III

Money

THE circulation of money determines the level of prices and of employment in a country, and fluctuations in the level of monetary circulation determine whether that country shall suffer inflation or deflation. These issues are too important to be left to the control of private enterprise; that has long been agreed, and in every modern country the government itself controls the supply of money and seeks to influence the demand. Modern progress in monetary control involves not new objectives, but simply new techniques.

INFLATION

All modern economists agree what the objective of monetary policy should be; it is to stabilise the flow of money at the level just appropriate to full employment, so that there shall be neither inflation nor deflation. Unfortunately this objective is not accepted unanimously by the politicians of the left or of the right. Many on the right would prefer a regular cycle of inflation and deflation, and many on the left hanker after continuous inflation.

The right would like a cycle of inflation and deflation because it thinks that deflation from time to time is necessary to keep the workers disciplined and to induce them to work hard. It may be true that the employing classes can continue to treat their workers as they treat them now only if the fear of unemployment can be hung over their heads at regular intervals. But to socialists this is a case not for deflation but for altering the existing relations between employer and employed. Discipline must find a new basis in the consent of worker and manager to work together for common ends; of this more will be said in Chapter VII. And as for working hard, if it is true that the worker, if relieved of the pressure of fear, would prefer to work less, or less intensively, then he should have the right to do so. His standard of living will be lower, and so will that of the country as a whole, but is it not a democratic right to decide whether extra income is worth the extra wear and tear of work ?

More dangerous is the demand of the left for continuous inflation. This, too, is rooted in the class struggle, for it is thought that if there are always more jobs than men, employers will be at the mercy of their workers. This also is true; but the left-wing politicians who accept it as a decisive case in favour of continuous inflation do so only because they are unaware of the harm which inflation does to the working classes no less than to the rest of the community.

That open inflation is harmful is seldom disputed. In open inflation prices always rise faster than wages; the workers and the middle classes suffer, while employers and property owners gain. The worst losers are the middle classes, whose salaries adjust too slowly, and whose past savings lose value, but the working classes also fail to keep up with rising prices. The left is therefore pretty firmly opposed in these days to open inflation; what attracts some of its members is suppressed inflation, in which the tide of money is allowed to flow, but is prevented from raising prices by administrative controls. Suppressed inflation is less obviously harmful than open inflation, but it too has evil consequences.

First, even if prices are controlled, inflation causes profits to rise more than wages and salaries. Inflation is a condition in which people are spending on consumer goods more than those goods have cost to produce; every extra penny of this spending, if it does not eat into stocks or upset the foreign balance, must go into profits, since this is the only residual element in income. This is why, for example, profits in Britain have increased more than wages and salaries in the last three years. The fact that this has been happening has in turn set up new pressures, demands for higher wages, and for tighter price controls; but the simplest way to check the movement, and to keep profits low, would be to check the inflation.

Secondly, suppressed inflation causes resources to be sucked away from essential industries, which are tightly controlled, to inessential industries, which are left more free, and which therefore become more profitable. Frantic efforts have then to be made to tighten up raw material allocations, but the greater the inflation the more difficult it is effectively to work such controls. Power has also to be taken to direct labour, in order to discourage it from flowing to the inessential trades. All this could be avoided by ending the inflation.

Thirdly, the inflation reduces productivity. Stocks of raw materials and work in progress are run down, and the smooth flow of production is impeded. Profits are so easy that employers become careless of costs. The competitive forces cease to work, and the stimulus to efficiency is removed.

And, fourthly, inflation brings external bankruptcy. Some of the extra money is spent on buying imports, and some is spent on attracting to the home market resources that should be working for export. The balance of payments thus becomes adverse, gold and foreign reserves are used up, and eventually unless foreign countries are willing to make loans, the external value of the currency falls.

In a mild inflation the government may strive to prevent all these consequences by using administrative controls and planning by direction. But the bigger the inflation the more difficult it is to operate such controls effectively. Administrative controls are not and cannot be an efficient substitute for controlling the level of monetary circulation. The task of such controls, on the contrary, is made all the more difficult by inflation. This is the plain lesson not only for our own experience in the last three years, but also of Soviet Russia in the nineteen thirties. Many of the most difficult and tiresome problems which that country had to face in the 'thirties were due neither to the adoption of planning nor to any national instinct for authoritarianism, but simply to having to maintain a continuous struggle with an overflowing tide of money. Inflation is as great a nuisance to those who try to plan by direction as it is to those who plan by inducement.

