INFLATION

by

The Rt. Hon. J. Enoch Powell, M.B.E., M.P.

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FOREWORD

The address to the Economic Research Council by Mr. Enoch Powell on February 23rd is of particular interest because he makes the point that most people who are informed about economics now agree with the case which has been argued for so many years by members of the ERC —that the primary cause of Inflation is the increase in the Money Supply brought about whenever the Governments overspends its income from Taxes and genuine Borrowing.

Mr. Enoch Powell declares that the time has now come to pay more attention to the reasons why the Government overspends its income. In particular he points out that in recent years the Government has predicted increases in the Gross National Product and then budgeted to spend more in anticipation of the expected increase in revenue from taxation.

However, official forecasts of increases in the Gross National Product have proved so unrealistic that they appear to have been chosen simply to justify the extra expenditure planned by the Government.

Another equally unconvincing excuse for Government overspending is that it has been necessary in order to combat Unemployment.

We hope that the arguments which are so lucidly presented by Mr. Powell in this address will encourage more critical examination of the explanations given by the Government for persistent overspending.

PATRICK de LASZLO,
Chairman,
Economic Research Council.

April, 1973.

INFLATION

There has been a certain classic quality about the way in which the present inflation was produced, as well as about the manner in which all parties in politics have reacted to it. The decision of 1971-72 to produce inflation was much more extrovert, much more openly taken, much more candidly described than any of the previous deliberate inflations which had preceded it. After all, in the winter of 1971-72, when it started, inflation was proceeding at a good steady 5% to 7% per annum. Against that background the Government announced that they intended to "reflate", which could only mean that, dissatisfied with the 5%-7%, they intended to speed inflation up.

Having announced this intention, they took exactly the correct measures for the purpose, as though a simple experiment were being conducted for the instruction of an elementary economics class. They set about increasing the level and incline of government expenditure (which they did with great success), and they set about reducing the revenue of government (which also they did with great success). They could claim that both on the expenditure side upwards and the revenue side downwards they had broken all recent records. This implied acceptance, presumably, of that theory which some of us have vainly attempted to propagate in years gone by—that an increase in the money supply arising from the financing of a government deficit is the ultimate, sole and sufficient cause of inflation; and if the Government had set out to prove that, they could not have acted with more determination.

And yet one wonders; for when the predictable consequences, which might seem to be aimed at all along, duly arrived, there was a slight tremor of surprise if not of regret and indignation. It appeared after *all* **not** *to have been the Government's intention that the rate of inflation* should be raised from 5% or so to 10% or so. So, in the summer of 1972 we were able to observe what has come to be the classic reaction of governments and politicians to the inflation which they have created—that is, to attribute it to the agency of others, and casting off the scales of the dragon to put on the armour of St. George. "Fighting inflation" was now the role of government, while those who were accused of having organised it comprised, broadly speaking, every section of the community except those who were actually guilty—the Government themselves.

PRICES-AND-INCOMES POLICY

With minor variations, the operation took the well-worn form of our old friend, prices-and-incomes policy. Some of us have worn ourselves hoarse, exhausted all possible metaphors, and used every demonstration from back to front and then from front to back, until we really have *nothing novel to offer by way of a refutation of prices-and-incomes* policy. It would therefore be boring if I were tonight to insert more than the briefest summary of the unrefuted and irrefutable explanations why the policy of preventing inflation by seeking to control individual prices and wages is foredoomed to failure.

By way of summary and refreshment of the memory I say only this much. First, in order to control prices or dictate prices, for whatever purpose, you must know what individual prices ought to be. Since prices move not only up or down together, but also in relation to one another, the policy and aspiration of dealing with inflation by dictating individual prices presupposes that you know not only what general movement of prices you wish to secure, but also how individual prices ought to change in relation to other individual prices. That, after all, is the one useful function of a price—that it varies in relation to other prices. So, if you get that variation wrong, you are bound to get everything else wrong.

