# Chapter 5
# Boom and Bust

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## §5.1 The Business Cycle

The Western world has long been familiar with the business cycle. Periods of prosperity alternate with hard times. In retrospect it is often easy to say why the good times did not last—sub-prime mortgages, bankers' greed, investors' irrational exuberance, the erosion of trust, political uncertainty, wars and rumours of war, all can be called in to explain why confidence suddenly failed, and everyone felt obliged to play safe. One particular factor in the recent craqsh was the widespread ignorance of the laws of probability. Financiers dealt in "financial products" they did not understand, and assumed that if they diversified their holdings, they were spreading the risk. They failed to observe that many apparently different products, were made up of elements that incorporated the same risks—notably in the American sub-prime market. It is no good putting eggs in different baskets, if the baskets all depend on the same rope. If financiers had been adequately intelligent, perhaps some booms and slumps might have been avoided—always provided also that they were prudent and honest;[1] Of course, there have always been those who go into the City to make money, but in recent years moneymaking has been allowed to be not only the dominant, but the overriding, motive.[2] And as in general, so in this particular case the transition from the moderated desire to have more money, other things being equal, to the unqualified goal of maximisation, has shown itself not only irrational but disastrous.

[1] Plato in *Republic* I, 333, noted honesty as the special virtue of bankers.

[2] For an intentionally provocative account, see below, Appendix I, "The Snob Theory of Financial Rectitude."

Although we can explain, it has proved difficult to predict or prevent downturns, recessions and slumps. Human folly and human greed are factors: but they are at work everywhere, and other walks of life do not seem to be subject to similar cycles. Cycles in business activity are ue in part to the in-built instability, inherent in marketable assets. Keynes noted that the value of stocks and shares, depends on what people think that other people are going to think.[3] This creates positive feedback. If any one person is unreasonably optimistic, his mistake constitutes a reason for others to make the same mistake. The word goes round that dot.coms are the thing to buy, and people start buying them, and the price goes up, thus proving that the word was right.[4] Booms boom, and become bubbles that finally burst, and turn into slumps.

There are many other factors that disrupt society and blow the economy off course—wars, floods, earthquakes and epidemics. When happy expectations are disappointed, we fear for the future; we become cautious, and prepare for outcomes we know not what, but likely to be adverse: and in our finances we seek liquidity.[5] If it is just me, there is no problem: my selling shares will be offset by others ready to buy them. But if everyone is wanting to go liquid, assets that were liquefiable cease to be so, and the whole pyramid of investment will be under strain, and may collapse. The banking system and stock market can offer to each individual investor liquefiability at a low price so long as he, on average, does not avail himself of that facility. The concept of liquefiability relies, as we have seen, on a complex conjugation of mood, tense and person which will not conjugate over all moods, all tenses and all persons at once. I can choose whether to spend my money now or whether to keep open the possibility of spending it at a later time, as can everyone else, provided we do not all want to have the choice available now. Normally we can suppress the proviso as an explicit condition, and have each separate decision-maker believe that he can, whenever he wants, at a small cost, liquidate his assets, and be ready to cope with uncertainties. But given the positive feedback of the stock market and the macro-economic world generally, we cannot all choose to liquidate at the same time. There are many other

[3] Like money itself; see above, §3.2. p.52.

[4] See above, §4.3, for negative feedback being a characteristic feature of economic entities in the micro-economy.

[5] See above, §4.6.

examples—the load factor in electricity supplies, the provision of fire engines or public W.C.s in a locality—where we give adequate provision because the demand will be staggered: what is peculiar to the financial word is the herd-like tendency of everyone to do as everyone else is doing. Once a disaster leads many people to go liquid in the face of perceived uncertainty, the cost of doing so will escalate, and there will large falls on the Stock Exchange, leading to yet further falls, as investors seek safety from even greater losses. Similarly banks, preparing for the possibility that depositors will want their money back, will call in overdrafts and other loans, and be unwilling to lend money, even to trustworthy borrowers, and there will be a credit crunch.

