INFLATION: MONEY, GOLD AND MARX

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It is now widely acknowledged, even in the citadels of the left, that Milton Friedman is an expert salesman of the 'monetarist' diagnosis of inflation. A tour of Australia, stage managed by the stockbrokers, Constable & Bain, was repaid with a brilliantly successful Monday conference which made a very deep impression on australian politicians. Perhaps less predictably, the basic 'line' was seized on by a panic stricken federal treasurer in the notorious 'Hayden budget' — arguably the most violently anti worker budget since Menzies. This was monetarism's first victory: the 'public sector borrowing requirement' and the supply of money came to dominate fiscal thinking around the time of Hayden's capitulation to treasury and the sinister 'CERC' recommendations which slashed into all of Labor's cherished priorities.

What is not so well known about Friedman is that since the australian triumph, his bandwagon has ceased to roll. Indeed, on 2 may, in a letter to the London Times he made damaging concessions to Nicholas Kaldor's savage neo keynesian criticisms of his whole theoretical structure. In admitting that the course of inflation could be influenced by 'the potential for real economic growth, the state of expectations, the exchange rate regime and the course of prices in the rest of the world', he seemed to leave little of the 'simple powerful model' that swept through those ALP politicians 'with training in economics'. What all those excited young turks from Michael Parkin's Manchester school and rising young professors trained in Chicago and the International Monetary Fund have now to face up to is that their human capital has been invested in a house of straw. No longer can economic policy debates — and, hopefully Lynch's budget speeches — be dominated by a cretinous over emphasis on money supply 'causing' anything.

In order to see this point it is necessary to hark back to three issues at the core of the dispute between monetarists and their opponents: the 'crowding out' theory of Friedman; the problem of the 'causation' alleged to exist between money supply and the price level; and the role of non monetary factors making for inflation.

The earliest and crudest version of the 'crowding out thesis' — the idea that the growth of the public sector chokes off the life blood of the private sector or gives it no room to breathe — emerged from the bowels of the british treasury in 1925. In particular, it was argued that a rise in government spending could only be achieved to the extent that it deprived private investors of an equivalent supply of finance. This would happen if, to finance the budget deficit, the government sold bonds to the public, thereby effecting a transfer of cash from private savers to the government.

This 'treasury view', as it came to be known, was thoroughly refuted by Keynes in an article, Inflation and deflation written in 1930 (and republished in

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his Essays in persuasion). Keynes showed that such 'crowding out' would occur even with a new private sector project on the absurd assumptions being made by the 'treasury view' — that there is a fixed savings fund: that no idle savings and credit balances could be mobilised by new activity, and that nothing resembling a 'multiplier' existed. Under such conditions any new investment would 'crowd' the private sector. All of this was possible on silly assumptions, but the final picture was unreal. Savings will not be 'fixed' if the government borrows from the Bank of England. New investment will mobilise idle credit. For the monetarists of 1925, on the contrary, increasing unemployment was the inevitable result of expanded public activity because of the 'inroads' made into the private sector. At the hands of a modern friedmanite, government deficit expenditure becomes the cause of stagflation: the stagnation and unemployment come from crowding out; the inflation from government finances which involves printing money or borrowing from the Bank of England.

At the height of the friedmanite frenzy in Australia, I wrote a number of published letters in the press drawing attention to the counter argument of Keynes. All I got in reply were flat assertions that Keynes was 'out of date'. David Vines, now a fellow of Pembroke college, Cambridge, did likewise. What he got for his pains was a summons to the Reserve bank's research department to explain himself and a three hour dressing down from the enthusiastic friedmanites who have taken over that section of our economic intelligence service. (One has since left to take a chair at the university of NSW.)

Since that time, a new and slightly more sophisticated version of 'crowding out' has been cooked up by the monetarists and has seen the light. According to this, 'crowding out' can occur in the presence of substantial under utilisation of industrial capacity, in which case fiscal intervention will not be useful in expanding job opportunities. Again, however, this result is only obtained by treating the 'public sector borrowing requirement' as being wholly met from private capital markets. If, on the contrary, some of the budget deficit is financed by the issue of new money, the 'pressure' will be that much less. More important, by issuing new money and injecting it into circulation, the government will be able to finance a higher level of its own expenditure without at the same time depriving the private sector of the available supply of loanable funds for investment.