Of course, looking back after the event upon a period of x% inflation, it is possible and indeed easy to deduct x from all the price changes and conclude that the residue represents the real price changes, that is, the variations of one price as compared with another. The trouble is that before the event no human agency can possibly predict or define what those all-important variations must be. So from the point of view of practicability, prices-and-incomes policy involves an impossible task. This is why the early stages are always so much better elaborated than the later ones, because the early stages are always a freeze. So long as there is a freeze, the problem does not arise; for if the change in all prices is to be zero, there is no difficulty for the time being in stating what prices ought to be. Stage II, which I hold in my hand in a green cover, as available this afternoon in the Vote Office, offers no solution to the problem how prices ought to move in relation to one another; for Stage II is also a freeze, differing from Stage I only in being a freeze at £1 plus 4% instead of a freeze at 0%. So today's Green Paper still answers not a whit the question which all prices-and-incomes policy presupposes to be answerable—namely, how the wisest of boards and the most profound of commissions shall know the right variation of each wage and price in relation to every other, so as to be able to assign them their proper values when eventually, in Stage III, that variation becomes not merely permissible but necessary.

So there is the argument of impracticability. On the other hand, there is the argument of irrelevance. If the total of money demand increases generally faster than the total of output, then no power available to man, whether backed by machine guns or by patronage—I am not sure which acts more powerfully upon man's emotions—can prevent inflation. The attempt to hold down prices or wages here will only have the effect that prices and wages rise all the more elsewhere. Either total money demand is marching in line with production (in which case there cannot be inflation and therefore a policy to prevent it is superfluous), or alternatively, it is marching ahead (in which case no attempt at direct control can be successful). Sure enough, that has been the story in each successive phase of this attempt which we have witnessed since the War.

BUILT-IN PARADOXES

I want this evening, however, to draw your attention, not to what

we know already—namely, the general course which the cycle has always run and will run again. I want to refer you to some built-in paradoxes and to pose this query, if not wholly to answer it. When politicians first of one party, then of the other, have seen their political opponents hang themselves with a prices-and-incomes policy, and when they have not merely watched its refutation but themselves taken part in that refutation from beginning to end, why do they themselves plunge in again with all the freshness and innocence of youth, at the earliest opportunity?

There is a great paradox here, for if you will listen carefully to the voices of Chancellors of the Exchequer, you will hear them assigning the true cause and the true remedy to inflation. Right the way through the speeches of Tony Barber, since he has been Chancellor of the Exchequer, has run like a refrain the proposition that the money supply ought not to be allowed to exceed the rate of real growth of the economy. On other occasions he has varied it by saying that he does not intend to provide more money than is necessary to match the expansion of the economy which he anticipates.

Now this is a pure monetarist statement. It is a statement which, if it is meant and understood, excludes any other explanation of the phenomenon of inflation and is inconsistent with all the rest of the attitudes and policies of the Government to which he belongs. So it was with his predecessors. Money supply used to be called "domestic credit expansion" in those far-off days when M. Pierre-Paul Schweitzer was coming every three months—by the way, I wish he would come again occasionally; one has almost got to miss him—but there was Roy Jenkins, throughout almost the whole of the period of the previous cycle, assigning the true cause and consequently the appropriate cure to inflation, if anybody would listen to him.

No doubt—and this time it was clearer than in previous cycles—the motive of presenting or dealing with a rise in unemployment took a high place in the minds of government. Yet search what they said and what they wrote, and you will find them disclaiming any pseudo-Keynsian merit for inflation. I was fascinated, when I got my copy of the Green Paper, of the Pay Code—by the way, the Pay Code is not binding on you, it is only binding on the Agencies; I just mention that in case you might be misled by the wording in one place or another—to read this about the general principles relating to pay: the general principles are "to limit the rate of increase in pay, etc., so as to progressively to reduce the rate of price inflation **and to improve the prospects of sustained faster growth in real earnings."**

STABLE MONEY

Why, so say I, and so say all of us who believe in and aspire to stable money! So say those of us who year after year have argued that there is no specific connection between inflation and economic growth. Yet here are the Government who say, if you want sustained faster growth, don't go for inflation (which was the method by which they themselves attempted to produce it last year), but go for stable money!

Thus we have, from the Government themselves, the monetarist explanation of the phenomenon of inflation and the repudiation of the myth that inflation is the prime condition for economic growth. The paradox is that the Government reveal that they know what is virtue in the very act of indulging in vice; they repeat with unabated ardour what they themselves have refuted.