It is foolish to suppose that booms and slumps are a thing of the past. Each generation seeks emancipation from the gods of the copybook headings, and only learns from its own experience that fire still burns and water wets. It may be that business cycles are natural and inevitable, because they fulfil, as it were some biological rhythm, with booms needed to encourage new ventures, slumps needed to tighten things up, and force firms to be lean and efficient. Certainly, recessions, depressions and slumps have been with us for a long time. Painful though they are at the time, they end. Most people are not financiers, and do not invest in the stock market. Their decisions are not subject to positive feedback: if the price of tomatoes goes up, the housewife is unlikely to be tempted to buy more of them. And whereas financiers are primarily moved by financial considerations, ordinary people are not. They operate within financial constraints, as they do within legal ones, but other considerations play a large part in the decisions they actually make, and these continue, as life continues, in a fairly stable way. Unless the authorities completely debauch the currency, it goes on being used for the ordinary purposes of life, as people earn their wages and buy their groceries. Farmers can sow, in the expectation that most of their crops will sell, grocers stock their shelves in the expectation that most of their comestibles will get eaten, doctors continue doctoring, schoolmasters continue teaching, buses continue running, musicians continue performing, actors continue acting, very largely for non-financial reasons, but, in so far as financial considerations do bear on their decisions, in the belief that things will continue to be much as they were. This maintains stability and trust in the micro-economic world, and re-introduces it into the macro-economic world. Some small-time operators see a *niche* in the market that they can fill, and borrow money from their friends to start up new businesses. Exceptions to the general gloom multiply. Confidence returns, on a small scale at first and then spreads. More people are prepared to tie up their assets for a longer time, and the more that people are prepared to enter into long-term commitments, the more does economic activity occur. Depressions, like diseases, end chiefly because the natural processes of the body economic re-assert themselves.

### §5.2 Salute the Slump

Slumps, depressions, recessions and downturns may cure themselves in the end, but are unpleasant while they last. Nonetheless, we should not exaggerate. If economic activity falls by 2%, alarm bells sound. But should we be alarmed if economic activity is still 98% of what it was? If my income falls by 2%, it is a trend I do not want to continue, but in itself it is not a catastrophe. Families and firms deal with downturns in sensible ways: forgo a holiday, postpone an investment, practise small economies to reduce the electricity bills, take on extra work. Most firms and most families survive recessions, not completely unscathed, but well enough—enough to enable the macro-economic sector in due course to recover from its ill health, and start playing a useful part in directing resources to the most profitable areas. In thinking about the problems of the macro-world, we should keep our feet firmly on the micro-ground, and maintain a sense of proportion. But still, depressions are painful for some people, and deep depressions can inflict great damage on many. We should like to mitigate their severity and speed their recovery, if we can.

In Prague there is a wall built by the King of Bohemia one winter when times were hard, to provide employment for his suffering subjects. The wall was of no value, defensively or aesthetically, yet it served its purpose: the hungry were employed, and could buy food with their pay. Indeed, the benefits were wider still. The bakers and corn-merchants were able to sell their produce, and buy things they wanted, thus further increasing trade. It is even possible that the King was not out of pocket in the end, for the increased prosperity generated by his payment of wages may have resulted in more taxes being paid, so that the Royal Treasury ended up no worse off than it had been before the King's outlay on public works. Keynes argued that money paid in wages for public works would have a similar beneficial effect throughout the economy, on account of the money's being spent, and thus enabling other people to buy more. Spending extra does give employment when work is short.

One response, then, to a depression is for people to make an effort to spend.—"Salute the Slump"—in Churchill's phrase. To spend is to de-liquefy completely. The choice, once open, is open no more. If too many people are keeping their options open, and not spending in their usual way, it helps if others will reduce their liquidity, and commit themselves, thereby making the world a little more certain, and assuaging the thirst for liquidity in those to whom they transfer encapsulated choice. Many people, of course, will be impervious to the exhortation, being themselves vulnerable to the down-turn, and needing to keep their resources readily available. But some well-established authorities—universities, independent schools, large charities, and the government itself—and, perhaps, possibly some rich individuals, are in a fairly secure position, and can time their spending to counter the business cycle, saving in boom times, and undertaking large expenditures during recessions, when they will get good value for money. Essentially in such cases institutions that can afford to are forgoing liquidity. Where before they had bank balances and stocks and shares that were easily tradeable, they now are acquiring illiquid assets, such as buildings, plant and infra-structure. They can afford to do this, because they are established institutions, able to face the future with confidence. It is the same as for the individual; if I lack confidence, I need to be liquid in order to be able take the appropriate decisions as an uncertain future unfolds; and the more I can be sure that untoward events will not affect me badly, the more I can afford to tie up my assets in less liquid or liquefiable forms: so too for the established institution, it is not only possible and public-spirited to become more illiquid during a slump, but prudent too—prices are likely to be lower.