So far I have discussed the stagnationist' aspect of modern monetarists doctrine. There is a connection between stagnation via crowding out and 'inflation' in monetarist theory. For what the government is seen to be doing is attempting to maintain a low level of unemployment, a level below what Friedman calls the 'natural rate of unemployment', which the economy spontaneously produces.

In Friedman's scenario budget deficits are all inflationary, since they push the economy beyond its equilibrium point. To get the economy back to a 'natural' employment rate, say the monetarists, you have to stop 'printing money' to cover budget deficits, and concentrate on borrowing from the private sector. But in turn, this will lead to 'crowding out' and stagnation. So why not avoid all this bother by letting the level of unemployment rise to its 'natural level' — a level consistent with true stability?

To assess this amazing return to pre keynesian thought, it is necessary to look at the other side of the monetarists coin: their explanation of inflation through a quantity theory of money.

The quantity theory of money is based on the more general theory of supply and demand — the psychology and language of a society of traders and 'lovers of baubles' (Adam Smith). It treats money as a commodity open to exchange with other commodities, and after a number of reasoning steps and comparisons of money supply and the general level of prices, arrives at the very firm conclusion that excess money supply is always the only cause of inflation. From this it follows, for most friedmanites, that control of the money supply is by itself sufficient to curb inflation.

A favorite 'case study' is the comparison of Germany and the UK. It is shown that until 1972 and the Barber budget, the two countries had a similar monetary restraint policy, with identical effects on exchange rates and balance of payments surpluses. After Barber, the UK adopts an easy money policy and gets inflation; Germany plugs on doggedly with 'sound finance'. The implacable conclusion follows: money supply and money supply alone explains the UK's inflationary ills and Germany's lack of them.

No account is given here of the different mood of the working class: Germany had a policy of a smaller number of unions, 'worker participation' schemes and illegal strikes imposed on it by Ernest Bevin's Central Commission in war ravaged 1945. Moreover, rapid wage rises started to explode in Britain about 1968, <u>before</u> the import price rises, and in a period of 'tight money'. They cannot be wholly disregarded in any story of post-1972 inflation.

For a long time, many people believed that Friedman had established his case empirically. That is, they believed with William Rees-Mogg (<u>Times</u>, 13 july 1976) that there is a 'law' discovered by Friedman (and confirmed by that author as 'his' law in the <u>Times</u>, 23 august 1976) that <u>the percentage rise in the retail price index will be equal to the percentage rise in the money supply (less any growth in real output) which had occurred two years previously</u>. The editor of the <u>Times</u> even tried to prove (7 april 1977) that the correlation of money supply and inflation in individual years in the 1970s has been closer than it was during the 1960s.

Since then, the 'empirical causation' thesis has been exploded by the critics. Norman R. Blackwell (<u>Times</u>, 7 april 1977) showed that a very similar degree of correlation existed between percentage changes in basic wage rates and lagged inflation rates as pertained to money supply and the price level. Martin R. Weale (<u>Times</u>, 7 april 1977) pointed out that for the UK 1965-1973, there are five out of eight possible cases in which the change in the rate of growth of the money supply was in the opposite direction to the change in the inflation rate. Conceding as much to the monetarist case as he could, he was only able to conclude from statistical correlation that a 1.0 percent change in the money stock tends to occur with a change in the rate of inflation of 0.34 percent two years later. But he added the ominous rider that there is a good chance, between one in four and one in ten, that the change in the rate of inflation is zero.