Those of us, therefore—and we are a large and growing company—who are convinced that inflation is uniquely the product of government action, the result of government financing of the excess of outgoings over incomings, must not rest content with that conviction. We have to realise that we are confronted with a great challenge; for there must indeed be strong forces at work which, despite all the evidence of repeated experience as well as theory, still draw governments back again and again into the old, false and foredoomed courses. As a professional politician it seems to be my duty not merely to argue, not merely to refute, but to try to understand the motivation behind the error; for if we can understand the motivation, we may be able to strike at the root of this nightmarish repetition.

PREOCCUPATION WITH UNEMPLOYMENT

Perhaps the simplest, and certainly the most obvious, motive in this present cycle was preoccupation with unemployment. I believe that the preoccupation of the Government with unemployment in 1971-72 was excessive both economically and politically. They grossly over-estimated the political blow-back from unemployment; and I say that as one representing a wholly industrial seat in a part of the country which had not experienced any substantial unemployment for a matter of 30 or 40 years, and which then moved rapidly towards the top of the regional unemployment league.

I have to record, what I would not have believed before the event, that not one single political repercussion reached me, as a constituency member, from beginning to end of that phase. No doubt this is connected with those well-explored facts about the statistics of unemployment, which have revealed how fallacious the gross totals are. Nevertheless, even when due discount has been made for those fallacies—and they are very far-reaching, one must admit—still the totals **have** varied upwards and downwards, and they did show a marked and continuing rise in 1971-72, though in its origins that rise went back to the late 60's. The variation, however, was grossly exaggerated by the politicians as to its political effect.

It is one of our characteristics as a profession that our analysis of public reaction tends to be extraordinarily time-lagged. Each generation of politicians seems to live very much upon the mythology of the previous one, and I am sure a most interesting study could be made of the way in which each generation of politicians is influenced in its actions, not by the phenomenon of its own times, but by inherited dogmas based upon the phenomena of the previous generation.

Be that as it may, an over-valuation of the factor of unemployment and an under-valuation of the factor of monetary stability was a

prime cause for starting the new prices-and-incomes cycle, of which we have now reached Phase II. I record it as my own opinion as a practising politician that we still greatly underestimate the public desire for monetary stability and mistake the fact that nearly all incomes are in fact revised in terms of depreciated money as arguing a general acquiescence in the depreciation of money. It appears to me that the anxieties inflation inspires are not banished by what we all know, namely, that, broadly speaking, prices and wages are bound to mirror the progress of inflation. In practice that does not render the instability more tolerable to the great mass of electors. Retrospectively, we can all quote the figures which ought to reassure the pensioner and the rest that their standard of living has not only not diminished but, if anything, advanced. The important thing is that it does not seem like that to them, when they have to live in a world of constantly changing and depreciating money values.

So my first proposition is that there is a grave and gross misappreciation of the factor of unemployment as compared with the factor of inflation.

MANIA OF "GROWTH"

Secondly, I designate as one of the culprits the mania of "growth". This can be traced very graphically through the last decade or so. In the early 1960's, when politicians wanted to talk about a good substantial growth rate, they referred to 3%, which was already higher than Rab Butler's "doubling the standard of living in 25 years". But 3% was obsolete before the Conservative Government went out in 1964; 4% was then the respectable figure, and nobody would have dared to go on to the hustings in 1964 and talk about a steady growth rate of less than 4% per annum. When the Socialists hoisted it to 4¼%, we tuttutted and said, "There you are, you see, inflation will soon be under way under a Socialist administration". But now 5%—5% under the Tories!—is the least anybody aspires to, that anybody would dare mention; and I guarantee that by the next election it will be 6%.

Remember these percentages are compound interest. One can do sums in compound interest. With compound interest at under 3% per annum (which doubles the standard of living every 25 years), the standard of living when a man who attains the normal Psalmist's span of human life dies, will be eight times what it was when he was born. Staggering as it may be to try to conceive what an eightfold increase in the standard of living in a single human lifetime could be, just try with 5% per annum. Our septuagenarian when he dies is then contriving to consume at 25 times the rate he did when he was born! The relevance of this to inflation is that these growth rates provide governments with a figure which renders an alarming increase of public expenditure respectable. The reason why 3% was hoisted to 4% in 1963 was that government expenditure was rising at 4% per annum. It was not thought desirable to curb that projected rate of increase. So a 4% growth rate was devised in order to cover it. Always your governments will overestimate the potentialities of long-term economic growth as a means of justifying the rate of growth of public expenditure which they have no intention of fully meeting by receipts from the public but in practice invariably bridge in part by inflation.

