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INFLATION AGAIN

It is two years since this journal drew attention to the mounting dangers of the post-war inflation. Since then, in spite of unceasing discussion and a stream of articles by economists and leader writers, the monetary balloon has continued to expand and the value of the Australian £ has continued to contract. Since March 1948 retail prices have risen by 23%, wholesale prices by 30%, and the volume of liquid spending power, as measured by cash and bank deposits, by 28%. Moreover, the figures of recent months suggest that there is little hope of any immediate abatement of the vast inflationary movement taking place. The rate of increase in retail prices has eased off only very slightly while the volume of spending power, urged on by devaluation, has risen alarmingly by 15% since September, 1949.

If the dangers of inflation stood out so clearly two years ago, why has nothing been done in the interim to arrest the rise in prices and to stabilise the purchasing power of the £?

Perhaps it is not strictly correct to suggest that nothing at all has been done. The Commonwealth Government has continued to drain some of the excess money out of the economy by achieving a surplus of receipts from all sources over its total expenditure. The Commonwealth Bank has exerted a tight control over the volume and direction of bank lending.* Price control remains over those items in palpably short supply. But the course of economic events over the last two years proves that these anti-inflationary measures have been woefully ineffectual in coping with the immense pressures making for expansion.

Some inflation, of course, was inevitable. No policy within the bounds of economic and political practicability would have been sufficient to stabilise the internal price and cost structure in face of the altogether extraordinary increases that have occurred in export prices and income. Two years ago it would have been hard to anticipate that wool which was then realising the very high price of 40d. per lb., would today be bringing 63d. per lb., and that wool receipts would have risen from £155m. in 1947/8 (which was a record), to £194m. in 1948/9 and to £286m. in 1949/50.

But even when this is said, and conceded, it remains true that there has been a serious failure to grapple strongly with the declining value of the £. It remains true that the two years 1948/9 and 1949/50 have been years little short of financial neglect and drift.

Why is this so? If the threat of inflation were already becoming ominous in June, 1948, why is it that so little effective action has been taken since that time?

The popular course is to blame the government, and no doubt if the rebound from the present inflationary boom should precipitate an economic collapse, the party then unfortunate enough to be in office (no matter whether it is primarily responsible or not) would receive the full weight of the electors' wrath. *But, in fact, the responsibility for the policy of financial timidity of the last two years is as much the public's own as that of any political party.* It is perfectly true that no section of the community has been backward in urging that value be restored to the £. But, when it has really come

* Despite the strict control over bank lending, bank advances have expanded by nearly £100m. in the last 12 months. But the Commonwealth Bank itself whose advances have risen from £56m. to £104m. has contributed as much to this as all trading banks together. There may be good reason for this large increase in the advances of the central bank, but at first sight it hardly seems to conform with the need for a policy of credit restriction.

to the point, no section has been prepared to do anything about it; no section has been prepared to make any worthwhile contribution to achieving the goal for which all have loudly clamoured. *Most people have deplored the sliding value of the £, but they seem to have been singularly unaware that they have any responsibility themselves for arresting the slide.*

"THE MONEY ILLUSION."

The main explanation of this is to be found in a deep-seated fact of economic psychology. While the average person has a great dislike of high prices, he has an even greater liking for a plentiful supply of money in his pockets. We all like our purses packed to capacity with notes, even if that involves, as involve it does, high prices for the things we purchase. "A 1,000 a year" has a magical ring; and the vast majority of people would much prefer to have a yearly income of £1,000 with high prices to one of £500 with low prices, even though the purchasing power of the larger income were no greater, and perhaps even somewhat less, than the smaller. Money for money's sake has an irresistible psychological attraction. It is pleasant to feel the notes crackling in one's pocket or to have a tightly-packed wallet, even though the notes may not be worth very much. Moreover, a high *money* income seems to confer a certain social prestige or economic status; when John Smith moves into the "£1,000 a year" class he begins to throw out his chest and feel his importance. There is, too, always the hope that if one can build up one's money income while the going is favourable, it will be possible to maintain the ground won when prices fall.

This fundamental fact of economic psychology, "the money illusion" as the late Lord Keynes called it, has been the root obstacle in the way of any effective action to stabilise the Australian £. Such action would inevitably have involved a lower level of *money* incomes all round than has in fact prevailed and would have certainly encountered bitter opposition. A government embarking on this course would have been taking its life in its hands, and as governments are only human, and naturally have to place the retention of office high on their list of objectives, little has been done. *The limits of government action, it is well to remember, are set by public*

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opinion; and it has been public opinion, and not any political party, which has been largely responsible for the failure to cope with inflation over the last few years. Not by any means wholly responsible! For it can still be argued that governments should have done much more than they have done to educate the public in the perils of inflation, and should have tried to create that climate of opinion in which strong action would have been feasible without a political upheaval.

