Problems of Inflation

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IN his article in the December issue of *Marxism Today* Emile Burns argues that since the war inflation has been caused mainly by the capitalists and their governments arbitrarily raising prices, as a deliberate act of class policy, in order to reduce the value of money wages and thus keep real wages down. He presents a picture of the workers desperately trying to catch up with rising prices but in general not succeeding in doing so.

We shall argue that this explanation fails because it does not fit the facts. On the contrary, when money wages have risen faster than productivity (and this has happened in most years since the war), the increased labour costs have to a large extent been passed on by employers in the form of higher prices; and this has in fact been the principal cause of the post-war inflation both in Britain and in all the other main capitalist countries.

The reason why wages have risen faster than productivity year after year is in our view primarily the result of the greatly increased industrial and political strength of the working class movement. Before the war the position was quite different. The basic contradiction within capitalist society, between private ownership of the productive forces and the social character of production, then had its classical and sharpest expression in the economic field in the frequent recurrence of acute economic crises involving large increases in unemployment. Since the war, however, the ruling class fears of the political consequences of a repetition of the 'thirties have compelled their governments to pursue policies of full (or relatively full) employment. This has led to the maintenance of a high level of demand for goods and labour which has simultaneously strengthened the hands of the trade unions and permitted employers to pass wage increases on to prices. *The basic contradiction within capitalism remains the same as before, but it no longer finds expression in mass unemployment and a decline in production; instead, it takes the form of a more or less continuous rise in prices.*

The classical economic crisis had a direct effect on production. Inflation, on the other hand, has held back production indirectly, by causing the government to take deflationary measures designed to achieve price stability, measures which have been the direct cause of the stagnation of the British economy. The determination of the British ruling class to achieve price stability has been dictated by fears of the political repercussions of inflation, by the changing balance of international competition for markets, and by the desire to maintain Britain's position as a world banker. Thus the social relations of production remain as fetters on the productive forces, but their mode of operation has changed.

The Process of Cost Inflation

Our argument implies that cost factors as well as demand factors have operated to cause inflation in the post-war period, and that those from the side of costs have been the more important. Emile Burns allows that rises in prices of imported materials have led to rises in the domestic price level. But apart from this, he seems to take the view that inflation has been mainly due to excess demand, in the sense of "too much money chasing too few goods" (p. 371). This is the situation that arises in a boom, when employers are able to raise their prices in a sellers' market, even though their costs may not have risen in proportion. This has undoubtedly been an important cause of inflation, particularly in the immediate post-war years and in the boom conditions in the early 'fifties. But it is very far from a complete explanation of price rises since the war. We have space only for two examples of the failure of Emile Burns's theory to fit the facts.

(1) It does not explain why prices continued to rise between 1955 and 1958. During this period output rose only slowly, surplus capacity developed in manufacturing industry, and unemployment rose from 1.08 per cent in 1955 to 2.1 per cent in 1958. All the evidence goes to show that there was no excess demand.[1] Prices of raw materials used in manufacturing, which had been rising all through the early 'fifties, fell sharply in 1957 and remained stable all through 1958 at a level $2\frac{1}{2}$ per cent below that of 1955. Nevertheless the index of total final prices rose from 103.5 in 1955 to 115.1 in 1958. The rise in prices continued, though more slowly, right through the depression year of 1958. The only possible explanation is that the continuing rise in labour costs was passed on by employers in higher prices.

Labour costs rose because money wages increased faster than productivity. Weekly earnings rose by $7\frac{1}{2}$ per cent between 1955 and 1956, by 6 per cent

[1] "Price Stability and the Policy of Deflation", *National Institute Economic Review*, May 1959.

between 1956 and 1957, and by 2 per cent between 1957 and 1958. On the other hand, whereas the average annual increase in output per man was 4½ per cent from 1952 to 1955, it was only ¼ per cent from the end of 1955 to the end of 1958. The net result of these two factors—rising money wages and almost stationary productivity—was that labour costs per unit of output rose by an annual average of 5½ per cent from the end of 1955 to the end of 1958. Thus the force behind the rise in prices during this period was the rise in money wages, unmitigated by an increase in productivity.

