

"Inflation Is Created by Government and by No One Else." Address moderated by Andrew Shonfield. *Controversy, British Broadcasting Service, 23 September 1974.*

Andrew Shonfield: Good evening and welcome to the Royal Institution. The subject we're going to discuss tonight concerns each one of us in every day of our lives. Nobody can escape the effects of inflation which has been with us for years and now threatens to accelerate out of control. This year in this country it may well reach 20%, and if it does, it means that anything that costs us a pound now will next September cost us a hundred and twenty pence. Now the odd thing is that though inflation has occurred before at various times in history the argument still rages around the two basic questions: What is the cause of inflation, and what is the cure. One man who claims to know the answer to both questions is Professor Milton Friedman our main speaker tonight. He's Professor of Economics at Chicago and is recognised as the world leader of the so-called monetarist school of economics – that is, he believes that the control over the money supply, that is over the printing of money by Government and its lending by banks is the key to the cause and to the cure for inflation. Professor Friedman's views have recently been winning some influential converts among politicians as well as among economists. However, four economists who have not been won over are here to lead the discussion with Professor Friedman tonight, and I shall introduce them. First, Professor Neild who is Professor of Economics at Cambridge University. Peter Oppenheimer who is a Fellow of Christ Church Oxford and a well-known expert on international finance. Geoffrey Maynard who is Professor of Economics at the University of Reading; and David Worswick who is Director of the National Institute for Economic and Social Research. And our audience here tonight includes many other academic economists as well as business men and bankers, trade unionists and as well as ordinary consumers among whom I number myself. All of us are deeply concerned about inflation. I shall be giving them a chance to join in the discussion later on. But now it's time to meet our principal speaker for tonight, Professor Milton Friedman.

Inflation is made by Government and no one else. Of course no Government likes to accept responsibilities. . . responsibility for its own defects, so Governments of course blame greedy business men, grasping trade unionists, and spend-thrift consumers. No doubt business men are greedy; no doubt trade unionists are grasping; and everyone knows that housewives are spendthrifts; but neither the greedy business men nor the grasping trade unionists nor the spendthrift housewives produce inflation. The reason they do not produce inflation is because none of them has access to a printing press on which he can turn out those lovely, or some people think not so lovely, pieces of paper with which you purchase goods and services. No one of them has the authority to create deposits at the central bank – at the Bank of England – which other banks can use to meet their obligations. Only Government has a monopoly of the printing press; only Government has the authority to create deposits at the Bank of England – the ultimate deposits. Inflation is always and everywhere a monetary phenomenon. It is a result of a greater increase in the quantity of money than in the output of goods and services which is available for spending. In order to bring home the fact that the proximate, immediate cause of inflation is always and everywhere excessive monetary creation I have had a number of charts prepared to present a little evidence for you. The first of these charts is for the United Kingdom. What it shows are two lines, the white line labelled money is the quantity of money per unit of output, that is to say the number of pounds in the form of currency in peoples' pockets and in the form of deposits at your bank expressed as a ratio to the total output of the country, and the whole thing fixed up so that it's a hundred in 1964. Prices is the index of consumer prices in the United Kingdom, and that too is expressed as an index of a hundred in 1964. So they have to be together down here. But if you look at them you will see that they show a very close resemblance throughout the whole period. In the last couple of years money has run sharply ahead of prices, that's a sure sign that you are not through with your inflation, that you have not yet absorbed that excess money that your Government has so busily been creating, and that as a result you probably have more inflation in store for you.

Of course you may say that's only a ten-year period and that's only one country – the United Kingdom – is that an artifact, an accident? Well just in order to have a little variety I have also the corresponding charts for a number of other major countries. Here's the United States for the same period, the numbers constructed

in exactly the same way, and I think you will agree that there is a resemblance between the two numbers, the two sets of numbers, of prices and money, is very close. What's true for the United States, what's true for the United Kingdom, is equally true for Germany. Once again you have the same picture of prices being a straightforward reflection of the changes in the quantity of money per unit of output. What's true for Germany is true for Japan. Indeed, the chart for Japan shows an extraordinary resemblance . . . oh, by putting these in this way I'm going to make inflation look worse than it really is. . . LAUGHTER. . . and that is something that I certainly have no desire to do. The chart for Japan is fascinating because it is so much like the chart for Britain. In both Japan and Britain the expansion of money recently speeded up very rapidly, and as a result, money has run ahead of prices, and in both countries therefore you have some unabsorbed inflation to come. Similar data are available for many countries, for centuries: two hundred years, for Sweden; a hundred years for Britain; a hundred years for the United States; a hundred years for Japan. The figures are consistent throughout. Whatever period you look at, whatever country you look at, you will find that the immediate cause. . . source of inflation is a more rapid rate of growth in the quantity of money than in output. But of course having established that it's only the beginning of the explanation of inflation. We have to ask: why the excess of monetary growth? Governments do not consist of people who are trying to produce inflation. They will protest, and protest honestly and sincerely, that that is no part of their objective. Why then in country after country in recent years and over thousands of years have we repeatedly had episodes of inflation? The major reason historically is that Governments everywhere are pressed by their own needs or by their constituents' to spend money. Their constituents like to see Government expenditures, but their constituents do not like to see extra Government taxes. It so happens that the printing of money and the production of inflation is the one form of taxation that can be introduced without ever being legislated, and without requiring a single tax-collector. It is therefore a particularly seductive form of taxation, and the overwhelmingly most important reason historically why we have had inflation is as a form of taxation without representation. A second reason, more recent and deriving very largely from the post-War experience, why Governments have resorted to inflation is because of the adoption of a full employment policy in the mistaken belief that Government has some magic way in which