MONETARY STABILITY

The right policy is to have neither too much money, nor too little money, but just the right amount, and the right amount is that which is appropriate to full employment, with no tendency either to inflation or to deflation.

The old techniques for achieving this laid greater emphasis on controlling the quantity of money in existence than on controlling the demand for money. The quantity of money in existence is important, but fluctuations in trade are caused as much by fluctuations in the use of money as by fluctuations in the quantity of money, and indeed normally the latter adjusts itself to the former. The runaway inflations are caused usually by the quantity of money being increased in response to government demand, and the big deflations also see the quantity of money being reducea simply because the demand for money is reduced. Firm control of the quantity of money can prevent a runaway inflation, and a severe cut in the quantity of money is also very useful when there is too much money about (as recently in Germany or the U.S.S.R.). But controlling the quantity of money in existence cannot prevent the smaller inflations and deflations that characterise the trade cycle, because they depend as much on changes in the velocity of circulation of money as they do on changes in the quantity of money. The new technique rejects the objective of stabilising the quantity of money in existence; instead, when the demand for money is increasing, it increases the quantity of money, and when the demand is diminishing it diminishes the quantity of money, so keeping the circulation of money constant.

The instrument of this control is the budget. When the circulation of money is flagging, it can be stimulated by reducing taxation and leaving the public with more in its pocket to spend. And when the circulation is excessive it increases taxation, thus reducing the amount that the public can spend. The corollary of this is the possibility of budget deficits and surpluses. These may offset each other in the long run or they may not; this does not matter. If, for example, there were a chronic tendency for the circulation of money to fall short, there would have to be a succession of budget deficits, and provided that these were no bigger than was needed to stabilise demand, they would do no harm. A deficit is harmful only when it is greater than can be justified by the gap in the circulation of money, or when, being of the right size for this purpose, the government borrows and pays interest on it, instead of simply creating more money interest free.

At one stage in the evolution of this technique it was suggested that the government should vary not the sum collected in taxes but its expenditure, spending more when the circulation of money is flagging, and less when it is excessive. Spending more is more effective than taxing less, in the sense that a given budget deficit will add more employment if it is reached by spending more than if it is reached by taxing less. But varying taxation is easier and more desirable than varying expenditure. Public works are needed even at the height of an inflation, and unnecessary public works do not become desirable just because there is a deflation. In so far as public works can be advanced or retarded without much inconvenience it is obviously sensible to use this as an additional means of stabilising demand; but the principal emphasis must be on varying the amount of taxation.

The use of this technique depends on forecasting the amount and distribution of the national income in the immediate future to which the budget relates. If there is much less than full employment, on the one hand, or raging inflation on the other, precise calculation is not necessary or possible. The Chancellor must aim at a pretty big deficit or surplus to get the circulation of money moving rapidly in the right direction, and it is only when full employment is reached, or disinflation achieved, that precise calculation becomes important.

At full employment the forecaster estimates how much resources, in money value, will be devoted to producing consumer goods for the home market, exports, investment goods, and government services. The total of these resources is also the total of the national income, because incomes come from production, and the total cost of production is simply the total sum of incomes paid out. The other side of the forecaster's balance sheet is an estimate of how people are likely to spend these incomes. If they will spend more on buying consumer goods than will be spent in producing consumer goods the prices of these goods will tend to rise, and inflation will be set in motion; if they will spend less, deflation will be set in motion. Full employment is maintained by keeping consumers' expenditure at the right level through making up any gap by having a budget deficit, and preventing any tendency to surplus by increasing the amount taken in taxes.

There must be no pretence either that this technique can be very precise, or that it can be fully effective.

Precision is prevented in the first place by slowness in adjusting taxation. Annual budgets announcing taxes that do not come into operation for some months are not good enough for a situation where, perhaps because of events abroad, there may be swift changes in the general level of activity. This, however, can be remedied; supplementary budgets can be made, and if the income tax structure is simplified, as was suggested in the preceding chapter, swift changes can be made in the standard rate.