WHY ARREST INFLATION?

Apart from the extremely annoying fact that as the months have gone by the £ note has purchased less and less, there is, for instance, still a great deal of popular misunderstanding of why it is necessary to arrest inflation at all. After all, the post-war inflation has brought great advantages to many people. It has brought about the condition, highly satisfactory to the great majority of income-earners, of over-full employment. It has resulted in record returns for many farmers and has bestowed high money profits upon industrialists. It has enabled us to import on a grand scale at the same time as we have been building up our overseas financial reserves to exceptional heights. It has resulted in an exceedingly high tempo of economic activity within Australia, and has made possible an unheard of flow of migrants into the country without the political resistance which such a flow would, under other circumstances, have certainly encountered. It has encouraged the investment of large sums of money from abroad in Australian industries. And it has brought about a great increase in the money savings of the lower income groups of the community, as shown by money held in savings bank accounts and invested in insurance policies.

From a superficial viewpoint, then, inflation is by no means an unmitigated evil. Is it an evil at all? Yes, partly because it brings a prosperity which is as much imaginary as real. It increases the *money* incomes of all sections of the community but not the *real* incomes. To many, particularly to those sections who are politically unorganised, such as pensioners and some salary earners, it means lower real incomes, and economic hardship. It diverts production into the inessential channels and obstructs the great work of national development. It weakens incentive and tends to make able brains concentrate on the easy gains to be had from capital inflation rather than on work of real national worth. And, of course, it produces the irritating and to some extent distressing phenomenon of a constantly falling value in the purchasing power of money.

"PUTTING VALUE BACK IN THE £"

It is at this last point that public criticism of the post-war inflation has been chiefly directed. The popular clamour to "put value back into the £" grows louder as the months go by. What does this mean when it is closely examined? *It cannot surely mean restoring the value of the £, and thus prices, to pre-war levels. If it means that it makes nonsense. The pre-war level of prices has gone for good and all.* In the last ten years the great world inflation brought about by the war has revolutionised the income and cost structures of all countries, and to adjust those structures so as to revert to pre-war standards would require monetary deflation on a scale impossible to contemplate.

A return to the pre-war purchasing value of the £ is therefore unthinkable. In fact it is even highly doubtful whether in the next 12 months it would be practical politics, or economics, to increase in any substantial measure the value of the £. *The best that can probably be hoped for—and an objective which we would do very well to achieve—is that 12 months from now the value of the £ will not have deteriorated any further, and that the rising trend of prices experienced over the last decade will at long last have been arrested. All that the objective of "restoring value to the £" can mean from any realistic standpoint is that over the next 12 months the purchasing power of the £ will be stabilised around present levels.* This is a realistic objective, but only just realistic. Failing an unexpected drop of substantial proportions in export prices, it could be accomplished only by the most stringent and positive measures of internal financial policy.

THE POLICY OF "DO NOTHING"

There are, thus, two ways in which we might hope to stabilise the value of the Australian £. First, there is the passive way of waiting till the reaction from the world post-

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war boom forces a lower level of prices and costs within Australia. Second, we can take definitive action now by embarking on positive measures of economic and financial policy.

Is there, then, any likelihood of a large fall in overseas price levels in the immediate future? Very little likelihood, it would appear, within the next 12 months! All the present indications are that present price levels will hold fairly well for another year at least. Beyond that it would be foolish to say anything. We can of course wait until world prices for basic foodstuffs and raw materials adjust themselves to a new post-war level and until world currencies shake down at a new post-war set of relationships. That might take some years and it would certainly be putting value back into the £ with a vengeance. It would in all probability force a very sudden adjustment of Australian prices to the new world level of prices. The purchasing power of the £ would rapidly improve, but with drastic and painful effects on industries and individuals in the Australian community. It is unlikely anyhow that we will be able to avoid eventually some reduction of money incomes and costs within Australia as the world buyers' market gathers strength, but this necessary adjustment will be the greater and the more painful the longer we delay in taking steps to arrest the rising price and cost drift, and the higher prices and costs in Australia are permitted to go.

Another two or three years of the present trends and the disparity at present appearing between our own costs and overseas costs might become of glaring proportions. An adjustment then could be accomplished only with severe hardships and unemployment on a considerable scale. That is why it would be most foolhardy to wait for a change in the economic weather overseas to bring an automatic end to inflation in Australia. That is why the stabilisation of the £ is not something we can or should postpone till next year or the year after, but something to be done right now. That is why the inflation problem is not an occasion for interesting or showy intellectual exercises but one of the most immediate and vital practical importance. *For nothing will save Australia from the supreme tragedy of depression and unemployment if we allow the gap which is beginning to appear between our own* *costs and overseas costs to widen until it becomes an unbridgeable chasm. No ingenious devices of financial or fiscal policy, or even large-scale spending on public projects, will then serve to save us from the unhappy and painful task of economic readjustment so that our economy can again proceed to operate on stable foundations.*

TO PREVENT UNEMPLOYMENT.