it could create employment and output that would not otherwise be there. Because of the memories of the Great Depression there has understandably been in every country great public fear and concern about the emergence again of large unemployment. There has been less concern about inflation. Therefore we have had the situation in which at the . . . when inflation gets under way and Governments attempt to halt it, this attempt is likely to result . . . to lead to . . . some increase in unemployment, and at the slightest increase in unemployment Governments are induced to turn the printing press on full flood again in order to offset it. And a third reason why you have had inflation is because of the misunderstanding of economics on the part of central bankers. Central bankers in country after country around the world have confused credit with money, and as a result, while they have been the strongest and most fervent preachers of objecting to inflation, they have simultaneously been producing it. There is no technical problem about how to stop inflation. We know very well how to stop inflation. There is one and only one way to stop inflation – that's to stop letting the quantity of money increase so rapidly. It's to slow down Government spending. It's to slow down monetary growth, and in that way restrain private spending. The problem is not the technical one of how to stop inflation. The problem is the political one of having the political will to stop inflation. When you stop inflation you must slow down spending – there is no other way. And the initial effects of slowing down spending are a slower rate of economic growth and a higher level of unemployment than you would otherwise have. Those are the bad effects. The good effects are that as it takes hold inflation will slow down, and once you have slowed down inflation, employment can be as full as your society is capable of making it with your institutions. The plain fact is that today Britain is suffering from a severe economic disease. You will suffer if you let that disease continue. You will suffer some pains of curing the inflation, if you cure it. But the costs of enduring the disease will be far greater than the costs of taking timely action to end it. Because the costs of enduring the disease are likely to be the destruction of your civilisation. I do not believe that our free democratic society can survive a continuation of recurrent inflation and recurrent application of the false measures that are used supposedly to cure it. The way to minimize the side-effects from stopping inflation, the way to keep down the costs, to have pain-killers as I have called them in another connection, is to ease off from your high rate of inflation gradually. There is no miracle drug which will cure your disease

overnight. It will take two, three, four years, perhaps longer, before you can bring inflation back down to a level of two or three per cent – a tolerable level. You must take action against inflation therefore gradually, not step on the brakes so hard that you send the passengers through the windscreen. In addition, you can ease the cost of stopping inflation by widespread use of escalator clauses, particularly on Government taxes, so that you will no longer have the situation in which inflation automatically imposes higher taxes on people by pushing them up into higher income brackets, with Government again having to legislate it. And also by requiring Government to borrow in the form of purchasing power securities in a form which is adjusted for inflation. The ordinary small saver in this country has been victimised by his Government. He has been required to pay his Government for the privilege of lending to his Government. I think that is immoral and disgraceful and ought to be ended regardless of other considerations.

Finally, one thing that you should not resort to, one thing that is not a pain-killer, are price and wage controls, so-called incomes policies. Far from being a pain-killer or a sedative, they are the worst part of the disease. They produce distortions in your economic system; they make the effects of inflation far worse than they would otherwise be; they divide your nation one group from the other; they promote political unrest. And moreover, they have no effects. LAUGHTER. You know why wage and price controls are introduced? They are introduced by Governments which want to inflate. If a Government wants to inflate, but wants to give the impression to the public that it's doing something against inflation, it introduces wage and price controls. That is what my Government did on August 15th 1971. It is what your Government did on a date that I am not as familiar with, but when Mr. Heath shifted in an earlier time from his policy of restraint to a policy of incomes policy. And what is true in your country and my country has been true in every other case going all the way back to the time of Emperor Diocletian. So I say to you, the way to handle the problem of inflation is to tackle it head on by slowing the rate of monetary growth gradually, by having sedatives in the form of tax and income escalators, and by avoiding like the very plague wage and price controls in any form shape or manner. Thank you.

Questions and Answers

Andrew Shonfield: Well thank you Professor Friedman, and now we'll turn to the discussion, and I'll ask David Worswick if he'll start it off.

David Worswick: The facts I think are not in dispute, that all industrial countries have had some degree of inflation throughout the post-War period of rather different rates, and all of them have had acceleration in the most recent period. The point to which I'd like to return is that the nature of that acceleration does seem to be rather different in different countries – a point which is not brought out very clearly in the particular graphs we've had in front of us. And I believe in a nutshell, one has to over-simplify, as we all will have to over-simplify this evening, that the.. the key to all this was the full-employment commitment. It was recognised in this country, and the argument I shall give is mainly about the British case but I think it may have application elsewhere in part or wholly. The people who wrote about this subject in 19.. at the end of the War – take Beveridge for example – were well aware that if you have full employment by Keynesian means that there was no inherent mechanism in the system which would ensure that with sectional wage bargaining the annual increase in money wages would be in line with growth of real productivity. The likelihood was that it would be greater. And they therefore recommended – the idea of incomes policy in this country dates from the very earliest – they recommended to the Trade Unions to form what was called a 'Unified Wage Policy', and I was involved in that discussion also. My recollection is two things: at that time we were obviously speculating, there'd been no experience of full employment for a very long time in industrial countries, speculating what would happen, we.. I thought and many others did, that it would accelerate rather quickly, which proved, as I will come to in a moment, not to be the case. And the second thought was that it wouldn't be difficult to get the Trade Unions to agree to a unified wages policy. The prize of full employment contrasted with the experience of the inter-war years was so great that this adjustment which was in everybody's interest would come about rather easily. It didn't. And one of the reasons I think was that in the 50's we had a period after the Korean War was over when the inflation, which was quite high at that time, dropped away in all industrial countries and it looked as though we could settle for rather stable and rather low rates of inflation – at least as seen from now – without involving yourself with all this palaver of an incomes policy or a prices and incomes policy. And during the 50's in most countries there

