. in 1938-9, £1356m. in 1944-5. Productio of peace-time goods and services was on course at the end of the war greatly below pre-war production—probably by about 20 per cent. On the basis of trade union returns 9.3 per cent. of all wage and salary earners were unemployed when the war broke out. At the end of the war there was virtually no unemployment except of a seasonal or temporary nature.

*There is a great deal of misunderstanding about the “C Series” index of retail prices. This does not measure, nor does it purport to measure, the average of retail prices in general. It measures only the changes that take place in the prices of a select group of commodities and services which enter largely into the consumption of the basic wage earner. There is no index published by the Commonwealth Statistician attempting to measure the average of retail prices in general. If an average could be taken of the increase in all retail prices since the beginning of the war it would certainly show a far greater rise than that shown by the “C Series” index number.
Since the War

The two years following the war saw an improvement in the inflationary situation. Retail prices rose by another 14 per cent., wholesale prices by only 2 per cent. The volume of money in the hands of the public increased from £1356m. to £1587m., an increase of about 14 per cent.; on the other hand, as peace-time production again got into its swing the output of many kinds of goods and services again reached normal proportions and probably increased in a much greater ratio than potential spending power. Up to the end of 1946-7 it could be said that the inflationary position had not only been held, but that some improvement had been accomplished.

Deterioration

Since then a disturbing deterioration has occurred. From June, 1947, to the first quarter of the current year, retail prices increased by 9 per cent. and wholesale prices by 21 per cent. These increases were with 5 per cent. and 2 per cent. respectively for the two preceding financial years. The volume of money, which, in June, 1947, was £1587m., had risen to £1600m. by March, 1948. The price shortage has also certainly become much more pronounced over the last nine months.* Thus, while by the end of 1946-7 there may have been some grounds for hope that we were getting a grip of the inflationary tendency in the Australian economy, nine months later the situation had deteriorated quite considerably. 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.*

*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.
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 that the present inflationary condition is one of the classical text-book type brought about by the over-expansion of bank credit and marked by an unhealthy ratio of cash and liquid assets to advances and a generally unsound structure. On the contrary, the pre-liquid position of the banking system was sufficient to support a further vast extension of bank lending.* The percentage ratio of advances to deposits for the quarter of the current year was 47 per cent. Under pre-war conditions a ratio of 80 per cent. was generally regarded as sound and healthy.

Bank Advances and Inflation

The large increase in bank advances which took place over the two years 1944-5 to 1946-7 was necessary to assist the reconversion and expansion of industry to peace-time purposes. Moreoever, part of this increase is to be attributed to the rising levels of values and costs which mean that producers and traders require additional money for working capital to finance raw materials, stocks, debts and replacement costs. When compared with the total of bank advances

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*Not that this would be desirable.

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<table>
<thead>
<tr>
<th>Cheque-paying Banks</th>
<th>Total Spending Power</th>
<th>Bank Advances</th>
<th>Bank Lending to Govts.</th>
<th>Overseas Fund</th>
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<tbody>
<tr>
<td>Deposits £m.</td>
<td>£m.</td>
<td>£m.</td>
<td>£m.</td>
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<tr>
<td>June, 1946 . . .</td>
<td>698</td>
<td>1516</td>
<td>259</td>
<td>630</td>
</tr>
<tr>
<td>Sept., 1947 . . .</td>
<td>710</td>
<td>1538</td>
<td>363</td>
<td>540</td>
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<td></td>
<td>+12</td>
<td>+22</td>
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<td>—90</td>
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<tr>
<td>Sept., 1947 . . .</td>
<td>710</td>
<td>1538</td>
<td>363</td>
<td>540</td>
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<tr>
<td>March, 1948 . . .</td>
<td>785</td>
<td>1600</td>
<td>395</td>
<td>555</td>
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<td></td>
<td>+75</td>
<td>+62</td>
<td>+32</td>
<td>+15</td>
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</table>
Since the war (1938—£238m.) the present volume of advances cannot be regarded as excessive. Latest figures suggest that the rate of increase of advances is slowing down. The recent aggravation of the inflationary situation has little to do with the expansion of bank credit. It arises primarily from the higher unit costs of production resulting from wage increases and the 40-hour week, and from abnormally high prices being obtained for our major exports.

Present Shortages Not Direct Result of the War

Inflation is at the present time the central problem and the greatest danger to the stability of the Australian economy. It is the key to most of the other economic problems. The economy is suffering today not so much from the after-effects of the war as from the continued inflationary pressure. Today's shortages are in the main not the direct result of the war, but of the excess of spending power which has been allowed to continue since the end of the war. No political party could have afforded to suddenly all controls whilst the imbalance between goods and money continued. The main point of criticism of the post-war economic policy pursued by the Labour administration is not that up till recently it has retained a tight structure controls, but that it has failed to take adequate measures to deal with the inflationary pressure which rendered these controls necessary.

Automatic Mechanisms

It is not easy to decide what should be done, for all possible alternative courses have their weaknesses and carry certain risks. Moreover, the whole problem is enormously complicated by the fact that part 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
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

*Further rises in costs, however, seem certain, but price control could do little to prevent them.
version of industry to peace purposes has, for the most part been accomplished, there should be no need for a further large increase in the aggregate of bank lending. In pursuit of this aim the Commonwealth Bank, in conjunction with the trading banks, should endeavour to hold advances at a point not greatly above the present figure.

Finally, this is a time when the business community should be expected to exercise the greatest restraint and self-discipline as far as its own price policies are concerned. Wherever possible prices should be cut to the minimum consistent with a reasonable profit. Increases should not be made unless absolutely imperative. Without the understanding and co-operation of the business community no policy for correcting the inflationary pressure can hope to succeed. The defeat of inflation demands a concerted effort by all sections of the community—all have a responsibility and all must play their part.

The essential elements in a financial policy to cope with the inflationary position in Australia should therefore comprise—

(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.