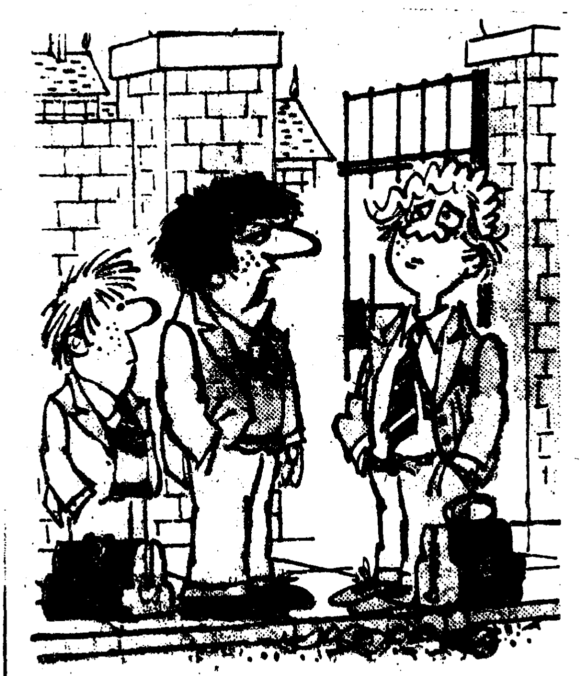
Most damaging of all, however, was a 'spoof' correlation scientifically as well based as Friedman's, by G. Llewellyn of Cambridge university (<u>Times</u>, 6 april 1977). This proved, by the friedmanite method, that the correlation coefficient between cases of dysentery in Scotland and the increase in the price level one year later was just as statistically significant as that relating the rate of inflation to the rate of change of 'excess' money supply two years before.

All of this seemed to point to a distinct possibility: that non monetary factors play a role in setting the <u>possibility</u> of inflation and the degree of its acceleration. Moreover, Kaldor (<u>Times</u>, 6 april 1977) raised a point that James Steuart made against Hume in the 18th century, that Bosanquet made against Ricardo and that Fullarton made against Overstone last century. This is that the causal direction of monetarism is wrong: it is the demands of trade and the price of traded goods that causes the money supply to vary. As Kaldor put it, Friedman's 'monumental' <u>Monetary history of the United States</u> nowhere 'proves the view that a supply of paper money in the United States since 1867 was exogenously determined and did not vary in response to the needs of trade'.

It is hardly surprising that after some initial blustering earlier in <u>Lloyds' bank review</u> (october 1970), now, Friedman has made damaging concessions to the critics (<u>Times</u>, 2 may 1977), who have not been slow to finish him off.

Summarising briefly, Kaldor was able to get an admission that Friedman's statistical evidence was not inconsistent with the hypothesis that non monetary factors making for inflation are partly responsible for increases in the money supply rather than the other way around. Amongst those conceded by Friedman was 'the course of prices in the rest of the world'. This was very much grist to the Cambridge mill. For the Cambridge Economic Policy group (Godley, Cripps, Tarling and Wilkinson) have long emphasised the 'leap frogging' of rising import prices and wages via 'threshold agreements' — what australians call indexation. On this view, 'outside shocks' plus partial wage indexation will be enough to set off cost push inflation.

To the extent that the effect of all this is to reduce the share of profits in national income, a common basis exists between a Cambridge and a marxist analysis. The latter would see inflation as a 'repressed crisis' in which contradictions accumulate and the fall in the rate of profit is held off partly by inflation. Another bit of common ground is that the refusal of british workers, until recently, to accept the real wage cuts needed to maintain the share of profits in face of a massive transfer of real resources to oil producers, was certainly a factor in raising prices.



"Will you be staying on at school or going straight into redundancy . . . ?"

It is perhaps not necessary here to put the last nail in the monetarist coffin, but Tarling and Wilkinson do it in the <u>Times</u> (9 may 1977). They show that the relevant correlation is not the one Friedman suggests at all, but the technical procedure should be 'that in the regression equation linking prices to the money supply, the sum of coefficients on money supply growth should be insignificantly different from unity and the constant should be negative'. Adapting this rule for UK 1960-73, they found first that the constant was significantly positive, implying that a zero growth in the money supply would be accompanied by a positive rate of inflation. They also concluded that the sum of the other coefficients was significantly less than unity, implying that changes in the inflation rate would be far smaller than those in the rate of growth of the money supply.

The task before anyone concerned with inflation as the present form that the capitalist crisis is taking, is to look at the role of class struggle and the role of the state as well as the political implications of 'the rupture of social equilibrium' achieved in the post-war period and its link to inflation. It is also to ask the all important question: at what point does the state decide that the dangers of hyperinflation are beginning to outweigh the dangers of dole queues and then deliberately decide to end 'inflation' by provoking a crisis?