were rather low rates of inflation, not all the same. In this country however, people began to worry towards the end of the 1950's, and with respect, incomes policy with us is not just the event of the Heath incomes policy. We in effect in this country have had an incomes policy of a kind for.. virtually for the last 17 years. The acceleration which I shall have just to mention, but I think this is an important point to consider, the acceleration which has taken place has not been uniform in all countries, and there's a rather important and interesting difference between the United States where Professor Friedman lives and the United Kingdom where I live. In the United States the acceleration of inflation coincides with that great period of growth and expansion of the '60's when you had a high rate of growth and diminishing unemployment and a slow acceleration of inflation – your price curve rises quite steadily. In our case the acceleration came in this country – the first big wave – we've had two in recent years, came in 19.. at the end of 1969, when we've had slow growth, rising unemployment and it came with a bang in a matter of two years, a wage-induced inflation, a wage explosion if you like. Now I haven't time to go into.. there may be an opportunity of going into this but to sum up, it does seem to me that the key thing is the full employment commitment. And now in one sense obviously the Governments by accepting this commitment – I agree with Professor Friedman – show their responsibility for inflation. But I would also say that we in a different role, not as citizens asking our Government to do something for us, because they didn't do it out of perversity, we wanted then to give us full employment, we as organised workers in our Trade Unions have not adapted our bargaining institutions in this country at any rate in such a way as to ensure that the wage increases are compatible with full employment. And this is the problem. I believe myself that the incomes policy, and I've long believed, is the way which we have to eventually resolve this problem.

Andrew Shonfield: Well there is a complete contradiction of your thesis that an incomes policy is no use and. . .

Professor Milton Friedman:.. Of course I should explain that I realise that you've had more than one failure with income policies. LAUGHTER: APPLAUSE: But in the widespread belief that one picture is worth many words I would ask Mr. Worswick to turn his attention to the picture of Japan as opposed to the picture of the United States. In the past two years Japan has had an acceleration of inflation which is even

more rapid than the United Kingdom. Japan has not had a fervent commitment to a full employment policy of the British kind; it does not have strong Trade Unions. If Mr. Worswick's view of Britain is right we need at least two theories of the sources of inflation, one for Britain and one for Japan. But the fact is that the one thing that is common to both Japan and the United Kingdom over the period in which both have had a rapid expansion in their price levels is a change in the money supply. Now why is it that this seemingly appealing view of Mr. Worswick's, this view that at first sight seems to be so reasonable and sensible, is wrong? It is wrong because.. excuse me.. it is wrong in my opinion because it confuses very much two very different problems: the problem of relative wages in different occupations; and the problem of the changes in prices of the.. changes in pound wages or pound prices. The effect of Trade Unions.. Now let me make clear, I think Trade Unions in your country and my country have done a great deal of harm. I think they have done a great deal of harm primarily by restricting opportunities for the ordinary man, by keeping down the number of places. By raising wage rates in highly skilled trades they have forced their fellow workmen into lower skilled trades where they get lower income. I think that people who have been hurt most by Trade Union restriction are the lower skilled people in the community. But the one thing Trade Unions have not done has been to promote inflation, because what a Trade Union does if it is strong and successful is to make the wage of its members high. That means there's less employment for its members; that means somebody else's wage is low; but once that Trade Union has achieved that objective it doesn't continue to have any inflationary pressure of any kind, and the inflationary pressure only derives if the Government through over-expansionary monetary and fiscal policy creates money and seeks to have a higher level of employment than is consistent with your basic institutions. And let me say one more thing: if you believe that Trade Union strength is a source of real difficulty in your society, then you should face up to that fact directly by altering your laws and your arrangements in such a way as to reduce the power of Trade Unions. But the idea that with these paper weapons of incomes policy you are going to be able to achieve a reduction in the real strength.. in the true strength.. in the true force of strong effective Trade Unions seems to me an illusion whose prevalence I find it very hard to understand.

Peter Oppenheimer: Could I chip in there Mr. Chairman?

Andrew Shenfield: Well, I think actually, can we just have David Worswick answer back because Peter you can come in later.

David Worswick: .. I would have to over-simplify that I was going to illustrate from the British example, and I believe that it has some application to other countries at different times. I believe that in the recent period in Japan they've had also some small increase of the order of 30% I think through Trade Union action in the rather recent period. I'm not saying that was true throughout the whole period, there are differences in this.

Professor Milton Friedman: I want to go back to one point before you go on. Unaccustomed as I am to defending Trade Unions LAUGHTER: they are absolutely right when they say that they are entitled to compensation for a rise in prices. The case you refer to in Japan was strictly a defensive rise – prices had risen sharply – and as a result the real wages of workers in Japan had been eroded, the 30% increase in wages in Japan was not in any way inflationary, as it is now here. An increase in wages per se is not inflationary. It means that workers have.. the workers temporarily have more to spend, and the employers have less to spend. It does not alter total demand. But more important, when Governments follow policies which force up prices, why this of course will lead to adjustments in wages, and should do so.