The other obstacle to precision is the inadequacy of the statistics available to the forecaster. This also can be remedied. It is a curious fact that there is much more statistical information available about the American economy, the home of *laisser-faire*, than there is about the British. Our statistical staff needs to be strengthened, and its power to command necessary figures needs to be increased. Fortunately we need not depend exclusively on national income estimates for guidance as to the direction in which budgetary policy should move, for there are at least two other useful thermometers.

The first of these is statistics of bankruptcy. Since business managers are not infallible there are always some using resources wastefully, and if there were no bankruptcies this waste would continue. In full employment something like 2,500 companies should go into liquidation every year. If the actual number is much above this, taxes should be reduced; if it is much below this, inflation is proceeding.

A much more precise thermometer is the statistics of unemployment. Not all unemployment is due to monetary shortage. There is also a certain amount of 'frictional' unemployment due to the changes occurring in the economy every day, whether fluctuations in demand, or new techniques of production, or changes in the availability of raw materials, or seasonal changes, or others. In consequence there are always some people out of work, moving from job to job, and it is estimated that these account for between 2 per cent and 3 per cent of the occupied population. The size of this frictional unemployment depends primarily on how well the labour market is organised, and it is our duty to diminish it as much as possible so that people displaced from any cause can find other suitable work at once. We can also diminish this figure by pursuing an inflationary policy, because if the quantity of money is large enough all employers will be short of labour, and the unemployed man need not look for the right job but can get some job immediately. But if we do this, not only do we have all the usual evils of inflation, but in the labour market also it becomes impossible to distinguish between jobs that are more important and those that are less essential. If the quantity of money is just right, when one employer discharges labour there will be another employer needing labour. It will take some time to effect the transfer, but it will be the right transfer; the worker will go not just to any job, but to the right job. But when money overflows all employers need labour, and this distinction disappears. There is no longer any means of ensuring that labour gets into the right job through inducement, and we have to resort to direction.

This is a hard and unpopular thought. Unemployment is such an evil that it is hard to reject any means that would abolish it completely. But some ways of achieving an end are better than others. The way to abolish the 3 per cent of frictional unemployment is to improve the organisation of the labour market. To abolish it by bringing down the evils of inflation and direction of labour is like cutting off an arm to save a finger.

The level of unemployment can therefore be used as a gauge for monetary policy. In the present state of the British labour market if unemployment is less than 2 per cent of the gainfully occupied population there is inflationary pressure, and if it is more than 3 per cent the monetary tap should be turned on. The more rapidly the structure of the labour market is improved, the sooner these crucial figures will be lowered, and the nearer we shall come to being able to claim that the tap should be on whenever there is any unemployment at all.

Another factor which makes it difficult to eliminate unemployment exclusively through monetary policy is dependence on external trade. If there is a slump abroad, and the demand for exports falls off, workers engaged in export industries will lose their jobs. At present many of these industries are highly localised, and there are not always enough other jobs in the locality to which the workers can be transferred. A slump abroad might thus push the unemployment figure rapidly up to 10 per cent or so, without the mere injection of money into the system having much immediate effect. The remedy for this is to promote the mobility of resources, both human and material, and this is such a large subject that we reserve to it a whole chapter (Ch. VI). In a sense this sort of employment also is frictional, because it is due to the imperfection of the labour market; and in this sense the estimate of 3 per cent as the upper limit of frictional employment is too low. Foreign trade, however, is such a special problem that it is better to treat separately the unemployment that it may cause.

THE PRICE LEVEL

Once the objective of controlling the quantity of money in existence is abandoned, and in its stead the quantity of money is adjusted to the needs of trade, the general price level becomes dependent solely upon the level of wages. If trade unions raise wages prices will rise, and the quantity of money will have to be increased in order that this should not give rise to unemployment. When there is an absolute limit on the quantity of money, wages and prices are limited, since if they rise too high there is unemployment, and this pulls them down again. But the new technique abandons the price level to the discretion of the trade unions, and many people are convinced that the result will be that prices will move continuously upward.

