INFLATION AND SOCIAL JUSTICE

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INFLATION has been one of the most serious and persistent of our post-war economic problems. Few people however take it seriously, for despite the repeated balance of payments crises it has produced, the threatened disaster has not overtaken us. Many indeed attribute the maintenance of full employment to the same forces that have produced inflation. They recognize that inflation may have incidental evils, but in their fear of unemployment they hesitate to adopt certain kinds of measures that may be necessary for the control of inflationary forces.

Inflation raises both economic and moral problems. It is the economic aspects that must be studied first, for without an understanding of how inflation comes about it is impossible to consider the moral problems associated with the process; nor can questions of social justice be discussed without a knowledge of the effects of inflation.

II

Inflation is a situation in which there is a general rise in prices as a result of an excessive demand for goods and services. When the demand for any commodity increases (or the supply of it is restricted) there is a tendency for the price to rise. When the overall demand for goods increases and the supply remains unchanged there is a general rise in prices. This idea is not so readily understood as the rise in price when the demand for some one commodity increases. The demand for one commodity may increase because people buy more of it and less of other things. How can the general demand increase? All incomes are rewards for making a contribution to production, either by working, supplying capital, accepting the risks of industry, or hiring out land. Every penny received by firms producing goods is distributed in wages, rent, and interest, or retained as profits.[1]

1 There are also 'transfer incomes'. The Government may tax people who earn incomes by contributing to production and use part of the revenue to provide benefits for those who are unable to earn an adequate income for themselves, e.g. the aged and widows.

The sum of all incomes therefore should be exactly equal to the value of the goods that have been produced. An excess demand would be impossible were it not for the power of the banks to put additional money into circulation by making loans to people who have made no contribution to production.

Most payments are made by cheque. If all bank deposits originated in the paying in of cash, cheques would merely be a safer and more convenient substitute for cash. Because most people are prepared to accept cheques there is rarely any net withdrawal of cash from the banks, and this enables them to make loans by granting overdrafts. The borrower is given the right to draw cheques although he has not deposited cash. These cheques are paid into his creditors' accounts, and the deposit liabilities of the banks are increased although no additional cash has been deposited. Cheques can be drawn on these accounts, so the total of the means of making payments (money) has been increased. It is this increase in the quantity of money that makes it possible for some people to buy more than they could have done with their ordinary earnings. The scene is set for inflation.

III

Money is an invention of man. There can therefore be no moral objection to the creation of additional supplies of money *per se* unless we regard the very use of money as immoral. Some people may have an uneasy feeling about entries in the books of the banks conferring on anyone the right to purchase goods that have been produced by the labour and enterprise of others. The same people see no objection, however, to digging up a worthless yellow metal and using that as money.[2] Money is such an important element in the economic life of a country that its creation should be firmly under the control of the Government, but the creation of additional money cannot be intrinsically wrong.

In Britain, new bank money can be created by privately owned banks. The power of the commercial banks to create new

2 Although gold may have originally been chosen as money because it was valuable, today its value springs from the fact that it is used as money. If the present system, where notes and bank deposits serve as money, were abandoned and only gold used (with notes and bank deposits serving purely as substitutes for gold) the general level of prices would fall considerably. Countries like South Africa, which produce gold, would then be able to buy greater quantities of all kinds of goods from other countries than they can at present.

money, however, is limited. They must keep a certain amount of cash to meet the day-to-day withdrawals.[3] If the amount of cash held by the banks falls, they have to reduce the volume of their deposits. The Bank of England, a state-owned institution, controls the amount of cash in circulation through its monopoly of the note issue, and it is also in a position to alter the cash holdings of the commercial banks. It has therefore effective control of the amount of money they create.

This control of the Bank of England over the amount of money created is exercised in two ways. The Bank of England may increase the Bank Rate, which will probably lead to a rise in other interest rates, including the charges made by banks on overdrafts. This will restrict the demand for bank credit and bring about a reduction in the amount of money created by the banks. Secondly, the Bank of England can sell securities. The buyers draw cheques in favour of the Bank of England, their accounts at the commercial banks are reduced, their banks have to make payment to the Bank of England, and this reduces their holdings of cash, and a contraction in the volume of bank money is necessary. In addition to this control by the Bank of England the Treasury has power to issue directions to the commercial banks requiring them to restrict the granting of credit (and if necessary the granting of credit to particular classes of borrowers).