Andrew Shonfield: Peter Oppenheimer. You go on.

Peter Oppenheimer: In the first place Professor Friedman just a moment ago said that in a quite general form workers are entitled to be compensated for increases in the cost of living – this of course isn't true as a general statement: it assumes that real output is rising. In the long run if real output per head were falling one could not say that workers were automatically entitled to be compensated because real wages would have to be falling and any increase in money wages would then be in some sense inflationary. However, I don't think that this particular point is really inconsistent with the rest of Professor Friedman's case because he himself would say and I won't bore us all by quoting from his writings, but he himself would say that in the short run increases.. LAUGHTER: increases in the general price level, as well as individual prices can have all sorts of causes, including misjudgement by Unions as to the kind of money wage increase which is appropriate for them to pursue. His argument would be that it's only after such short-run changes

have taken place that one could say clearly that the continuation of inflation is Government responsibility, and that what the Unions will do if the Government acts sensibly is to price themselves out of the market and cause unemployment. Now I'd like to ask him a question. You see what worries me about this is the following: Unions are agreed to place Governments in a dilemmatic position where they have to chose between financing inflation and causing unemployment. Now why if they chose to finance inflation you say it's the Government's fault; and if they chose to cause unemployment it's the Trade Union's fault.

Professor Friedman: Well, first of all I don't accept the dichotomy The fact is that Unions do not place Governments in that dilemma: that isn't the dilemma in which Unions place Governments. Trade Unions. . the argument that you've been making would apply only if Trade Unions were getting stronger. If. .

Peter Oppenheimer: They are. .

Professor Friedman: . . Trade Unions are equally strong, if they are of a given degree of strength, they've caused this dilemma long ago. The wages of. . in our country – I don't know the data in yours so it's hard for me to discuss – but the wages of carpenters and plumbers have for long been high relative to other people; they haven't created any additional unemployment; they don't put the Government in this dilemma at all. The dilemma which Trade Unions raise is opening up a wider range of opportunities for the ordinary people in the community. In the second place, if I may go back to the place where you started. I quite agree with you with your interpretation of my view. There are many factors that will cause brief changes in prices. If you look at all of these charts the lines are extraordinarily parallel but they are not identical, and those minor deviations are the results of the kinds of short-run forces that you are talking about. They may work one way or the other, but over any period of time it takes a prolonged expansion in the quantity of money. What has put the Government in a dilemma is not the Trade Unions; it's the Government's own attempt to finance expenditures by hidden taxes, by taxes that have not been voted by the Parliament, that are collected in an indirect way, it's the Government's attempt. . egged on by. . when I say the Government's don't misunderstand me: we're talking about democratic societies; it's the electorate's belief, it's the ability of Governments to fool electorates into believing that somehow or other somebody else will pay for the electorate's. . for the Government expenditures. It's the old story that Bastiat, do you remember his famous

statement? ‘Government is that fiction whereby everybody thinks he can live at the expense of everybody else’ – and inflation is a device whereby Governments have been able for a time to fool their electorates into believing that this is going on. But as electorates learn, as they do, they are going to force their Governments to face up to the fact. That’s why I say sooner or later you have to face up to it, and the blame should not be put on Trade Unions. As I say, if you want to attract. . . attack Trade Unions, attack ‘em.

Oppenheimer: (Interrupts). . I don’t know a ready-made index of recent increases in the power of Trade Unions; I don’t think such an index exists, but I think most qualified, many qualified, observers of the social and political scene in this country would argue that in the last five to ten years the power of Trade Unions in various aspects of life in this country, including wage bargaining has, for various reasons, increased. And in any case it seems to me quite a significant concession on your part to say that the dilemma which I put to you in the previous question could in fact result, if there was an increase in the power of the Trade Unions going on. Because that is surely not a monetary phenomenon, yet you’ve agreed that it could pose a dilemma for the Government in which it has to choose between two very uncomfortable alternatives.

Professor Friedman: (Interrupts). . No, no, no. It’s a quite different phenomenon; it poses a dilemma not between inflation and unemployment, but between a once-for-all higher price level and unemployment, which is quite a different thing. It is not an explanation for any such continuing process. What we have been observing after all in Britain is a process where you have had a steady acceleration of the rate of increase in prices. It’s not simply that the price level has risen. It has risen at an increasing rate.

Peter Oppenheimer: That’s not so.

Professor Friedman: Excuse me. I don’t mean steady; I don’t mean steady in the sense of year after year; you’re quite right. You have had a distinct acceleration from. . . and if you take it decade by decade, the level of price rise has been higher in successive decades. If you look at the chart that I had here to begin with, that’s only a ten-year period, but during that period you have a slight deceleration for a few years and then you have a rather steady acceleration from about ‘66 on, in which the rate of price increase has been rising, and it’s that steady acceleration cannot be explained by growing . . .

Andrew Shonfield: (Interrupts). . Could I now bring in Robert Neild.