At first sight it might appear that marxian economics has completely vacated the field, when it comes to inflation, to the keynesian and monetarist theories. The appearance of a remarkable article on inflation by the Cambridge marxist Bob Rowthorn in a forthcoming issue of the <u>Cambridge journal of economics</u> underlines the relative scarcity elsewhere of solid marxist research in this area.

This impression is reinforced when one recalls:

that Marx himself dealt largely with an economic model governed by convertible (gold) currency, which seems a million miles away from today's monetary institutionsm and that the most recent, substantial work by a Marxist economist, Ernest Mandel's Late capitalism, is distinctively 'monetarist' in many of its aspects.

This overall impression is misleading. There is, in both Marx's own work and that of Hilferding, Sweezy and other of his followers, an implicit role for inflation. It is possible to extend this to account for the present situation in most western countries.

In order to see this role, it is necessary to picture the modern state tolerating and/or producing similar economic results to those achieved by gold in the last century, and to see inflation as merely one form in which the crisis of unplanned production expresses itself.

Marx began by criticising David Hume for saying that the laws of circulation of money govern the laws of circulation of commodities and their prices. For Hume, one compares a pile of gold and a pile of money prices. Marx agreed with James Steuart that the actual causation is the other way around: money supply cannot be thrown indefinitely into circulation if people do not accept or need extra money.

Marx goes on to show that gold exercises a discipline on the price level. Gold enters the picture as a commodity produced under certain cost conditions, and all other commodities have money prices which relate to the value of gold. While there are certain gaps in Marx's analysis — notably no theory of why people hoard and how much they hoard — he does succeed in showing that in a convertible currency system, gold stops hyperinflation automatically and it also prevents monopoly profit inflation: the capitalists cannot just bump up their prices.

If gold does spontaneously exercise reasonable longterm restraint on the price level, then Marx is able to present a theory of crisis in which bargains — real wage rate: the rate of profit etc — can be expressed in 'real' terms. Then the familiar marxian theory of crisis arising from a falling rate of profit can also be presented. Moreover, conflict which presses on the rate of profit will tend to cause another kind of inflation, arising from price increases made by corporations to maintain their rates of profit. Having eliminated the 'pure monetarist' case by allowing gold to maintain reasonable price stability over the cycle, Marx allows us to look for the causes of inflation in pressures on the rate of profit and — as early as chapter 3 of Capital — in the mechanisms of state finance.

Among the claimants on the mass of industrial profits ('surplus value') are: 'fictitious' capital; the state; the working class; primary producers; the middle class. Where these claims conflict, the last four will make desperate attempts to shift the burdens on to each other and will promote inflation in so doing. Thus, capitalists can pay a negative interest rate to savers by inflation; or the state can finance its needs from a disguised tax on those who hold money balances by tolerating or encouraging inflation. These kinds of unrequited transfers of real resources, and the general importance of competitive claims, are analysed by Rowthorn in the article already referred to. In it he is trying to bring Marx up to date and show that a 'conflict of claims' perspective is necessary to supplement an analysis of lax state financing procedures. Even if these are not the cause of inflation, they are inextricably bound up with the possibility and origins of inflation.

As for 'fictitious capital', Marx himself paid quite a lot of attention to its role in accentuating crisis in the third volume of Capital. This is the reference to the creation, by the state, by the mortgage market etc, of paper claims to future wealth, not backed by real production. The existence of a growing number of bits of 'fictitious' capital, all with a claim on the share of profit, will contribute to a fall in the profit rate. The result will either be the familiar output, capacity and employment collapse or the promotion of inflation to allow the claims to be met in that way.

Here we come to what must be a major element in any socialist theory of inflation. Inflation is one way of delaying the output-employment crisis, which is rooted in a falling rate of profit. It is a dangerous device, for it blocks a very crucial function of the crisis — its role in cleansing out the system and producing a more efficient capitalism at a higher level of technique, once the agony of unemployment, closure of marginal firms and scrapping of old technology has been gone through. In another context, Nicos Poulantzas gives an apt description of this process: 'Capitalist crises play the role of a purge of capitalism and are in fact the very conditions of its extended reproduction and perpetuation.' Moreover they are 'orchestrated from above by the state itself' (Classes in contemporary capitalism).