It seems a sensible policy for the government itself, but there are *caveats*. First, the government may not get good value for the money spent. We need to distinguish the economic policy of countering recession from the political policy of providing employment. There may be good reasons for doing the latter at the public expense,[6] but it is an expense, not a prudent investment.

Secondly, it may not work. Keynes advocated public works using unskilled labour. He argued that money paid in wages for public works would have a beneficial effect throughout the economy,

[6] See next Section, and §6.2, p.127.

on account of the money's being spent, and thus enabling other people to buy more. In his time it was reasonable to assume that wages earned by the recently unemployed, would be spent at once, thereby generating more business for publicans, tobacconists, grocers and coal merchants. But things are different now. Many working families are in debt. Some were conned into buying houses with mortgages they could not afford. Others have credit-card problems. Instead of going straight to the pub, the recently re-employed may use much of their wages to pay off some looming debt, in order to stave off re-possession or the loss of credit-worthiness. These are laudable aims, but in such cases the result of extra government spending will not be to have money circulating fast through the economy, but to reduce the level of indebtedness. Instead of tills ringing up extra business, there will be sighs of relief from bankers and credit-card companies, as the ratio of deposits to loans gets less bad, and the burden of likely bad debts diminishes.

**The Paradox of Thrift**

Keynes thought that thrift was bad, because thrifty people, instead of spending their money, which would enable others to earn it and then spend it again, saved it, and so put it out of circulation.
That argument might work if we still had only coined money, which could be sequestered in stockings under the bed.

**but** money saved now is not sequestered, but is banked or invested. If banked, it can be lent out again, if invested it is spent on some new enterprise.
So thrift is not bad after all

Thirdly, public works can do more damage than good. Politicians like eye-catching projects, new airports, railways, or roads, which slice through the countryside, damaging the environment, and depreciating property prices. Cost Benefit Analyses neglect or underestimate external costs. A Norman church was valued at £2,000 when a third London Airport in Buckinghamshire was under consideration.

And finally, we need to ask where the money is coming from. It could come from extra taxation, but that would suck liquidity out of the economy, and might well make matters worse. The government could run a deficit, and raise money by borrowing. But those who lent money to the government would be forgoing their liquidity. That might not matter in the short term: some home lenders might be tying up funds, relying on the government's credit-worthiness to keep their assets still reasonably liquefiable; nor would it matter if the lenders were foreigners living in an undepressed economy. Such deficit financing is tolerable, but only if the government, like the lesser authorities, balances its extra spending during recessions with extra saving in easier times. But modern orthodoxy denies this, and maintains that deficit financing is the way to stimulate the economy and promote growth.

**Salute the Slump**

Spending money on public works may help,

**But**

1. it may not be good value for money
2. the money may not be spent the way Keynes supposed
3. the public works may do more damage than good
4. obtaining the money may depress the economy further

### §5.3 Demand and Stimulus

Modern governments defend deficit financing, invoking the concepts of supply and demand from macro-economics. If there are factories closed and workers idle, it is thought that there is plenty of supply available, and what is lacking is sufficient demand. But supply and demand are not simple things that can be aggregated and equated. Demand is not simply demand, but demand for a certain goods or services at a price. Sports cars at £20,000 may be much in demand, as also honey at £1 a pot. But we cannot add them. Demand is demand by someone for something, and is usually cost-sensitive, and additional supply usually comes at a cost. Only in a few cases can available supply be mopped up by extra demand at no additional cost.[7] The factory can be opened and the workers paid, but the cars produced may cost more than people are willing to pay, when given the actual choice between cars and some other desirable outlay. Subsidising inefficient activity is not a

[7] For example, issuing free bus passess to pensioners for use at non-peak times.

**Demand**

Demand for what by whom at what price rather than what?

1. for beer? mobile phones? Jaguars?
2. by teenagers? housewives? schoolmasters? oldies?
3. costing £2? £10? £10,000?
4. than hamburers? blackberries? freezers? holidays?

way to make us better off. It was widely practised in Soviet Russia, resulting in a system where the people pretended to produce, and the government pretended to pay them.

