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THE NATURE OF INFLATION

INTRODUCTION

Everyman's Dictionary of Economics (*pub. J. M. Dent & Sons Ltd.* 1975) p.185 defines inflation as 'a fall in the value of money due to a persistent expansion in its quantity. When total monetary demand exceeds the value of goods and services currently available for sale.' *The Oxford English Dictionary* defines inflation as 'Econ: general increase in prices and fall in the purchasing value of money b. an increase in available currency regarded as causing this.' Or, more briefly in other words, that well-worn definition with which most of us are familiar, 'too much money chasing too few goods'. We have then to decide why this is so and what makes it undesirable.

If money's intrinsic use is as a convenient means of exchange, how is its value measured? Implied is that it accurately reflects the value of production. If it does not no one is going to receive the full value of his or her production in exchange for it. Whose responsibility is it to maintain the integrity and value of this universal means of exchange? Historically it has been, and still is, the government's responsibility to maintain the value of the currency and its measure of the country's wealth. Any devaluation of the currency so that it no longer accurately reflects production is regarded as inflation.

There is an understanding that the government is responsible for the natural equilibrium of the amount of money in circulation and its relationship to and reflection of total production. If indeed the monetary unit is a stable measure of total production which is what it should be by its nature, this includes material goods of all sorts, including intellectual commodities such as new inventions for instance and all other 'invisible' services such as banking, insurance, legal, educational and medical services.

All these constitute the wealth of any nation and the cost of each individual good or service is decided in the market place by the natural means of the supply of all of these and the demand for them. This is established by the maintenance of their natural value being represented by a steady state of the monetary unit which is the prerogative and responsibility of the government. If not, who else, or what other agency should have this responsibility? This 'steady state' is also to include of course the natural fluctuations of supply and demand of everything in the market.

So, any devaluation of the monetary unit, as anyone who shops for anything will know, will mean more has to be paid for the purchase of any item. This is inflation caused by the monetary unit losing its true function as the measure of any part or item of production. Price fluctuations may also of course be due to the natural rise and fall in the supply and demand of any item of production, material or intellectual. Supply and demand must continually fluctuate simply as a result of less or more production and less or more purchases for whatever cause and this, the main market in everything, will of course affect market prices.

So, how is the currency devalued? If it is the responsibility of government to maintain its value, does it follow that only government can effect any devaluation? In so far as government is responsible for printing money this would appear to be so. But there are rogue producers of money which might adversely affect it.

BAD MONEY

Henry VIII had a unique way of devaluing the currency by arranging to have the coinage shaved when gold was the legal currency and gold had its intrinsic value. He had the shavings melted down and made new money this way. Supposedly the Royal Mint did this for him. This would be 'bad money' and would mean all citizens had to pay more for all goods and services because the natural relationship between the currency and production had been interfered with.

So how else is bad money created?

For instance, if government issues more money than the delicate balance of the market requires. Government itself begins to use money as a commodity by issuing bonds, loans or any other instrument which pays interest. *The Everyman's Dictionary of Economics* gives the definition of this word 'interest' as 'the price paid for loanable funds'. However grand this sounds, this is treating the all important means of exchange, money, as a commodity. But it is nevertheless a way of devaluing it and reducing what can be bought with it. To keep this equilibrium, production will have to keep up with every devaluation.

This action by government opens the floodgates for banks, investors and lenders of all sorts to offer loans and to create their own interest rate for the service. This is perceived by most of society as a perfectly legal and moral business. What is not appreciated is that interest for whatever function (and the rate can vary as much as the lending market allows) at the same time is a devaluation of the currency and, it is suggested, the most pernicious and damaging practice by which any community suffers. It is an instrument only to the advantage of the lender and not borrowers. The only control available is the ebb and flow of the interest market itself, i.e., the competition between lenders. The rate has been very low for some years, presumably it is perceived by the interest-imposing market as due to the natural supply and demand for its provision. This is not to say however that money itself cannot be used as a commodity. Clearly, it can, but it seems to mean benefiting a small part of the community at the cost of the natural rewards of the bulk of the community.