Robert Neild: Now I want to start from very basic. . . just to correct one factual statement of yours, which is the notion that Governments consciously choose between inflation and taxation. With respect, this is nonsense. I've worked for Governments of both sorts, for Chancellors of both sorts, and never consciously or unconsciously does that choice occur. The choice which occurs. . . LAUGHTER. . in a framework of national income forecasts, which in my view have often been nonsense, is whether to adjust taxation in such a way as to achieve a given level of employment in the coming period, or possibly to please some constituent part, whichever part of the community supports you before an election. These are the normal standards of behaviour. There's no choice between inflation and taxation. That, with respect, is simply invalid. But I think the danger with your presentation is to put money on the centre of the stage as if it were the key variable, the key instrument, on which a Government can operate. But let me give you my view briefly of how we've got into this inflation. We had a long period – through the '50's and so on – when in most countries wages moved in line with productivity in the leading sector of manufacturing in the principal industrial countries of Europe, and here it seems a possible explanation is that the bargaining mechanism was such, in a system of administered prices, that if you take a sector with very rapidly growing productivity, which by and large accepts prices set by the America and other countries, if it doesn't concede large wage increases it makes very good profit increases; it shares these; so you get a natural tendency for wages to rise with productivity in the leading sector. The bargaining mechanism achieves this. If that occurs, and productivity grows more slowly elsewhere, but relative wages cannot keep shifting backwards, you have a mechanism which is automatically built in through the process of price setting and wage bargaining, a tendency for the average price level to rise, and this explains up to the moment when acceleration took off well enough what was happening to prices in countries such as ours. Now in the late '60's inflation accelerated. At this stage several things happened. One was the United States, because of a war and various other things, ceased to be a stabilizer in the price system as a price leader, its prices took off, and it, as a stabilizing element in price leadership, I think, gave way. At the same time its balance of payments deficits meant that through a monetary mechanism other countries were subject to much less external discipline, they could run balance of payments deficits more easily. And at this stage in a whole variety of industrial countries inflation began

to accelerate. But the significant thing was after that initial acceleration we reached a stage fairly recently when all the industrial countries of the world simultaneously went in for a tremendous wave of expansion such as we've rarely seen for a very long time since the Korean boom. Now I think the key explanation for this is in fact political. You will find at that moment there was an extraordinary coincidence of elections coming up amongst all the OECD member countries – Germany, Japan, France, U.K., endless countries were having elections simultaneously – a thing which had very rarely happened before coincidentally at the same time, and they all, partly for this and partly for other reasons, followed more expansionary policies than they would otherwise. But I think that is wholly subsidiary to the other effect which occurred, which was that industrial production at this stage outran the limits of primary production. We suddenly hit limits of raw materials, foodstuffs and primary commodities of this kind where, as we all know, supply is very inelastic; we can't respond quickly to sudden changes in demand, given that Nature sets certain limits; and also it is par excellence the kind of market that you like where prices are settled from day to day by the free interplay of supply and demand and speculators so that if there is a shortage they rocket up, as we have witnessed. And this moment when, owing to simultaneous expansion we hit the limits of primary production, caused a tremendous twist to inflation in our countries; and it was further aggravated by the behaviour of the oil producers in jacking up one particular price. What it meant was that real wages were suddenly squeezed, the food price went up, and you are bound in this situation to get a reaction from workers, ill- or well-organised, in demanding higher wages and compensation for this, particularly since the automatic response of the system on such an occasion is to cause a shift of profit so that you see other people doing very well out of it, and this certainly inflames the social situation, the wage situation, and everything else. And this being so, we have a very powerful external force that has generated inflation here, and the money supply could not but follow this. Had the authorities, and indeed they have to some extent, really tightened the money supply in the face of this increase in prices coming from outside, which could not be offset by raising the exchange rate, you could not compensate for it by that, the only thing they would have done was to bankrupt firms who were unable to carry their new stocks at the higher prices.

Andrew Shonfield: I think Professor Neild has made a number of points, perhaps you could take them seriatim.

Professor Friedman: Yes he has, and I want to separate out those in which there is a real disagreement from those in which we are all describing the same mechanism which is not one of cause and effect, but a description of the way the disease proceeds. A germ which produces a disease is the cause of the disease, the disease will then have certain characteristics. Almost everything you have said about the course from one price to another price in raw materials to other prices really has nothing to do with the issue at all, it is solely a description of the . . . of how the disease proceeds. The key element of disagreement between us is the assertion by Professor Neild that money is not the centre, my assertion that it is; his assertion that the whole movement of these two series reflects money following prices, rather than prices following money.

Robert Neild: I'm sorry, let me correct you. You've corrupted what I've said. LAUGHTER. I said: that to some extent money can. . . you can influence credit policy obviously within some limits – all central banks do – but there are very severe limits to how far you can do this without bankrupting the financial system and bringing down the financial pyramid, the credit pyramid, or bankrupting firms so ruthlessly and suddenly that you will cause troubles which politically and socially are unacceptable and which will not necessarily contribute to the solution of inflation short of the destruction of your society.

Professor Friedman: Again this is not really, not really . . . I believe a key element. Obviously I agree that there are political problems stopping inflation; that's what I emphasised. I agree with you that there is joint expansion in many countries, but it took the form of a rapid increase in the quantity of money from which the other things flowed. The central key analytical difference between you and me is your assertion that the relationship that is observed between prices and money reflects some independent changes in prices, which then are passively followed by money because the monetary authorities must match those prices. You know the essence of a theory of inflation is that it ought not to be provincial. It ought not to be a theory that it works within 30 miles of Cambridge and nowhere else! APPLAUSE. and we have . . .

Robert Neild: I'll say the same for Chicago.

Professor Friedman: Let me go on. . I agree with you about Chicago as well.

Robert Neild: Right. .