In the 1930s Britain and America suffered from severe unemployment, which caused great social problems, and left deep scars in the public consciousness. It was taken for granted that slumps and unemployment were the same: Keynes uses the term 'employ' sometimes to cover the use of all resources, but usually to describe only the human resource of available labour. In order, therefore to avoid there being workers left idle, it seemed necessary to have the economy going at full stretch. That was a mistake. We need to separate the problem of providing work for willing workers[8] from that of coping with recession. Faced with a recession, governments and economists look for macro-economic remedies, and mislead themselves, using ill-defined concepts, such as supply and demand, velocity of circulation, and growth. Although there are some measures it is sensible to take, it is even more important not to chase after illusory mirages.

**Two Questions**

1. How to recover from depression?
2. How to alleviate unemployment

the former is an economic problem
the latter is a social and political problem

Muddling the two leads to neither being solved.

[8] See below, §6.2.

## §5.4 Growth

"Anyone who believes in perpetual physical growth on a physically finite planet is either mad or an economist"

Kenneth Boulding
(advisor to J F Kennedy)

"You can't compromise growth"

David G. Blanchflower, Professor of Economics,
Dartmouth College, USA
(on BBC, August 2, 2011)

Growth is worshipped by politicians as well as economists. An increase in economic activity increses tax revenue, and provides them with more money to spend, and, they think, solve all their problems: they take credit for themselves when the economy does grow; and are chided by their opponents when it does not. Extreme environmentalists often take the opposite line, demonizing growth as the destroyer of the natural world, and looking back nostalgically to a pristine age, when men were not herded into the mirky neighbourhood of dark Satanic mills, but lived peaceful lives in rural surroundings. Both are wrong. Growth is a flawed concept, not worthy of worship; but in so far as we can make sense of it, it is not always bad; indeed, in time past it has been, on balance, mostly good, though now we may be reaching the end of its being what we want.

Growth is a flawed concept. It is measured in terms of the Gross Domestic Product (GDP), which, like measures of the quantity of money,[9] dissolves under scrutiny, into concepts which are inaccurate measures of economic or social well being. Once measured, the Gross Domestic Product acquires scientific status, and can be cited in arguments as an indisputable fact, much as at one time the increase in body weight was cited as incontrovertible evidence that school milk was improving children's health. We always should be wary of figures in economics. They do measure what they measure, but whether what they measure is relevant is a different issue. A crude example shows the unreliability of the Gross Domestic Product as a measure of well being: we could achieve a great deal of growth by having a law that required husbands to pay their wives for cooking, housekeeping and sexual services, and wives to pay their husbands for rent and handyman jobs around

[9] See above, §3.1, pp.50f.

the house. Other, less fanciful examples make the same point. Mr and Mrs Jones retire to the country, where she takes up voluntary work with the WVS. A new government takes over the voluntary work she has been doing, and puts it on a paid basis. To meet the additional cost, it has to raise income tax. Mr Jones finds his pension no longer adequate, but the shortfall is matched by Mrs Jones' earnings. Financially Mr and Mrs Jones are no better or worse off, but the Gross Domestic Product is increased because her activity now counts as gainful employment. Miss Smith is an elderly patient, who used to have to take a bus to the surgery to get a repeat prescription, walk to the chemist, take another bus home, and next day go back to the chemist and collect the medicine. Now she telephones the surgery, which prints out the prescription, gets the doctor to sign it, sends it over to the chemist, where it will be waiting for her next day. The Gross Domestic Product is diminished, but the world is a better place. David Hume had a small income. He could have supplemented it by taking paid employment, but chose instead to live frugally and spend his time philosophizing. The Gross Domestic Product would have been greater, but he, and we, would have been worse off if he had. University and Colleges in Oxford and Cambridge cooperate in fostering teaching and research, and no account is taken of whether a copying machine has been used for college or university business. If in the name of transparency an exact tally was kept, and Colleges billed the University for each item and *vice versa*, the Gross Domestic Product would be increased, with no increase in the teaching or research done; similarly in the many universities which collaborate with teaching hospitals. Indeed, we could greatly increase the Gross Domestic Product by requiring every firm to be split up into its component individuals, who would invoice and pay one another for each bit of help given or received. The existence of families shows that the Gross Domestic Product is not to be equated with well being, and the flourishing of firms shows that it does not even register economic efficiency.[10]

The Gross Domestic Product is not a reliable measure of well being, but it is an indicator of economic activity. If an economic transaction takes place, both parties are better off.. It is easy to argue from this that the more economic transactions there are, the better, and often this has been the case. At the beginning of the

[10] See above, §4.3.