Unfortunately if a very gentle rise in the devaluation of the currency is accepted as the norm, it implies that inflation is a natural and legal process. It is also a way of hiding a gentle or violent rise in the devaluation of the currency.

TAXATION AND INFLATION

Taxation, another tool and responsibility of government, may also encourage or discourage any kind of production. For instance, taxation on employment (NHI and income tax) discourage those two factors, i.e., employment and income. Any tax on production either directly or indirectly such as VAT actively discourages production. So, do not all taxes have this deleterious effect? Such taxes can be lifted or abolished of course but how else is necessary revenue for defence, peacekeeping and essential social services to be raised?

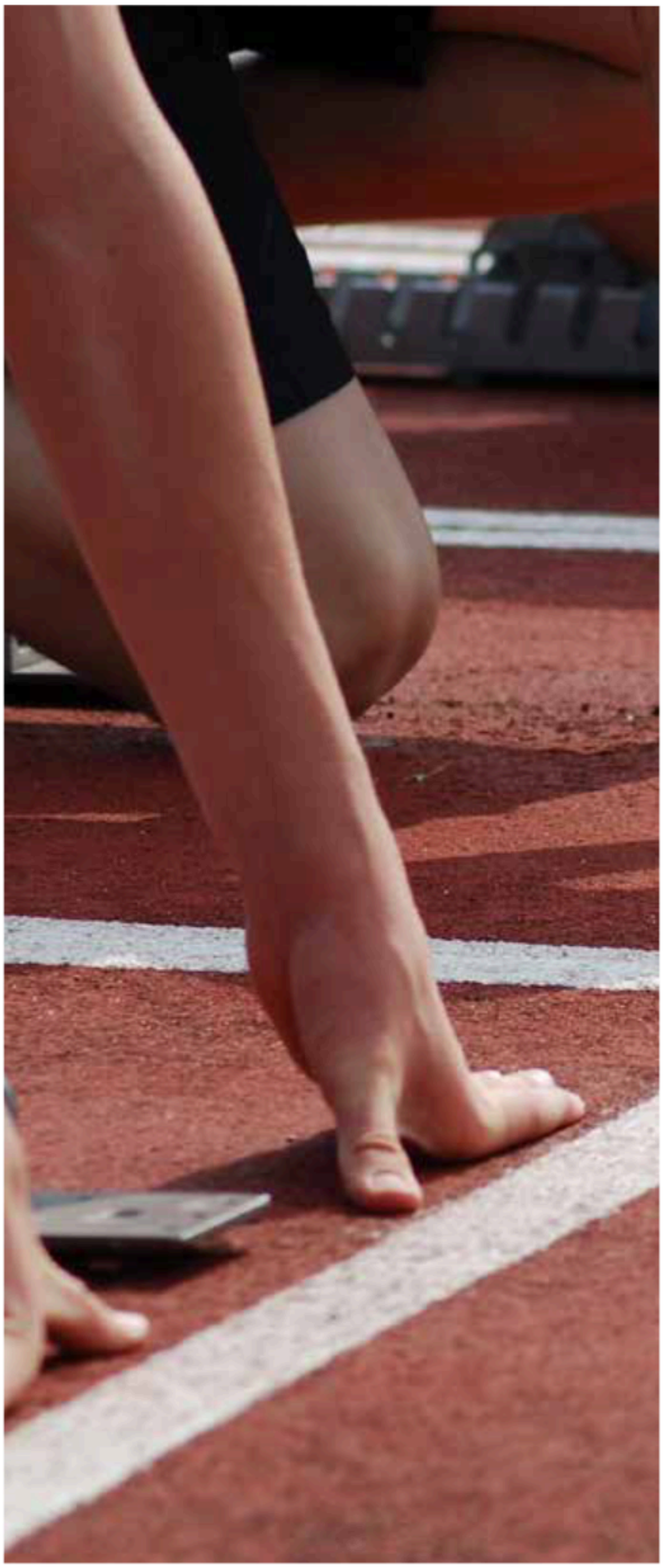
What then is the remedy for inflation if it is completely out of control? Suggested is that governments should stimulate all round production in any legal way at its disposal. This will enable the difference between the value of all new production to gradually catch up with the value of the inflated currency unit. Is there a tax/revenue which encourages production, or at least does not discourage it? Can there be any good reason why production should not be encouraged?