IV

Interest is charged on the bank loans which create new money. It may be asked whether the charging of interest on such loans is permissible. This necessitates a preliminary survey of the Church's attitude to usury in general. The traditional teaching behind the ban on usury was that money was unproductive. In parting with his money the lender 'sold' the money outright, and was entitled to receive a just price in exchange, and this could only be the later return of a sum equivalent to that originally loaned. No charge could be made for parting with the use of money, since this right is inseparable from the ownership of the money. The owner of a house, on the other hand, can sell the right to use his house whilst retaining the ownership of the house itself; a legitimate distinction between ownership and use may

3 The banks now keep a cash reserve equal to 8 per cent of their deposits.

be made in the case of such goods. As Dr Stark has pointed out recently, this is not in keeping with current thought.[4] The modern economist and business man does not regard money as unproductive. More commonly it is regarded as representing the real capital that it could be used to purchase. If a person were to use his money to buy land, buildings, machines, and so on he could legitimately hire these out at an appropriate charge to somebody who wished to undertake some enterprise but who did not himself possess the necessary resources. Why then should a person not be entitled to make a charge for lending the money that is used to purchase real capital?

It has been held permissible to charge interest if either or both of two conditions are satisfied. First, that by lending a person incurs a risk of default; and secondly, that by lending he forgoes the opportunity of himself using his money in a profitable enterprise. In medieval times loans were frequently made to those in some kind of distress. Today the loan for productive purposes is far more common, and it is now quite reasonable to assume that the person making a loan forgoes the opportunity of profit. It may therefore be generally presumed that the charging of interest is permissible whereas in medieval times a special justification was required in each case. So long as we grant that the banks have the right to make loans in a form which creates new money there appears to be no valid objection to their charging interest on these loans.[5] The banks run the risk of default, and it would always be possible for them to enter profitable enterprises for themselves instead of lending money to those who do. It may also be argued that the provision of bank credit is an important service to the modern economy and that the bank is certainly entitled to make a charge for providing this service which is rather more than the mere lending of money.

V

Although there may be nothing intrinsically immoral in the

4 W. Stark: *The Contained Economy* (Aquinas Paper No. 26, Blackfriars Publications, 1956), pp. 12-16.

5 If bank loans were free of interest there would be several economic anomalies. There would of course be a greatly increased demand for loans, and the banks would have to devise some system of priorities to check this demand, being unable to do so by means of the rate of interest. Moreover, those who obtained loans from the banks would be in a favoured position *vis-à-vis* those who borrowed from other sources and were charged interest.

creation of additional money by the banks and in their charging interest on the loans that create this money, it is possible that the process may in certain circumstances be contrary to social justice. The argument therefore becomes primarily concerned with the economic and social effects of inflation. To begin with, however, one or two basic principles may be set out. First, that it is the duty of the State to promote the welfare of the community as a whole, and above all its duty is to protect the interest of the weaker members of society. But it is not merely the duty of the State to provide for the material needs of man. As a rational being, man should be free to act responsibly and make provision for his own needs. Where the State allows the creation of money by the banking system to lead to inflation it is failing in its duty in both these respects.

In inflation, the creation of new money increases the demand for goods beyond the productive capacity of the country. Prices rise, and those whose incomes do not rise are unable to buy as much as they did before; this makes part of the output of the country available to those who have obtained the additional money by borrowing from the banks. There is little doubt that, since the war, wages have risen more or less as quickly as prices. Other sections of the community have been less fortunate. Old-age pensions and so on cannot be adjusted as readily as wages, and, in any event, such adjustments undermine the actuarial basis on which national insurance benefits are supposed to rest. Other people living on fixed incomes are also hit in the same way as old-age pensioners. Those who have saved in the past to make their own provision for their future are the worst hit of all, for the real value of money is falling, and they have no hope of increasing their money income.[6] The State is failing in its duty towards the weaker members of the community when it permits inflation, and it is also tending to make them more dependent upon the State and encouraging others to demand State provision against all emergencies instead of trying to provide it for themselves.