twentieth century each English village contained a large number of agricultural labourers who worked long hours to till the fields and tend the flocks. Now tractors and milking machines have replaced farmhands and milkmaids, and farmers employ only a few well-paid workmen. The old village economy provided employment for all, and fostered fellow feeling as communal effort brought the harvest home, but the fruits of all their labours had to be shared among many, and gave to the agricultural labourer only a paltry wage in return for back-breaking work, which left them exhausted, if not crippled, in old age. The modern farm, of course, depends not only on its workmen, but on those who make tractors, provide diesel oil, manufacture fertilisers, and invent new strains of wheat; but even so, there are far fewer to claim a share in the proceeds of production. In spite of many ills, growth has made us better off than our ancestors. Life is less nasty and less short than it was when we were unable to exploit our own special skills, and in return obtain goods and services from distant suppliers.

Economic growth has been, over the centuries, a force for good. It can be still, but it need not be always so. Arms-length transactions are only one form of cooperation. As cooperative endeavours go, the ones where both parties have shared objectives naturally fulfilled by them are better than ones where one party is not naturally a whole-hearted collaborator, but needs an adventitious incentive to make the exercise worth his while.[11] Economic transactions, although they do benefit both parties, take time, possibly displacing activities that are more worthwhile. than the economic ones that displace them. It is not only a question of crowding out, but of social togetherness. I want family, friends, colleagues, companions, mates, as well as shops, customers, suppliers, employers, and employees, Money enables me to do business about all manner of different matters with distant parties with whom I have litle in common, but I do not want to put my nearest and dearest at a distance from myself. What gives meaning to my life is not money and the anonymous relations it engenders, but face-to-face conversations with those we care about, and the shared activities we do together.. We need to set economic activity in context with the other forms of social activity, and the many other values of the good life. Getting and spending money is important, but not all-important. Although it is by and large the case that if I spend

[11] See above, §3.4, p.62.

more, I am getting more of what I want, and to that extent, am better off, it is also the case that by and large and over time, I have to earn it, which means that, by and large and over time, I have to work. And though not all work is a disutility,[12] it is reasonable to suppose that paid employment mostly is—that is why it is paid. If there is more economic activity, we shall have more money to spend, but shall have to work harder to get it.

**Growth**

Growth is often good—
if two people do business with each other, both end up better off.

**but**

(i) They might have been even better off if they had cooperated voluntarily, with no money changing hands: we mostly enjoy things we do voluntarily more than those we are paid for
(ii) DIY: although the greengocer grows better marrows than I can; and I am better at mending fuses than he is, I would rather grow my own marrows, and he be his own handyman, than each of us pay the other to do it for him.

Many people are willing to work harder in order to get more money, but it is a choice, and there have always been some individuals who at some time have decided the other way. Victorians would labour long hours to make a pile, and then retire to enjoy life as country gentlemen. Today some take early retirement, others downsize, and exchange lucrative employment in London for much less well-paid job that they can do from The Old Rectory in a pleasant country village. Their numbers seem to be increasing. Although it is still worth earning money to get certain positional goods, the attraction of being able to buy a fourth wide-screen TV set is resistible. It may be that not just some individuals, but whole populations in mature economies are becoming satiated with consumer goods, and are altering the balance between economic and other activities.[13]

[12] See further below, §6.3.

[13] See further below, §6.4.

As with demand, it is a mistake to generalise: different parts of the economy grow and contract in the ordinary course of events. In Victorian England railways boomed and coaching inns fell into disrepair; in modern times the dot.com bubble was an exaggerated response to a real shift in business activity. Growth and contraction in different areas are features of a vibrant economy. Although it is sensible to put in place institutions and strategies for countering contractions where and when they occur, sometimes even at the cost of running a deficit, deficit financing is tolerable only provided that it is temporary, and will be balanced by a surplus in due course. Unfortunately, as we have noted, governments find it much easier to spend than to save, and having spent their way out of a recession, do not budget for a surplus to repay their borrowings, Instead, the government prints money. Inflation results.

### §5.5 In- and De-flation

It is currently held that deflation is bad, but inflation, at least in moderation, is good. Severe deflation is associated with slumps and unemployment. Inflation goes with booms and full employment. That severe deflation is bad may be granted. But that deflation of any degree is bad, and that inflation, at least in moderation, is acceptable, is one of the illusions of our age. Inflation and deflation are both bad, if severe or prolonged; but a small degree of either is tolerable, if in due course counterbalanced, so that over the long term the currency remains more or less stable.