Professor Friedman: Let me go on. We have had many episodes of inflation around the world. Let me name you just some obvious cases to show why your analysis cannot be a uniform theory of inflation. I do not think you would tell me that the inflation that occurred in Europe as a result of the gold and silver discoveries in Spain . . . of Spain in the New world back in the 16th century, I doubt that you would tell me that that resulting inflation resulted because some prices originally rose and there were all sorts of difficulties in wages tending to run ahead of productivity and the authorities had to go get that gold . . . LAUGHTER. . . ALL TALK TOGETHER.

Robert Neild: There is a great deal of difference between gold and credit money and you know this.

Professor Friedman: I doubt that you will tell me that the inflation which arose as a result of the gold discoveries in Australia in the 1850's. . .

Robert Neild: Look, gold is different from credit money – we are talking about credit money, not gold.

Professor Friedman: Very well. I doubt that you will say to me that the inflations which arose as a result of the financing of world wars. . . the various world wars, as a result of, . . . that the hyper-inflation which arose in Germany or in Hungary or in other countries, I doubt that you will tell me that in every one of those cases there were somehow some autonomous changes in wages and prices imported from abroad but somehow multiplied by a magnification factor of 10 to the 10th or something, which . . . in which the monetary authorities had to follow. The fact is we have had inflation for thousands of years and whenever we have had inflations two kinds of explanations have been offered: the kind you have offered, one which is rooted in very specific circumstances of the particular time. That particular explanation has been different from time to time. In the Napoleonic period in England the explanation that was offered, a hundred-odd years ago, was a blockade of the Continent; in other times it's been other things. But in every one of these episodes there's also been offered the correct explanation, LAUGHTER. which is that inflation reflects the creation of money. Now the plain fact is that if we take all of our episodes of inflation that we know of, there is no way of explaining them or reconciling them along the line that it is prices that are the initiator and

money that follows. Moreover, the notions you have expressed of imported inflation are invalid in a country which has a floating exchange rate. . .

Robert Neild: I beg your pardon. . .

Professor Friedman: I grant you that so long as a country has a rigid exchange rate with another, then it is true that inflationary impulses or deflationary impulses in one country will be transmitted to the other. But that link is broken when you have a floating exchange rate, and when you have a floating exchange rate inflation is produced by the policy of the Government within the country itself and not . . .

Robert Neild: (Interrupts).. This is not true, with respect, and I'm sure you know this. If you take one set of countries producing primary products which get into scarce supply, another group producing industrial products that use those primary products, you require, owing to the relative scarcity and the supply constraint in the primary ones, a rise in their real price relative to industrial products for your whole price mechanism to work. . .

If you are to suggest that the exchange rate can be floated up to the point where that shift in relative prices is nullified your whole corrective mechanism is in itself nullified.

Professor Friedman: You know.. Professor Neild has access to my subconscious as well as to that of the authorities.

ALL TALK TOGETHER.

Robert Neild: Yes, well, I've scotched all that. . . .

Andrew Shonfield: I wonder Professor Friedman we didn't get diverted into the floating rates argument for a moment because my friend Professor Maynard, who has remained decently silent so far, has something to say on this and other subjects.

Professor Maynard: Perhaps wisely silent. The University of Cambridge having been dismissed, and the University of Chicago having been dismissed, perhaps I could introduce the University of Reading rather hopefully. And also maybe offer you a lot of. . . more confusion to demolish. It seems to me that if we look at the last twenty years we've got sort of three periods. It began in 1950/51 with quite a high rate of inflation throughout the industrial world, associated with the outbreak of the Korean War, and the fear of the Third

World War; and it may well be that Professor Friedman has a theory which says the creation of money creates the Korean War and the fear of a Third World War, but I don't think we can ignore the fact that the outburst of inflation at that time was due to the Korean War and the fear of it. And we've ended the period with another period of fairly rapid inflation in which, I agree with Professor Neild, rising primary product prices has played an important part – it's certainly contributed to inflation in the U.K., I don't believe it's been the whole cause of inflation in the U.K. by any means, but it has certainly contributed to it. Now in between those two periods we had the long period of really rather moderate inflation throughout the industrial world, averaging I suppose about 3% per annum. One major characteristic was that manufactured goods prices throughout that period were pretty stable. Stable in the U.K. as well as in Japan, as well as in Germany, as well as in the United States, in fact they were stable in all countries irrespective of their own overall rates of inflation. Another characteristic of this inflation, certainly as far as the United Kingdom is concerned, was that the money supply grew much less fast than the value of Gross National Product. I've got some figures from. . . for the U.K., and I can give you one or two others for the other countries. Generally we get something like this: that real National Product in the U.K. grew by about 45% in this period. The money value of Gross National Product probably grew by about 115%. The money supply only grew at 60%, and the ratio of money supply to the value of Gross National Product fell by about 30% in this period. (ACKNOWLEDGEMENT FROM OTHERS). Now I don't know if that is consistent with a monetary theory. . . LAUGHTER. . . this is one piece of confusion that you may be able to satisfy me. Now I think I could give an explanation of why we've got this inflation, and it's one you are familiar with that if productivity's growing at different rates in different sectors of the economy, and if it is true that money wages in the fastest productivity growth industries, the growth of wages there sets the pattern for the growth of wages in the economy as a whole, then you have a situation in which prices in the fast productivity growth industries remain pretty stable but cost pressures appear in the industries where productivity is growing less fast, and as a consequence in order to protect their profit margins and so on, their prices begin to rise. As a consequence of which the average price level rises.