PROPENSITY TO SPEND

So I designate the mania for growth as the second factor which is at work. The third factor is as old as government itself. That is the long-term propensity to spend more, to over-bid one's opponents in spending. We have seen what can be done in this direction in the last 18th months. It is not often that one turns to a report from a Commons expenditure committee to produce the material for an extreme monetarist **exposé** on the causes of inflation—this at any rate is one of the bonuses on this particular cycle—but here is what, under the leadership of the good Sir Harry, the Expenditure Committee reported to the House of Commons last week:

> "According to the figures estimated by our Specialist Adviser, the new public expenditure plans imply that even if the economy expands at the rate of 5 per cent per annum between now and 1974, the rate of growth of personal consumption will have to slow down from nearly 7 per cent in the past year to about 2½ per cent per annum."

That is a very nice way of putting it. What it really means is that since in the run-up to a General Election (which covers most of a parliament even under own own happy constitution in Church and State, let alone in the United States), it is most improbable that the rate of increase in personal consumption is going to be cut to a third, other measures are going to be taken to meet that rate of increase of public expenditure. There is, then, this built-in tendency of all governments to spend, and to increase spending, unless some countervailing force exists.

VESTED INTERESTS

Finally, I invite your attention to the vested interests, including vested intellectual interests, of the three main partners in the dance: the trade unions, the Socialist opposition and the Conservative government. You might have thought that the trade unions, tired of being falsely denounced as the authors of inflation, would have rejoiced to hear people like the Member for Wolverhampton South West going round year after year declaring that, so far as inflation is concerned, the trade unions are "innocent as new born lambs and white as the driven snow."

Why should not the unions embrace the proposition that it is the fault of government, that the government is doing it all by over-spending, under-financing and producing (what no one else can produce) an excess of monetary demand? Answer: Because the unions' power and influence, their sense of importance in the community no longer rests upon the belief that they are defending the real living standards of their members, but upon the fear and awe in which they are held by the public at large, as the unchained forces which, unless they will agree

at No. 10 or somewhere else upon a modest concession towards the other elements in the State, will have their own way and sweep us onward into ever-accelerating inflation. So the trade unions, as one of the parties concerned, have a vested interest in the denial of the true explanation of inflation and the exaltation of the false explanation.

Then the Socialists. I never think that professions of dislike for inflation come very convincingly from a socialist party. After all, inflation can be a very powerful engine for achieving some of the objects which socialism sets itself. Apart from having been themselves the authors and the victims of the previous cycle of this same operation, the Labour Party is not averse from the proposition that Whitehall can and should determine what each man is to receive and what is to be the relative position of each good or service in the price spectrum. So there is a built-in pre-disposition on the part of a Socialist Opposition to accept and to defend the false mythology of inflation as a manifestation of original sin and to scout the explanation that government has done it and therefore only government can control and reverse it.

Finally, there are the producers of the current drama. We have examined some of their motives, but what a tremendous act of will, now, in February, 1973, would be required to say: "All this is really the consequence of our own miscalculation in 1971-72; this is the result of our having boosted public expenditure and cut taxation; it was bound to follow, and followed it has. "Now therefore" (addressing the public and Parliament) "If you do not like it, we must do the other thing: we must, and we call for your support in this, increase taxation in the short term and reduce the present trend in public expenditure in the longer term". You see how immensely strong are the bonds of a government's own past acts.

So I am not appealing to this Council as economists. The economic argument is really all over. There is no longer any serious economic debate about the monetary causation of inflation. I am appealing to it to recognise that economics always partakes in great measure of politics, and that it is the political reasons why this thing recurs to which we are bidden to direct our minds and our energies. We must identify separately, then weaken, and finally defeat these various motives which I have detected, and perhaps more. They are motives so strong that despite all the demonstrations, all the proof, all the past examples, the corpses littering the sides of the road, corpses of one's former antagonists who perished in the same way, they still tempt governments down the primrose path of prices-and-incomes policy to the perdition which lies at the end of it.

Therefore, I beg the Council to leave aside for the time being the demonstration, which it has carried through more than completely, of the true causes and mechanics of inflation. Instead, go and crusade against those motives which obscure and frustrate what I believe to be the underlying, predominant will of the public of this country—**that the prime service they require of government is to give them once again honest money with which to live their lives.**

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