Is it clear then that the creation of inflation in a community is not the same as a rise or fall in the price of anything, either of which may be due to a rise or fall in production or concomitant changes in the demand for any commodity or service. It is not therefore caused either by a rise in wages which will reflect a healthy growing market. The market in wages is a natural response to the demand or lack of it for any of the goods or services available in any society. Whilst both inflation and the natural performance of the market in all infrastructural and goods and services in the community affects prices, the causes of the rise and fall in the goods and services market is different from any rises in price caused by devaluation of the currency.

Unfortunately the man in the street cannot appreciate two different reasons for the increase in prices. And how could he, since it is so unacknowledged and well hidden. One is natural, the ebb and flow of the market in all goods and services, and the other imposed by the adulteration and manipulation of the value of the monetary unit by governments, the interest market and negative effects of taxation. If we acknowledge that all the aforementioned goods and services are the most important thing to mankind, a shortage should be addressed by any government into introducing as many incentives it can to promote economic recovery or, in the case of services, such as water, an adequate flow.

If production can be encouraged or discouraged by government monetary and fiscal policies, it is surely incumbent upon government to identify and apply those policies best suited to such growth.

One of these would be to legislate for a living wage for all those not in receipt of such a wage already. Adequate wages are not only the natural outcome of production but they encourage production because people spend them. In particular adequate reward for any work is lawful but it keeps most people happy as well as productive. Well paid people are happy people and happy to work. Most people like being independent and able to pay their way and this is surely the natural order of any



human community. Adequate wages which enable everyone to pay for all their certainly essential goods and services is not a bonus from some to others, but a natural recompense for every person's work.

So that all may realise their own abilities and naturally make a useful contribution to the whole wealth of society, a standard of education which fits everyone for some sort of employment seems to be very necessary for a naturally well-functioning society. If education is inadequate poverty, illness and crime is encouraged and most people become dependent on the rest of society for their existence. This is - of course - a most unhealthy condition for all individuals as well as the whole community.

Unemployment is also a drag on any society which wants to be prosperous. Any snobbish ideas about the inferiority of any section of the community are damaging and due to a misunderstanding of the causes of poverty. A good education system is paramount and benefits everyone.

A MONETARY PHENOMENON?

Inflation has been described elsewhere as 'a monetary phenomenon' and by implication there is an opinion that such a phenomenon can only be dealt with by monetary or fiscal means. Initiation and creation of inflation is at government level and there is a general lack of acceptance that this is so. If inflation is caused by too much money chasing insufficient production, it follows that as well as stimulation of production the exactly correct fiscal remedies need to be carefully scrutinised to effect a return to the natural equilibrium which exists between the organically healthy balance where the amount of money in circulation accurately represents the value and quantity of production. The natural flow of production might therefore be free to function without any stay on its progress. A natural rate of wages would also be another effect and those with such a wage would be able to look after their own living expenses without the need for any assistance or subsidisation from government.

CONCLUSION

Since there is no money without production it behoves government to carefully stimulate production in all fields either by not using money as a commodity and making more money out of it, or by carefully considered taxation. However, the main purpose of this piece is to highlight the difference between inflation which is caused by devaluing the currency by using it as a commodity - and the fluctuation of prices caused solely by the natural ebb and flow of the market for all goods, material and otherwise. Both of these activities can and do combine to affect prices and get erroneously called 'inflation' by the media.