Professor Friedman: Let me separate out the two issues. The first issue which you raised is how can I reconcile with this monetary interpretation the admitted fact that the quantity of money in the '50's rose less rapidly than prices in our total national income. But if I had extended this chart back to the '50's, well there would be a general similarity. There would be an opening up in which the quantity of money would have been above prices earlier and come closer together. And the answer is in the chart which I don't have here, but I wish I did, which shows a similar relationship for a hundred years of the United Kingdom. And it turns out that what happened in the United Kingdom as also in the United States is that during World War Two in both countries there was accumulated a very large excess of liquidity. The quantity of money in those periods rose much more rapidly than prices went up, and you had a post-war period in both your country and mine, and I may say in a number of others that I have also studied, a readjustment in which over a period of time you had this excess liquidity re-absorbed into the economy so that it was perfectly possible for prices and incomes to rise more rapidly over that period than the quantity of money. . . .

Professor Maynard: But that means of course you would admit that over at least a period of maybe fifteen to twenty years the price level rose independently of the stock of money?

Professor Friedman: Not at all. In that same period if, while the excess liquidity had been worked off, the quantity of money had increased less, the price level would have rose less. I have argued that what you have to do is consider the changes in the quantity of money relative to the changes in the demand for money via output increases and via the fact that you came out of the war with an excess liquidity that was to be worked off.

Professor Maynard: But I think. I must say I don't accept the fact. Many people would argue that by the early 1950's given the inflation from about 1946 to 1951 then the Korean War inflation, that the excess of liquidity in the United Kingdom had been substantially worked out.

Professor Friedman: That's why I say you need to look at a hundred year period in order to see that in the pre-war . . . that what you did back over here was to get back to the pre-World War Two relation. I agree that's a quantitative question, that's not a question to be decided by . . . appeal to. . .

Andrew Shonfield: (Interrupts).. I think we're getting dangerously into a technical point which does need to be elucidated. If one's talking about excess of liquidity, as if this was something you could grasp in your hand, one needs some kind of definition to help us all.

Professor Friedman: Ordinarily, there is a certain amount of money that people want to hold which is best expressed as a fraction of their annual income. On the average, people want to hold something like, in the form of currency plus deposits, all people, businesses and people, something like – in the United States this number is something like six months' income depending on what definition of money you use.

David Worswick: (Interrupts).. Constant fraction of income.

Professor Friedman: Roughly constant fraction of income.

In the United Kingdom this fraction is not very different from what it is in the United States. Now this fraction of income is constant on the average but it's not precisely constant, it's not identical from day to day, and in particular, over a period like World War Two when you have countries engaged in massive wars, major wars, when consumer goods and products are not available, because they are not being permitted to being produced, when countries are financing much of their expenditures by creating money, the ratio of money to peoples' income is permitted by then to rise to a much higher level. That's what I mean by the excess liquidity. And the working of it off after the war is returning to the basic fraction which they seek to attain.

Andrew Shonfield: As I interrupted you on your second point.

I think we will deal with that and then we will call in our audience to make some comments.

Professor Friedman: Professor Maynard was arguing that changes in relative productivities in different industries could affect the average price level. That somehow or other the fact that some prices were going to fall, relative to other prices, required all prices to rise. Now historically this has not been true. If we go back over many periods of history we have had some prices falling, some rising, it's not true today. Despite the inflation we have all had – the price of computer services today is probably one tenth or one one-hundredth of what it was twenty years ago. In the United States there are large T.V. sets, refrigerators, many

things like this which literally have fallen absolutely in price. There is no reason why some prices cannot fall, others cannot be stable, others cannot rise.

Andrew Shonfield: Professor Neild, very quickly..

Professor Neild: Very briefly. Now that graph you've got there is a perfect example of an association where the causation is ambiguous. I could draw you just as good a graph of the number of meals a man eats in his life and how long he lives, and you may argue that it's, if he ate more meals he'll live longer; but you can equally argue that it's only because he's living that he can eat the meals, and the causation of which way round you argue it..

Professor Friedman: I would be delighted. . .

Professor Neild: . . is complicated, ambiguous in certain situations, if he's starving, the meals. .

Now this is what we've got here. Now the evidence as to whether altering the money supply will slow down prices is particularly ambiguous here because through most of that period the authorities were following a passive monetary policy in which, a lot of this still, in which they kept interest rates rather stable, tried to keep an orderly market, and essentially let the money supply vary a good deal of the time, not all of it but a lot of it.

Professor Friedman: Excuse me, I gave that as my third reason, why we have had inflation, because monetary authorities have confused credit with money they've..

Professor Neild: Good now tell me. . .

Professor Friedman: .. and in the process have created too much money.

Professor Neild: You concede that the evidence then is of no relevance to indicating what will happen when they tighten the supply. That is the question I would like to know. .INTERRUPTION. I want to know the mechanics of this process by which wages are going to slow down without industrial strife, without any of these troubles, this particular mechanism.

Professor Friedman: There are two different questions you have raised, and I will be glad to answer them. I gave you some evidence that the causal relation was running from money to prices. You said to me: Ah, but gold is different from credit money. I will now cite you a number of episodes with credit money. In

the famous Civil War in the United States, the Confederate States had a pretty sizable inflation. At one point in the War the Northern Union Army overran the place at which the Confederate Government had been printing its money. That was strictly credit money; it was strictly a physical circumstance; I don't believe it was a decline in prices that caused the Government troops to overrun that place. LAUGHTER: It took the printing authorities, the Government authorities, something like three or four weeks before they were able to set up anywhere else. Prices over that three or four week period stopped rising and fell. Now I think you can find no clearer example that I know of, of cause and effect. LAUGHTER: APPLAUSE.