The perils of deflation have been over-stated. It was not the only cause of unemployment between the wars, which witnessed not only the decline of traditional industries, but great growth in the manufacture of cars, chemicals and electrical goods. Nor are the effects of mild deflation as damaging as is currently made out. It is supposed that if the value of money goes up, real prices will go up in consequence, and sales will go down, which will put a downward pressure on wages too. Wages are notoriously—and understandably—sticky, and it is difficult to cut them; hence employment will be cut instead. So the argument goes. But this not an inevitable chain of cause and effect. Small changes do not have great impacts either way, and can be accommodated by suitable countervailing action. If the value of money goes up, monetary prices may be cut; a marginal increase in the real price can be offset by an improvement of sales service. Firms do not compete on price alone; and better quality control, or even better-targeted advertising, can compensate for an increase in real prices. And although cutting wages causes trouble, a temporary slow-down in promotion, or recruitment for a lower grade at a slightly lower wage, is likely to pass unnoticed.

It is further argued that in a period of deflation firms will postpone investment, reckoning that they will be able to get better value for their money if they wait. But counter-examples abound. With new computers not only does the price fall but the performance improves with the passage of time; yet when new models come out, queues form to be able to buy the newest model the moment it comes onto the market. Indeed in general, although buying something next year will cost me less than getting it now because of the interest on the purchase price over the year, I nonetheless buy it this year because I want to have it now; the interest arising from postponed purchase would not make up for not having the use of it. Similarly with deflation: if the rate of deflation is relatively small, and comparable to the general rate of interest—and often deflation is accompanied by a low general rate of interest—its effect in dampening down demand will be relatively small too.

It is widely believed that inflation secures full employment. It is difficult to understand Keynes' original argument, or to accept that inflation has generated the sort of full employment claimed for it. Paying people who would otherwise be idle, to do things which nobody had been willing to pay them to do, does create employment. But if it is at the cost of government IOUs being issued, with no immediate prospect of their being honoured. there will be too much money chasing not enough goods and services. Money will be easily come by, but not command much attention when it is spent. Manufacturers will not be under much pressure to keep up standards of workmanship and reliability, because if one consumer decides the goods offered are not worth the money, there will be another consumer who will also have money in his pocket and be less demanding. "Service with a snarl" was commonplace in Britain in the 1950s and 1960s, because customers could either put up with it, or not be served at all. That was acceptable according to the rhetoric of the time, because Producers were Good, and Consumers were Bad. In the aftermath of the Second World War it was plausible to think that production was essential, and the workers who produced it public benefactors, and consumption an undesirable drain on national resources. But in reality the roles are reversed. Production is valuable only if what is produced is wanted by some consumer. Producing large numbers of badly made cars was not a virtuous activity, but a wasteful one. As standards slipped under the pressure of inflation, so markets were lost, and the economy stagnated. Money needs to be hard to earn in order to keep manufacturers on their toes, and service-providers ready to practise smiles instead of snarls.

Inflation does great damage. It causes social strife. If money is losing its value, wages and salaries will go down unless people take action to push them up. Few people are content to put up with a continually declining income, and eventually will feel bound to assert themselves. Inflation requires continual wage bargaining, and strengthens Trade Unions, each of which will try to secure a better deal for its members. Relative wage rates will constantly be an issue, each successful negotiation by one union triggering fresh demands by others, not wanting their relativity to be eroded. There will be strikes and constant labour unrest and industrial indiscipline, as different trades jostle for position, readily persuading themselves that they are being treated unjustly. For there are many different sorts of justice, and there will usually be at least one sort of justice in the light of which they really are being treated unfairly: those at the bottom of the scale claiming that they need more if they are to have a reasonable standard of living; those who were at the top arguing that they deserve more because their work is difficult, and demands great skill. Dustmen demand more because their work is dirty, miners because it is dirty and dangerous, doctors because it is demanding and carries great responsibility. None of these contentions is absurd, but they cannot all be embodied in wage differentials. Disappointment and discontent are therefore inevitable. Rivalry, of course, can exist when there is no inflation. But resistance to granting an increase of a money wage is greater when this is to concede a greater real wage, with a consequent diminution of profitability or loss of markets. I may think I need more, deserve more, am entitled to more, but I may settle for what is on offer rather than risk being without a job. Over the years the different arguments and different market forces reach some sort of equilibrium, as people entering the labour market know what to expect, and make their own choices in the light of their own individual preferences and circumstances. It will not be perfectly just, or completely stable: new industries will spring up, as did the manufacture of motor cars between the two world wars, and pay higher wages to attract labour from other, and especially declining, industries. But most wage levels will remain fairly stable, only changing slowly, if at all, over the years. The cost of inflation in instability and industrial indiscipline is great.