Since it is undesirable for prices to rise continually, the corollary of this technique is that the trade unions should agree as nearly as possible to stabilise the general level of wages. It cannot be stabilised completely. The social interest demands that some wages be higher than others, and since, with changing conditions, there will always be some wages needing to move upwards in the scale, while downward adjustments are difficult to secure, the general trend must always be upwards. This is not new; the general trend has always been upwards, and if in the future the upward movement were confined to what is needed to adjust particular wages relatively to the average, the general level would seem almost stable, when compared with what has happened in the past.

Moreover, absolute stability is not required. Since productivity is constantly increasing, prices would fall constantly if wages were stable. Now a falling price level has the disadvantage of raising continually the real burden of debt. If therefore wages rise as fast as productivity increases, prices will be stable, and it may even be desirable that they should rise a little faster than this, so that the debt burden may constantly be eased. If by adjusting the wages of particular workers from time to time the general level of wages were made to rise by between 3 per cent and 5 per cent per annum, we should get a price level that was just about right.

Such relative stability could not be achieved unless the cost of living ceased to be subject to cyclical fluctuation. The cost of living depends to a large extent on the cost of imports, which depends very largely on American prices. If we let import prices move freely with American prices, the cost of living will rise in the upswing, and wages will chase upwards; but in the downswing the trade unions will resist a fall in wages as the cost of living falls, and can resist successfully if we maintain full employment. So wages will always rise in the upswing without falling in the downswing, and British prices will soon be well out of line with prices abroad, and the real value of the pound will be continually depreciating. We can avoid this by stabilising import prices, either by destabilising the external value of the pound, or by subsidising imports in the upswing and taxing them in the downswing. In the past three years we have pursued the latter policy, somewhat half-heartedly; prices have been rising, but not as much as they would have risen in the absence of subsidies. The Chancellor of the Exchequer has now called on the workers to agree to wage stabilisation. But they cannot be expected to accept this for long unless he applies himself with much greater determination to stabilising the cost of living, as a *quid pro quo*. To this issue we shall return in the chapter on foreign trade.

The second condition for wage stability is that wage demands should cease to be made in a competitive spiral, with each union chasing the successes achieved by other unions. There would have to be a code of rules, to determine which wages should be above, at, or below the average, and unions would have to accept a ruling from a general body representing all the unions, which would determine which wage claims should be supported. More difficult still, the rank and file members of the unions would have to be convinced that this was desirable, or the trade union movement would disintegrate through unofficial strikes, and wages and prices would rise rapidly.

Before any of this could be achieved, the workers would have to be won over to the view that raising the general level of wages is an inefficient way to try to redistribute income, and therefore that wage adjustment should be confined to setting particular wages into the right relation with the general level. This in turn will not be accepted unless the workers' attention is directed to alternative and more efficient means of procuring equality, and unless they are convinced that these means are being adequately operated.

There is little hope of these things happening in the near future. Left-wing propaganda has concentrated so long and so much on the wage struggle that it will take a long time for different views to prevail. It will not, perhaps, take as long as we think. The reception given to Sir Stafford Cripps' appeal for stabilising incomes shows that if the confidence of the working classes is won, and the issues explained, it is possible for cherished beliefs to be set aside, even if only temporarily and experimentally.

This is the biggest educational job that socialists have to do. Full employment and an uncontrolled level of wages are incompatible, and sooner or later one must give in to the other. Either the workers must understand this and agree to stabilisation, or harassed governments will be tempted either to answer further wage demands with some deflation, or to follow in the footsteps of Hitler and of Stalin in controlling wages from above. To reach agreement demands a revolution not only in left wing tactics, but also in the structure of the movement; but to fail to achieve agreement means, we can be sure, revolutions no more difficult, and very much less pleasant for the working classes.

CONCLUSION

These conclusions may be summarised as follows.

(1) The aim of monetary policy should be to have the right quantity of money in circulation, not too much and not too little. Less than full employment is an unnecessary evil; and so is inflation, whether open or suppressed by price controls.

(2) The best technique is to offset tendencies to fluctuation by adjusting the level of taxation; this may also be supplemented by timing some public works appropriately.

(3) Estimates of profits, records of bankruptcies and the unemployment percentage are the thermometers of monetary policy.

(4) The wage level should be kept relatively stable; and the structure of trade union bargaining should be adapted to this purpose.