THE ROCKY ROAD TO PROSPERITY

INFLATION – DEFLATION

Good or Bad?

To 'ornery' folks like thee and me it would be great if the cost of living was constantly falling – in a word, deflation. Ask the proverbial man in the street and he will probably say that deflation, falling prices is just great. Your money buys more, right? So that's got to be good.

But search the internet through several pages of results and you won't find any 'professional' one who favours deflation. On the contrary. Inflation is positively encouraged.

Everyone who *knows*, knows that inflation, albeit not too much, is *good*. *The Economist* says so. As do numerous Economists who are expected to *know*.

Professionals, or the regular guy? Opposing views. Someone has to be right.

Let's start with money, money as a common exchange or trading medium. Without it, we'd all be back to bartering. I've got a chair to trade, I want five loaves and two small fishes. So I need someone who has what I want and wants I've got, which let's face it, is pretty unlikely. I'm going to spend a long time wandering round the market.

This problem can be facilitated with the adoption of a common trading medium, think rare seashells to packets of coffee (war-torn Vienna) or precious metals – anything which is durable, portable, stable in quantity, and commonly acceptable. So civilization developed coinage, struck from precious or fairly rare metals, bearing some insignia of authority guaranteeing its accuracy in terms of composition and weight. This can now be used, not only as a commonly accepted trading medium, but also as a savings medium.

Saving is as vital to civilized life as trading. We grow up, we work, we earn, and we spend so we can feed, clothe and shelter ourselves. But the time inevitably comes when we can no longer work, failing as we are wont to do, in mental and physical capabilities. But even if we can't work, we still need to feed, clothe and shelter ourselves.

So the Wise amongst us seek, during our working lives, to save, to put a little aside on a regular basis 'for our old age'. Indeed few, if any, are the comments, descriptions, text-book definitions of money which do not list one of its basic functions as a 'savings medium'.

But this is an ideal, far removed from reality. As we all know, our money loses value day-by-day, sometimes and in some countries rapidly, while in others central banks attempt to set limitations on the decline in the real value of their currencies. Money loses its value in terms of its purchasing power as the prices of goods and services slide slowly and inevitably upwards in the process well-known to us all as inflation.

So back to Question One: *Is inflation good or bad?*

Inflation is good for Government. Yes really. And the reason is obvious. All western governments are massively in debt, and inflation steadily reduces the real value of their debt. The debt stays the same in money terms but loses value in real terms.

Another lesser-known advantage to governments is that they actually tax inflation. Yes really. You have £100 spare so you invest it at 3% for a year. At the end of the year you have £103. This is not a real gain because inflation is 3%, but at least you've prevented inflation from eroding your £100. But wait. The taxman sees that 3% as an income, and he'll surely tax it. So you're paying tax on a non-existent income. No wonder governments like it.

But inflation sure has a lot of negatives.

Inflation is bad because inflation renders money totally useless as a savings medium, which should of course be one of the prime purposes of a properly functioning monetary system. Don't put your money under the mattress, Nellie. By the time you're retired and want to spend it, it'll be worthless. If the mice don't get it, inflation will.

This has an adverse knock-on effect on the housing market. We still need to save for our old age, so with our money useless as a savings medium, we must inevitably look elsewhere, and for millions of people who are not sophisticated investors, this means your house. As a result there is considerable upward pressure on house prices, putting the dream of 'a home of your own' beyond the reach of many young people today – which, incidentally, is probably why they're not marrying and having children, so we have an 'aging population'.

Inflation also discourages saving, especially among the younger generations, who perceive the reality that with money deteriorating continuously in real value your 'savings' will be worthless when you come to need them. So what hope for your old age? Guilty governments, fully aware of this problem, tax today's earners to pay today's pensioners. But this system has a couple of drawbacks.

First, the administrative costs of taking money from those in work then handing it back to retirees can be substantial, the administrative 'loss' between receipts-in and payments-out being variously estimated at anything up to 20%-plus.

A second drawback is that the system whereby people in work are funding the pensions of people in retirement presumes that there are, at any given time, more people working and paying-in, than there are retirees not working and drawing-out. As long as this balance remains, that's OK. But Japan is coming perilously close to having more retirees than workers.

If money was steadily *increasing* in value, you could simply save a regular amount into the bank (or under the mattress if you prefer), then, when you retire it's there ready for you, without need for investment plans (and paying people to administer them), or scrambling to fund a mortgage in a grossly over-inflated property market. If... but unfortunately not.

So with all those negatives, why does anyone applaud inflation?

Is inflation good or bad? There are arguments for and against. But in reality addressing the question is a waste of time because we simply have no choice. Inflation is inevitable, and ain't nothin' we can do about it. Here's how the story unfolds.

GROWTH – STAGNATION

Inflation is inevitable. So is recession.