Inflation causes uncertainty. Long ago postal rates were engraved on scales for weighing letters: now they change every year, and often even the Post Office does not have a leaflet to say what they are—it is a great disadvantage, not only in the present but in planning for the future, not to know what the value of money will be. Long-term leases and long-term contracts cannot be drawn up in simple monetary terms, but must either be written in terms of some foreign currency not expected to lose its value, or have monetary terms adjusted with reference to the retail price index or the consumer price index or some other trans-temporal measure of monetary worth. This is not only inconvenient, but ultimately destructive of the currency itself, whose nominal value will be written out of all serious economic transactions.

The erosion of a long-term standard of value promotes intergenerational conflict. The only robust basis for pensions is for each person during his working life to save for his old age. Contributory pensions, with contributions invested in trustee securities, provide a reasonably secure basis for pensions not susceptible to politicking. But once money cannot be trusted to keep its value, it becomes more and more difficult to define benefits in any meaningful way. Final salary schemes were often adopted, but had the great disadvantage of giving high-flyers larger pensions than they had contributed to, at the expense of the average earner. Governments have largely moved to unfunded schemes, effectively writing post-dated cheques for their successors to honour. But the workers of any one generation are inherently less willing to pay for the previous generation's pensions than they would be for their own. With increasing longevity, pensions have become a thorny political problem. Inflation makes it almost intractable.[14]

Inflation and deflation exert equal and opposite pressures on the economy. Inflation benefits borrowers and penalises lenders. But that makes lenders unwilling to lend, unless the interest rate is high enough to off-set inflation. So although it is good for those who already have mortgages or debts, it is bad for first-time buyers,

[14] See further below, §8.5, pp.180-182.

Inflation

1. Benefits borrowers and penalises lenders
2. Penalises savers and pensioners
3. Encourages consumption
4. Has the producer as king
5. Money easily earned, but not worth much

Deflation

1. Benefits lenders and penalises borrowers
2. Penalises debtors
3. Encourages thrift
4. Has the consumer as king
5. Money hard to come by, but commands much attention

and businessmen wanting an overdraft to expand their business.[15] It penalises those who have saved, but it does not benefit would-be borrowers, or act as a genuine stimulus to the economy.

Deflation benefits lenders and penalises borrowers, but naturally leads to lower interest rates. In a period of deflation the consumer is king. He can be demanding, because his money is wanted, and not easily come by except from him. He can afford to be discriminating, and potential suppliers will compete to provide the best goods and services. But there will be losers as well as winners in the competition to secure custom, and life may be tough—unreasonably and unfairly tough for the unsuccessful providers.

If we are to hold a balance between earners and spenders of money, we should seek to avoid both inflation and deflation; any large change in the value of money is to be deplored, as it creates uncertainty, and disrupts established practices. In so far as we fail to smooth out the business cycle, there may be periods of inflation alternating with periods of deflation, in which producers and consumers alternate in having the upper hand. But it is bad if either is large or prolonged. The natural symmetry between earner and spender suggests that zero is the best figure to aim at, which also alone can confer the immense benefit of long-term stability and predictability of prices and wages. The current idol of continuous two percent inflation not only has feet of clay, but is, in having governments issue IOUs which they do not intend to repay, dishonest.

[15] See below, §8.4, p.174n.

### §5.6 Liquidity, Credit and Trust

Liquidity is linked with confidence and confidence with trust.[16] A major factor in the current recession is the widespread loss of confidence in the powers that be. People do not trust bankers, MPs, the Home Office, the judiciary, the police. or the government. The bankers gambled with their money; MPs trousered thousands of pounds in phoney expense claims; the Home Office let dangerous criminals out of prison and ne'er-do-well immigrants into Britain; the magistrates are no longer independent citizens of repute, able and wiling to do justice on the merits of the case; the police determinedly do not pursue muggers and law-breakers, while prosecuting householders for defending their property; the previous government stole pensions in the private sector, and the present government is about to steal those promised to people employed in the public sector, and desecrates the countryside in order to reward donors to party funds.