(2) If rising prices have been mainly caused by excess demand we should expect to find a widening of profit margins as business men responded to boom conditions by raising prices, with the prices of raw materials and wages being dragged up behind. But no such widening has in fact taken place; profit margins have remained remarkably steady throughout the post-war period.[2]

Emile Burns states that capitalists put up the prices of their products "on the excuse of higher wages costs", and that they raise prices "not just by the actual rise in wage costs but by considerably more" and in support of this he cites one instance only, namely, the rise in engineering prices early in 1964. But if capitalists had consistently behaved in this way all through the post-war period their profit margins *must* have widened.

Emile Burns also supports his thesis that wages are always trying to catch up with price rises with a table comparing the movement of retail prices and wage *rates*, and showing that since 1946 these have risen at about the same rate. But if we are examining the causes of inflation we must use figures of actual *earnings*. An employer is affected, not by the nationally negotiated rate, but by the actual wages he has to pay out to his workers and it is these that present themselves to him as a cost that he endeavours to pass on in higher prices.

Between 1945 and 1960 the working class in fact succeeded in pushing up money wages faster than prices by an average amount of 2¼ per cent per year. (This rise in real wages measures the rise in the standard of living that took place, and is a measure of the achievement of all the trade union struggles during the period.) Moreover, the annual average rise in productivity was also about 2¼ per cent.[2] Thus increases in wages have been passed on to prices except in so far as productivity has risen, the capitalists have managed to maintain their profit margins, and the division of the national product between capital and labour has remained about the same.[3]

Profit margins have not, of course, stayed absolutely constant since the war but have varied from time to time in response to changes in demand. Whereas a sellers' market creates an opportunity to widen profit margins, the reverse happens when demand is slack. In other words, short-run changes in demand are liable to cause short-run variations around a trend of rising prices, this trend itself being basically determined by rising costs.

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It is important to make clear what our theory of inflation does *not* mean.

First, it does not imply that wage increases *initiate* the rise in prices. It may well be that each wage increase follows a rise in prices (although other considerations, such as raising the levels of the lower paid, sharing in increased productivity, etc., have played a part in wage negotiations) but what is crucial is the ability to raise money wages *faster* than prices irrespective of which rose first. Over the post-war period as a whole this ability cannot be doubted as the quite substantial gains in real wages make clear.

Second, the view we are putting forward does not imply that demand plays no part in the inflationary process. On the contrary, cost inflation is only possible because a reasonably high level of demand has existed ever since the war as a consequence of the maintenance of relatively full employment, itself the product of the strength of the working class movement. But a given state of real demand relative to capacity is consistent with a wide range of possible rates of price rise. In other words, the role of demand is *permissive*, in that a given minimum level of real demand permits prices to rise but the actual rate of price rise is determined by the rate at which money wages are rising in relation to productivity. So long as the level of demand is above a certain minimum a self-sustaining price rise is possible without the existence of a general excess of demand over supply.

In this connection it is important to note that on the one hand rises in money wages generally occur more or less simultaneously throughout an industry so that employers can raise prices with the fair certainty that their competitors are doing the same under the same stimulus, and on the other hand that to some extent and for a wide range of industries, a rise in wage costs represents a simultaneous rise in monetary demand which economically speaking "justifies" the employers in raising prices.

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[2] The most careful calculations of profit margins are by J. C. R. Dow, covering 1946-60, in *The Management of the British Economy*, p. 248.

[2] Dow, *op. cit.*, p. 350.

[3] C. H. Peinstein, *London and Cambridge Economic Bulletin*, June 1964.