Besides the threat to the future involved in the present inflation, the discomforts and irritations suffered by the Australian public from rising prices are of little importance. *It is not so much for its own sake that we should take steps to put value back into the £, as for the sake of what will probably happen to us if we neglect to do so. The real argument for stabilising prices is not to add a little now to the real purchasing power of the weekly wage or salary, but to prevent unemployment later on—nothing more or less than that.*

The next twelve months are likely to be critical. On present indications, export incomes may not increase greatly but will probably remain very high. They will in all probability be sufficient to maintain a high degree of activity internally with considerable pressure on prices and costs. At the same time wages and other incomes are almost certain to increase further. Apart from whether or not the wage claim before the Commonwealth Arbitration Court is successful, the quarterly adjustments still retain a strong momentum. Higher wages lead to higher salaries and other incomes by way of compensation. The immigration flow will buttress internal demand more than it will solve the problem of internal supply. The profit outlook is on the surface excellent and the volume of private investment will no doubt remain high. Moreover, with war gratuities amounting to £60m. falling due in the current year, and with government costs rising for other causes, Commonwealth finances, which have had an anti-inflationary bias over the last few years, are beginning to take on a flushed inflationary appearance.

It is now time therefore when a supreme effort should be made to grapple with the problem.

What can be done?

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A MULTITUDE OF PROPOSALS.

A multitude of proposals have been put forward over the last few years. Many of these, such as a return to price control and subsidies and the restoration of the 44 hour week, are of academic interest only: They are outside the ambit of what is strictly practical. Others, concerned mainly with the expansion of internal production, while eminently good in themselves, will bear fruit only in the long term—they cannot be taken seriously as a solution of the immediate problem. In this category are incentive payments, profit-sharing, the elimination of Communist-inspired industrial unrest and increased mechanisation. We should push on with all these measures as fast as we can, but we should not regard them as a remedy for the short term issue of inflation. *Something might be done to increase supplies by heavier imports of machinery and essential materials—steps are apparently already being taken by the Commonwealth Government to this end—but the short term remedies, must, of necessity, be mainly concerned with the monetary or demand side rather than the supply side of the economic equation; with reducing, or at least damming back, the monetary pressures on the price level.* And, of course, it is here that the great obstacle of the "money illusion," which has been fundamentally responsible for the failure of all previous attempts to deal with the problem, so strongly persists.

A NEW APPROACH.

Is it not possible to take a new approach—an approach that would enlist the combined goodwill and commonsense of all sections of the community? This might be achieved by the Commonwealth Government inviting all major organised sections to appoint representatives to a conference on inflation for the purpose of thrashing out immediate remedies. Representation at such a conference, in addition of course to the Commonwealth and State Governments, would embrace the manufacturers, commercial and other business sections, the primary producer bodies, the trade unions and banking and financial institutions. This conference would enable the Commonwealth Government to place its proposals for monetary stabilisation before the representatives of those people directly concerned, and the sacrifices which each section might legitimately be expected to make for the ultimate good of all. It would provide the government with a unique opportunity for educating the community in the basic economics of the problem. It would open the way to that kind of national co-operation to reach a solution of a national issue, which is the real inner test of the strength of a democracy.

And apart from those advantages it has obvious political merits from the Government's point of view. The great obstacle to stabilisation lies in the reluctance, and up to the present tacit refusal, of the representatives of any section to contemplate any measures which would involve some immediate sacrifice on the part of their members. If these sections of the community persisted in this attitude after the full facts of the situation were placed before them, the government would, in the eyes of the public, shift quite a large part of the blame from its own shoulders, and responsibility would fall where it rightly belongs.

THE LAST CHANCE.

The threat of inflation to the future stability of Australian economy presented in this article is no alarmist picture. Three years ago those who thought most deeply about the economic problems of this country were sufficiently concerned to emphasise the dangers inherent in a continuation of the inflationary trends. Since then the trends have continued and gathered force and the dangers have magnified and become more imminent. It is not too much to say that we are now presented with our last chance, and that if we fail to take it we may as well resign ourselves to the consequences—which will certainly be severe, and could be disastrous. This is a problem above politics, above sectional interests, above all narrow and short-sighted concerns. It is a problem which demands the united intelligence and sacrifice of all sections of the community if a solution is to be found.

NOTE:—

The above article was completed before the serious implications of the Korean War became fully apparent. At present it is impossible to tell what effect the Korean outbreak may have eventually on the world economic position and on the Australian economy in particular. While there will be greatly increased emphasis on defence expenditure, at the time of writing it appears that the economies of the countries of the western world will continue to be devoted substantially to peace production. The analysis and conclusions of this article, therefore, in our view, still hold good.

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