It is not only because inflation is contrary to social justice in so far as the weaker members of society suffer most and because

6 This will be true particularly of the smaller saver, who will buy gilt-edged securities or purchase an annuity. The richer person who keeps part of his savings in ordinary shares will find that his dividends increase as a result of the price rise.

man's responsibility for his own affairs is reduced and his dependence on the State increased that inflation is to be condemned. The State that permits inflation is failing in its duty to the community as a whole. There are easy profits for business men and the value of competition as a spur to efficiency is reduced. Moreover, when prices rise more rapidly in one country than in the rest of the world, that country's exports will become relatively dearer and she will have difficulty in selling abroad. This is becoming a serious problem for Britain at the present time. Whilst rising prices are causing exports to fall, imports will be rising because of the strength of monetary demand. The result is a deficit in the balance of payments, the excess of imports over exports being paid for by drawing on reserves of gold or foreign exchange or by the sale of overseas assets.

It is clear that such a drain on our reserves could not be allowed to carry on indefinitely. Britain is in a specially difficult position in this respect. To us, foreign trade is not a luxury superimposed on our economy; our whole economy is dependent upon foreign trade. We could not maintain the high standard of living of our present population were we not able to obtain a substantial proportion of our food from overseas; nor could we keep our industries working to capacity without supplies of imported raw materials. Whilst some people fear that measures to check inflation will lead to unemployment, the truth is that if we lose much of our export trade because of high prices there will be widespread unemployment because there are no raw materials for our industries.

VI

The control of inflation implies a restriction on the creation of further bank money, and if possible a reduction in the existing level of deposits. Monetary measures are not the only ones that may be taken to bring inflation under control. The demand for goods is made up of three main elements, the demand of ordinary persons for consumption goods, the demand of business men for machinery and the like (investment) and government expenditure of various kinds. If business men and the Government have been borrowing from the banks, inflation could be checked by monetary measures designed to check such borrowing and the

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expenditure it made possible. This is not necessarily the best solution. It presumes that demand should be cut in a particular way. In certain circumstances, it may be essential that Government expenditure or investment be maintained. If a choice has to be made between the Government spending on the means of self-defence and the consumer spending on television sets there can only be one answer. Again, while we might prefer to increase our present standard of living by a modest extent rather than to devote our resources to producing investment goods that will raise our future standard of living much more but at the expense of a present increase, the choice may not be open to us. Without adequate investment in our industries they may fall behind in world markets, with the result that we are threatened by balance of payments crises and unemployment because of our inability to buy the raw materials we need.

Not all Government expenditure however is vital to national well-being. The social services are provided at present in various ways, but one feature is common to most. The beneficiary makes no direct payment for the service he receives. The purpose of this arrangement is to make the services and benefits available to those who would not value them sufficiently to pay for them, or who would not have the foresight to make provision for possible future needs—a denial of man's right to act responsibly in providing for himself and his family. On a national scale, this has created the illusion that these services are costless. The result is that whilst people demand the provision of these social services on the present scale, they are not prepared to pay the price in the ultimate sense of accepting a cut in their ordinary consumption.

VII

In economic theory, inflation can be checked. It is much more difficult to check inflation in practice, though it is essential to do so if the welfare of the community is to be secured. The Government may begin by balancing its own budget. This does not necessarily mean cutting expenditure, but it must see that it covers its expenditure by taxing the public (and if necessary creating a budget surplus) so that the demand of the public falls as that of the Government rises. It must adopt a monetary policy that prevents new money being injected into the system, thereby increasing demand. There is a danger that where taxes are imposed on commodities and the prices thereby increased the trade unions will demand higher wages on the ground that the cost of living has risen. Where a strict monetary policy is adopted, employers, knowing that no additional money is being created to enable output to be bought at higher prices, may be more likely to resist such wage claims. This, however, may lead to considerable unrest in industry. Whilst income tax has not normally formed a basis for claims for higher wages, it cannot be ruled out that if such taxation fell on the working class they might try to contract out of their liability to contribute to the expenses of the State[7] by claiming higher wages. Finally, measures to control inflation are almost invariably unpopular; thrift is less attractive than riotous living. A dictatorship may impose its will on the people but a democratic government is dependent upon their support. The control of inflation may be impossible under a democratic system unless all the main parties are prepared to accept the necessity for the appropriate measures, and are not willing to gamble with the nation's welfare in order to win votes.

7 With the existing distribution of income, no adequate control of inflation would be possible without reducing the consumption of the working class, unless cuts can be made either in government expenditure or in investment.

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