Consequences of the theory

Ruling circles in Britain have only accepted with great reluctance the views of those bourgeois economists who have stressed the role of costs in the inflationary process. During most of the 'fifties the dominant view in the Treasury and governing circles was that excess demand played the main role[4] and that inflation could therefore be prevented so long as the government took sufficiently severe deflationary measures to restrain demand and create unemployment; on this view an incomes policy was unnecessary. But the persistent rise in prices all through the years 1955-58, when there was clearly no excess demand, finally undermined the position of those who held this outlook. The First Report of the Three Wise Men in 1958 was, as it were, the last ditch stand of the demand inflationists. The Fourth Report, issued in 1961, fully accepted the "upward push of rates of pay" as a major cause of inflation.[5] A parallel change of opinion took place on the continent, as can be seen by comparing the first O.E.E.C. report on inflation published in 1952 (blaming excess demand) with the second report issued in 1961, stressing the central role played by wage increases and urging all member governments to adopt an incomes policy.[6]

The ruling classes in Britain and on the continent have naturally been unwilling to accept the need for an incomes policy (and the economic theory justifying it) because the recognition, however formal, that all incomes ought to be *planned* by the State carries with it all sorts of dangers from their point of view. The adoption by the State of partial planning is bound sooner or later to stimulate the demand by the Labour movement for real planning and for more effective measures by the State to restrain the freedom of the capitalists. Nevertheless, economic developments in recent years (together with the failure to prevent money wages from rising even with a degree of unemployment) have compelled ruling circles, here and abroad, to adopt an incomes policy.

From the point of view of the working class, on the other hand, this analysis of the causes of inflation leads to the conclusion that the struggle for a better standard of living cannot be confined to the industrial battle for higher money wages, since the undoubted achievements of the trade unions in raising money wages since the war have been to a considerable extent frustrated by the defensive action of the monopolists in raising prices. It follows that the working class must enter into the political battle against inflation by demanding that the State should take the necessary measures to prevent it—restricting the freedom of the capitalists to raise prices, for example, and promoting the growth of the economy so as to raise the rate of increase in productivity, which has been so drastically held back by ruling class policies against inflation.[7]

The struggle between the two classes over the distribution of the national product is becoming more and more a political struggle. Economics is being transformed ever more obviously into political economy. If we are right in thinking that inflation has become the principal expression of the basic economic contradiction within monopoly capitalism, it will (like unemployment) not be overcome completely until capitalism has been abolished, but the struggle to defeat it can very greatly strengthen the working class movement and hasten the end of capitalism. It is all the more important, therefore, that a political party seeking to lead the fight against inflation and retarded economic growth should base its activities on a correct understanding of the inflationary process.[8]

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[4] This has also been the dominant view in the Communist Party and its main publications for reasons which deserve analysis.

[5] *Council on Prices, Productivity and Incomes. First Report, 1958. Second Report, July 1961.* The change of opinion inside the Treasury between 1957 (guiding light rejected by Thorneycroft) and February 1962 (Selwyn Lloyd's guiding light White Paper) is charted by Samuel Brittan in his recent Pelican, *The Treasury under the Tories, 1951-64.*

[6] *Report of Experts Committee appointed by the Council of O.E.E.C.* (O.E.E.C. Information Division, Paris, June 1952) and *The Problem of Rising Prices*, a report prepared by six economists for the Council of O.E.E.C., 1961.

[7] The working out of a comprehensive policy against inflation requires an analysis of the imperialist and other conditions which have caused Britain to suffer more severely from the consequences of inflation than the other major capitalist countries. This is a task which urgently needs to be done.

[8] An article "Inflation as an Economic Policy" by the Italian Marxist Amedeo Grano is published in the January 1965 issue of the British Communist Party's *Economic Bulletin* (1s. 6d., from Central Books).

Published by the Communist Party, 16 King Street, London, W.C.2, and printed by Farleigh Press Ltd. (T.U. all depts.) Watford, Herts.