There might have been a time when money was something real, like gold or silver, with a real, stable value of its own. But that's for the history books. Today's money has real meaning only in terms of how much you earn, and what you can buy with it – in other words, wages and prices. But both are floating, established by on-going dispute. The wage is as much as an employee can squeeze out of the boss, and the price is as much as the seller can squeeze out of the customer. And since everyone wants more for the same work or the same product, we get inflation: an upward pressure on wages and prices, restrained during a recession, let loose when the economy grows. Inflation's not economics – it's human nature.

The result is the 'economic cycle'. The economy is slack and inflation is low. Producers and retailers find difficulty in moving their goods so they introduce price reductions and special offers. Similarly with wages. Employees are naturally reluctant to demand more money at a time of high unemployment. So Government or the Central Bank expands the economy by lowering interest rates, thus encouraging borrowing both by industry, and by consumers.

But when near-capacity is reached in the more prosperous regions, producers and retailers slide their prices up, and workers demand more wages, so inflation begins to rise. The Central Bank attempts to control inflation by slowing down the economy with increased interest rates. This halts economic expansion, despite continued unemployment in the economic periphery.

Business operates ideally and most productively at full capacity in conditions of economic and financial stability: the ideal business climate which our modern, supposedly sophisticated economy is structurally incapable of manifesting. This in turn has a terminally destructive effect on our longterm growth and prosperity. The essential ingredients of maximum, nation-wide prosperity are simple and straightforward, devoid of any esoteric complexity or the obfuscation with which professional economics can so often cloud the issues.

One. Full employment is clearly a primary ingredient of prosperity. If 5% of the working population is unemployed, 5% of productive capacity is wasted.

Two. Maximum productivity – everybody working productively. Even if everybody is working, but working inefficiently using outdated equipment with poor organization, then again, output and potential prosperity, will be reduced.

Three. Maximizing productivity requires secure, longterm, committed investment, in education, training, research and development, in the tools and machinery of industry, and in the nation's infrastructure.

Four. Finally, and vitally, we need an accepted, universal system of remuneration, price and profit evaluation creating social and monetary stability, a foundation on which we can maximize economic expansion without inflation.

A powerful combination which cannot fail to give us the widespread prosperity of which we are surely capable and which would so enrich all our lives. Unfortunately our present social and financial system does not satisfy any of these most fundamental requirements, and will never maximize prosperity.

Structure and Stability

The current absence of any demonstrably fair and just relationship between work and reward represents a failure of social justice. A fair day's pay for a fair day's work is an essential ingredient of a civilized society. So too with a fair price. As human invention and creativity develop ways of making products better and cheaper, so prices should also fall and life get progressively easier. But in reality the benefits of productivity gains have gone almost entirely to the "top", leaving the average standard of living unaffected.

Is it possible to establish a more just and meaningful relationship between work and reward, leading in turn to a measure of social justice and a structural, stable definition for our monetary unit? In fact solutions are already in place, and in widespread current use.

For many years, several systems of **Job Evaluation** have been established, now well tried and working successfully in major corporations and departments of government, systems which analyze, define and measure with considerable accuracy the work contributed by each employee in the organization. Surprisingly perhaps, the origins of Job Evaluation can be traced back 80 years to that haven of free enterprise, the USA in the late 1930s.

Job Evaluation links pay with the defined requirements of the job, rational criteria such as skill, education, experience, responsibilities, hazards, etc., offering a systematic procedure for determining the relative worth of each job. An equitable wage structure is a natural outcome of job evaluation. The job "value" is then directly linked to remuneration. In this way, pay is fair, both in relation to the work done, and in relation to the pay and the work of others.

An unbiased job evaluation tends to eliminate pay and salary inequities by placing jobs having similar requirements in the same salary range. Employees participate as members of the job evaluation committees determining rate grades for different jobs. This broad participation ensures a basic stability, and helps in solving any wage related grievances quickly.

The concept of Job/Remuneration Evaluation already exists, with several systems in widespread current use. The establishment of a national standard, applicable at all levels and incorporating a maximum remuneration differential between top and bottom earners would create a climate of economic stability, and the industrial peace of social justice.

But pay has value only in terms of its purchasing power, what you can buy with it, and without some direct link between production cost and selling price, remuneration evaluation of itself will not achieve its potential of economic and monetary stability. A fair wage must be accompanied by a fair price which in turn raises the issue of profits.

While 'shareholder value' is vital in attracting investment, there is enormous benefit to be derived from translating a major part of productivity-increases into lower prices. Lower prices increase sales, thus reducing the company's own unit production costs through more productive use of equipment. Overall, gradually falling prices and rising purchasing power yield a climate of increasing prosperity and stability, as well as enhancing the nation's international competitiveness.