To a certain extent the state can be a surrogate for the crisis in this purging operation. Whitlam thought he could try that: and it has been a consistent dream of social democrats from Ramsay MacDonald to Olaf Palme that they might one day directly restructure capital and labor. All Whitlam's 'swedish manpower schemes', his proliferation of committees on tariffs, research and development, small business and so on, were supposed to overcome physical shortages, knock out backward firms, transfer resources to the more productive sectors and introduce new technology. In other words, they were supposed to hold up the inexorable effect of a rise in the capital-to-labor ratio on the rate of profit. When they failed, he let inflation do the job.

Yet this is a capitalist state we are talking about: it can delay the crisis for a while, it can 'hold up' the rate of profit by various devices, but in the end the accumulated contradictions must find an outlet; the boil must be lanced. In other words, 'direct restructuring' and inflation will both be abandoned once certain political and economic limits are reached. Of these, the political dimension is crucial. The state does not, in the end, 'deal with inflation' for purely economic reasons. Ernest Mandel is, I think, wrong in arguing that the renunciation of inflation has been due to fear of the collapse of the international credit system. The political motive is the key.

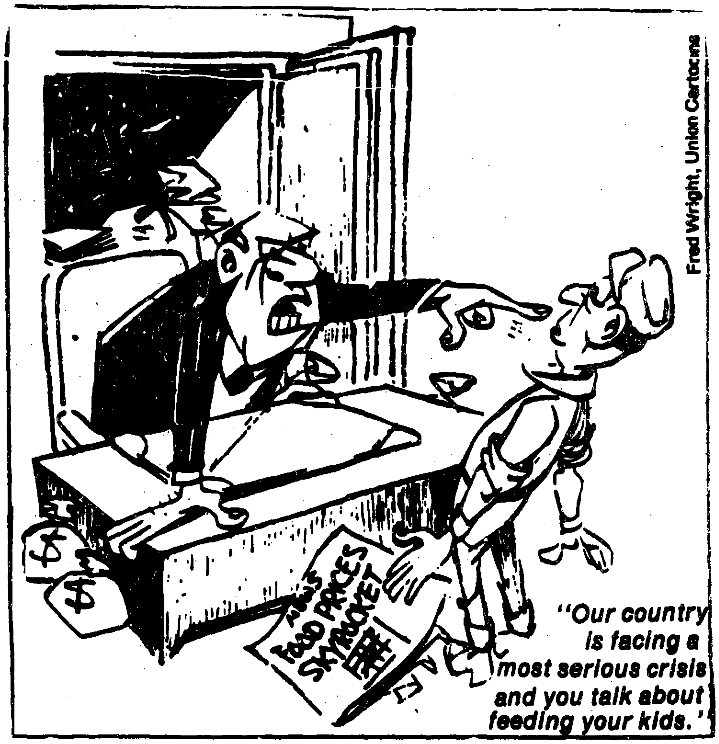
Whitlam found this. A study of his economic policy between 1974 and 76 would show that fear of political backlash, as taxpayers money illusion was shattered, the growls of the stock exchange and the banks, the fear of growing working-class successes in redistribution of income, all led to the abandonment of the alternative economic armory that he had sought in the days when the treasury was still regarded as part of the 'enemy camp'.

A very important political motive for puncturing the inflation boom is the fear of the left and right on the part of modern western governments. Such british monetarists as Peter Jay and Sam Brittan are surely right when they warn that hyperinflation will lead at least to a middle class rightwing revolt, and possibly to bolshevism.

Enrico Berlinguer, the italian communist party secretary, expressed the same idea when he admitted that the present crisis in Italy is partly a result of a class stalemate — the refusal of italian workers to return to the status quo that existed before 1969, a year that marked a rupture of the old social equilibrium. When Robert Moss and other extreme monetarists describe the inevitable left and right backlash that must develop as inflation accelerates, they are describing a part of the reality: middleclass riots could take place if the social equilibrium is drastically altered by inflation and trade union power.

Here we have one important reason why governments finally bring to an end the very inflation they have permitted or encouraged. The economic limits on the other hand are those that Rowthorn talks about in his conflict model of inflation: the inability of the system to contain a continuing process by which each group shifts the burden of inflation on to another group.