It is an exaggeration. Some bankers were notably generous; most were at least honest; so were most MPs—many were squeaky clean, and many of those who claimed expenses did not abuse the system; Home Office softness was the result of popular pressure, Directives from Europe, and Human Rights Legislation; magistrates were appointed in order to make the bench more representative of the population as a whole, and so needed to be instructed on what they had to do; many policemen wanted to serve the public and maintain law and order, but had to obey the instructions that were handed down to them; the stealth tax hit charities and widows as well as pension funds; and the present government needs to re-negotiate the time and terms on which its employees retire and draw pensions because they are going to live longer, and is encouraging development so as to kick-start the economy.

All this is true. The trouble is that it takes only a few cases of bad behaviour to undermine trust.[17] Honest MPs slogging away night in, night out trying to make sense of detailed legislation after having written innumerable letters dealing with constituents' problems are taken for granted and forgotten, while ridiculous claims

[16] For a full discussion of the importance of trust in public life, see Onora O'Neil, *A Question of Trust*, Cambridge, 2002.

[17] Evolution has bred in us a much more rapid response to threats than to opportunities (if I miss a meal, I may eat later, but if I become one, I shall never eat again): and so bad news is news, while good news is not.

for expenses get the headlines; so too the sensible decisions by the magistrates, and the patient protection provided by police constables against violent demonstrators trying to provoke them.[18] To focus on the bad and ignore the good is a recipe or losing confidence.

But there is a pervasive culture of public relations and spin, which engenders habitual disbelief of what people say. Public relations deal with appearances rather than realities: images are brushed up, awkward facts brushed under the carpet. Public authorities and private firms issue self-congratulatory hand-outs, reporting all the good things they have done, while failures are covered up or dismissed as exceptions. The fund-raiser, as he issues his next mail-shot, takes no account of donor fatigue he generates. "No-reply" emails are sent to a large number of people at a click on a button, ensuring that no unwelcome feed-back is received. The cumulative effect of there being no dialogue is to induce a mood of cynicism, in which what is said is routinely disbelieved, and people feel that they are being manipulated by those with power, and not treated as responsible citizens with their own concerns, and capable of making their own contributions.

**Never believe anything until it has been officially denied.**

One factor in boosting spin at the expense of substance is "short-termism". Truth will out, but often in financial matters, only in the fullness of time. Dealers in dodgy derivatives could reckon to move on, having pocketed their bonuses, before it came out that they had been running unreasonable risks in their quest for quick profits. They did not feel responsible for the long-term welfare of their clients or for the public generally.

[18] There is a lesson here more modern trade unions. Although they are right to give each individual member the support he needs if he is being unfairly treated, they damage the long-term interests of their members generally, if they concone bad practice. The mediaeval guilds served their members better, defending both their interests and their good name.

**The Public Relations Culture**

1. Self-congratulatory Handouts
2. No Dialogue
3. Shielded from Bad Tidings
4, No Negative Feedback
5. Short-termism

Some attribute the lack of public spirit to the passing away of the generation that lived through the war years. Then the immediate threat of defeat and subjugation to Nazi tyranny evoked a togetherness that shaped men's minds for the rest of their lives. Subsequent generations, brought up under the *aegis* of the welfare state, are more conscious of their rights than the need to do their bit to save the country from defeat. Others discern a lack of moral compass, due perhaps to the decline of religious belief; or to the teaching of certain philosophers who espoused extreme moral subjectivism—which is shared by members of the political elite, who seem to be hollow men that make up for their lack of any real centre, by a general softness in the face of difficult decisions combined with deep antagonism to all things traditionally British.

It is easy to blame the moral turpitude of the present generation, and conclude that things will go on being bad until there is a general return to morality, and meanwhile stand to one side with our hands turned upwards, as the world goes progressively downwards. But it was always thus. Every generation has bewailed the prevailing lack of moral principle. It is part of the human condition to live among people who are not as good as they ought to be. The reasonable response is not to bewail, but to beware. Rather than lament the inadequacies of others, we should aim to think more clearly about what has gone amiss, and what we can do to remedy it. We should focus our attention on liquidity, confidence and trust, and ask ourselves what can we do to regenerate liquidity by restoring confidence and re-establishing trust. We need to beware macro-economic measures that alleviate the symptoms, but exacerbate the disease, yet need to recognise that trust is as much a matter of social psychology as of economic technique. Scholars may argue whether Roosevelt's New Deal really worked, but even if ineffective in hard economic fact, his fireside chats undoubtedly did have a good effect on morale. If people can be shown that they have nothing to fear except fear itself, they are well on the road to recovery.