SECURE, LONGTERM INVESTMENT

Regional Development Banking

The ability to expand the economy to full employment without inflation establishes a firm foundation for secure longterm investment in infrastructure and new industries. The concept of banking institutions and financing facilities established specifically to provide longterm investment for industry and infrastructure is well established, from Napoleon to present-day Chicago and Basque Spain.

But Germany has long set the pace in dedicated investment banking. The "Big Brother" of German public industrial banks, KfW banking group is a German government-owned development bank based in Frankfurt. The *Kreditanstalt für Wiederaufbau,* or Credit Institution for Reconstruction was formed in 1948. Owned by the Federal Republic of Germany (80%) and the States of Germany (20%) KfW remains fully active today.

In addition, Germany's strong industry-supporting group of 423 savings banks and 1,116 co-operative banks are clear that their business model is focused on working *for the public or mutual good rather than for shareholders*, and are well suited to the mixture of households and small-medium *Mittelstand* companies that they serve. The savings banks and co-operative banks provide over 60% of all lending to *Mittelstand* companies and 43% of lending to all companies and households.

The two broad principles of Development Banking focus on analysis, and commitment.

The Development Bank begins by thoroughly researching each loan proposal from design to production, management and sales, calling on outside expert advice and assistance where necessary, followed by a close working and constructive partnership with the successful loan recipient on start-up, then continuously monitored with an ongoing flow of performance data. By setting up Development Banks to operate at regional level, focusing on regional and local needs, investment benefits can be spread widely and uniformly across the nation, avoiding the usual pockets of non- or under-development.

With investment risk minimized through proper, pre-investment research and positive on-going monitoring of physical production, sales, and accounting, the Development Bank would be in a position to offer investment at a constant, and relatively low cost, backed by the on-going monitoring of the recipient business ensuring safeguards for the investing bank, the recipient business and all those involved with and dependent on it.

A percentage of the investment charge should also be set aside to fund apprenticeships and on-location training. High youth unemployment is largely caused by the mismatch between the skills that young people offer and those prospective employers need. Indeed, countries with the lowest youth jobless rates have a close relationship between education and work.

Most significantly, Regional Development Banks can create jobs and industries NOW, with the guaranteed longterm finance needed to maximize productivity and most importantly, maximize quality. And the availability of genuine, repayable investment loans avoids the need for deficit-increasing grants, now well beyond the means of debt-ridden governments.

PRODUCTIVITY, STABILITY, PROSPERITY

Retirement Guaranteed

Increasing productive efficiency, developing ways of making better goods more cheaply, is nothing new. The civilized world has been, and is doing it continuously. And it is not unreasonable to suppose that as a product becomes cheaper to make, so it should be cheaper to buy.

But in reality the benefits of productivity gains have gone almost entirely to the 'top', leaving the average standard of living unaffected. The resultant near-static or falling purchasing power and the mounting demands of taxation combine to place an increasing economic and psychological burden on contemporary generations, forcing an increase in hours worked, the rise of dual-earner households and yes, late marriages and no children.

With a limit set on profits, in parallel with, and as a counterpart to wage evaluation, a major part of productivity-increases will translate into lower prices. As productivity *in*creases, the work-content *de*creases, and it becomes possible for goods and services to be produced and offered at lower prices, thus progressively lowering the cost of living.

And the longterm effect of productivity maximization, combined with the stability of a work-based monetary system, is *negative* inflation. Your money buys more each year, not less. This would in fact become a completely normal, natural process.

Evidence has already be seen in the field of computers and other electronics. Buy a computer today, and it is almost guaranteed that in three months' time the price will be lower for a faster machine with more storage space on its hard drive.

This in turn means that as we get older we can look forward to increased purchasing power for our savings. A wild dream? No. This is as it should be, the normal course of events. We *should* be increasing productivity, producing more and better at less cost, as indeed we are. And with a consensus on wages, profits and prices, increased productivity involving less labour *should* be reflected in lower prices.

Currently we are forced to rely for our old age on pension schemes defined in terms of inflating currencies, and government plans which are already heading for deep deficit. So we console ourselves with inflating home prices, ignoring the warnings that bust can follow boom. Indeed, the dream of retiring with a comfortable pension is becoming increasingly faint. And remember, your few percentage points of growth are promptly eroded by inflation. That's life, living, saving and retiring in a country with a continually deteriorating currency.

The idea of living in a society where the cost of living goes down slowly, year by year instead of up, where your savings are not only safe but increase in value, where a fair day's pay for a fair day's work in decent conditions is an accepted norm rather than an on-going battle... it may all seem utopian. But it's possible. We can begin right now.

And critics should ask themselves whether the alternative – of boom and bust, on-going uncertainty for business and industry, structural unemployment, labour disruptions and money which fails to serve as a store of value – is really any better.

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