We had a taste of this kind of limit in Australia during the inflationary boom induced by the korean war. In that period there was an export boom. The terms of trade for wool and wheat turned sharply in favor of australian primary producers. At first no offsetting action was taken by the government; inflation accelerated. The economy, as it were, moved along the 'Philips curve' in the technical jargon of economists. Eventually the government moved to stop the spending spree of the graziers by raising taxes, blocked funds, and 'stabilisation levies'. The question posed at that time, given the presence of the Country party, was whether the primary producers would accept this, and whether the private sector generally would absorb higher income tax. If they had not done so, a spiral of compensatory wage and price increases would have continued and the already existing high level of inflation, more than 20 percent annual rate, would have spilled over into hyperinflation.



In the event, higher taxes were accepted and dampened down demand. As a quid pro quo, the capitalists got the 1953 arbitration decision to freeze wages and abandon quarterly cost of living adjustments. The metalworkers got the bludgeon of the Galvin award in 1954 to complete the package. The slide along the Philips curve was brought to a halt.

The question of whether the various claimants on industrial profits will accept both the offsetting action taken by government and the need to forgo their 'burden shifting' efforts, will be quite crucial to the course of inflation, as Rowthorn points out.

Summing up our alternative approach to inflation so far: the conditions for inflation are in efforts to hold up the rate of private profit; in lax state financing; and in how conflicts between claimants on the mass of surplus value are resolved. The state comes under strong political pressure to provoke an end to inflation when it perceives that the dangers of hyperinflation to the social fabric and its own survival outweigh the dangers of an output-capacity employment slump. In this way, the state 'mimics' the disciplinary role that gold performed, as described by Marx. The essence of a more modern marxist approach is to start from this perspective: that once gold's discipline over the price level is removed, the state can and does permit or encourage inflation, even if accumulated contradictions are certain to break out later.

How well does such an analysis explain postwar inflationary experience? It certainly does not entirely explain it. But then, neither do the rival keynesian or monetarist schemes. The left keynesians have no real explanation of the dynamic possibility of accelerating inflation. The only one to attempt one was Michal Kalecki in his Model of hyperinflation (Manchester school journal, 1962). The limitations of the friedmanite school have already been explored.

What can be brought into the story of postwar inflation by a marxist perspective is that after the easy profit postwar boom there followed a lot of pressure on the share of profit in national income. Partly this was the rising taxation to pay for the welfare state, a process in which the capitalist class could not wholly escape the net. There was also strong pressure from the growing ability of the working class to 'eat into profits' and to extend and improve the welfare state. Here, at least, Milton Friedman's 'correlations' have a base in political reality. In some countries like England, Germany and Australia, but not Italy, France or the US, the exhaustion of the industrial reserve army of labor led to wage drift and cut into profits.

Inflation was allowed in order to check these pressures, because profits are easier when prices are rising. A decisive switch to accelerating inflation occurred, however, in the 70s when a transfer to resources to third world primary producers took place. This ended the process of 'cheapening the elements of constant capital', to use Marx's term, or holding up the profit rate by obtaining cheap inputs of raw materials and energy. Once this development bit into the share of profits the alternatives were either to allow the transfer to the third world to take place by real wage reductions in the west, or to raise western manufacturing prices across the board.

At first, workers in the UK, France and Australia resisted this, so the balance of payments deteriorated and prices rose. Later, the cuts in real wages were more and more imposed on them as the 'industrial reserve army of labor' was allowed to grow and weaken trade union bargaining power. In the UK today real average earnings after tax per week are 2.5 percent lower than they were in 1975, and they are expected to fall further. As real wages are forced down, the real profit rate is held up; inflation moderates, the line is held with the 'social equilibrium'.

That is what Fraser is after. Once again, it is the capitalist class who are the realists. 'Leave our surplus value alone or you will get inflation', they cry.

Viewed in this perspective, Friedman's monetarism was a false start even for its enthusiastic admirers — the Jays, Brittans and Flemings; only some academic economists stand to gain by sticking with it any longer. Instead, we have the not very surprising conclusion that marxists and capitalists both — opposite sides of the same coin — have come to a similar conclusion about inflation as part of capitalist reality.

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