Professor Neild: I think Groucho Marx could do better, go on.

Andrew Shonfield: Might I suggest, with that dazzling illustration, if we did throw this discussion open to the rest of the. .

Professor Friedman: Well, I think it is important to meet his second.. I could give many such examples – and what I'm trying to say is that the evidence, the historical evidence for the causal relationship, has to be obtained by examining the circumstances surrounding various episodes. And if you do, there is overwhelming evidence which we have presented time and again, and again it's a sign of the provinciality of English economics that this question should be raised over and over again, despite the number of times..

Professor Neild: It's a sign of the provinciality of Chicago which suggests that if troops enter the mint the prices will fall..

Professor Friedman: Excuse me. . . .

Andrew Shonfield: I really think we're beginning to. .

INTERRUPTIONS BY ALL: Gentlemen. Really we are trying to pursue an intellectual point and lets proceed in that spirit. .

Professor Neild: Very good, yes I will. .

Andrew Shonfield: I think you've made your general point.

Professor Friedman: The point he wants is a different point, and he wants to know about the cause. . .

Professor Neild: I want to know if troops enter the mint will prices fall. .

Andrew Shonfield: Can we just have. . .

Professor Friedman: He wants to know about the causal mechanism. What he says is: What is the mechanism, because again this is not a new question it is one that comes up over and over again; it's answered over and over again: it was answered in the 18th Century by David Hume, and in the 19th Century by Marshall, and the 20th Century by Fisher and Keynes, but it keeps on coming up.

The question is what is the mechanism whereby an increase in money causes a rise in prices or whereby a decrease in the quantity of money causes a decline in prices. I want to answer that question. I can't answer it as masterfully as these masters of the past have answered it, but I can get to their central idea.

And the central idea goes back to the one I mentioned before: that there is some quantity of money, some quantity of currency plus deposits, that individuals wish to keep by them. This quantity depends on prices. It is a real quantity. People want to have purchasing power equivalent to a certain number of weeks of income for unexpected circumstances, to meet their ongoing bills and their ongoing obligations. If a larger quantity of money is created, whether it is created by gold discoveries, by printing money to pay for Government bills, by the purchase of bonds by Government, or whatever way it is created, the effect is that somewhere or other in the system individuals have larger cash balances, and these cash balances are larger than the quantity, in real terms, that they are accustomed to keep by them. And people who have such balances will seek to adjust to their proceeding level. How can they adjust them? By trying to spend them. Well, one man's expenditure is another man's receipts; we have a game of musical chairs. The total quantity of money, the number of dollars, the number of, the amounts of deposits and so on is there, and it's going to be passed from hand to hand and in the process of attempting to spend it you increase total spending; this tends to raise prices; it tends to lead to this kind of association and causes the causal mechanism to run that way. In the same way the other way. Now far be it for me to say that this process is instantaneous or frictionless. Far from having denied that in the process of slowing down inflation there will be industrial disruption and difficulty, I have asserted that's a cost you cannot escape, that once you have gotten yourself into this fix there is no easy way out of it; and of course it is true that as people try to reduce spending, throughout the economy, people don't know whether a reduction in demand for their products is for their

special products or for products in general, and therefore there is some tendency in the first instance for people to reduce their activity, for lower employment, for a slightly lower rate of growth. .

Oppenheimer: The first instance may last 15 years.

Professor Friedman: No.

Oppenheimer: Yes Sir. .

Professor Friedman: Excuse me. .

Andrew Shonfield: I think Professor Friedman it is fair to say that you have now expressed the central point about the mechanism, and I feel. . No, no. INTERRUPTION.

Neild. I feel that I am now in an avuncular relationship with our distinguished audience and they must, having been patient, be allowed to speak.

Michael Parkin, Professor of Economics, the University of Manchester I want to ask two questions of the parochial English school, as it has been called. The first is, how is it that when we were pursuing the full employment Keynesian policies that we have been pursuing since the War, that inflation in this country was pretty well under control during the 1950's, indeed it was following a downward trend. In the 1960's it's been on an upward trend, and that trend at first was gentle, indeed hardly discernible until later in the '60's, been very sharp in the late '60's and extremely uncomfortable recently. How is it that Trade Unions, or some other mystical creatures, have behaved in a manner that's conducive to a trend fall in the inflation rate in the 1950's and increases subsequently. Furthermore why is it that these people behave with such remarkable cyclical regularity?

Andrew Shonfield: David, would you answer. David Worswick?

David Worswick: I would like if I may have a word. I would give two answers to that. One is that during this period the United States was particularly stable and suffered as a matter of fact from rather rising unemployment which helped; and the second factor was that from the external influences coming in to us, the terms of trade the commodity prices which lately we've been hearing about hitting us badly, were rather coming in our favour. It's not commonly realised how enormously the terms of trade of manufacturers

improve with respect to commodities during the '50's and the early '60's. And I think elsewhere I would look for, I don't regard, as a matter of fact I wouldn't explain the Middle Ages with Trade Unions. I. . .

Professor Friedman: We welcome that concession. . LAUGHTER:

David Worswick: I would look for in the more recent period in this country – and I believe this is true of some European countries that I know – changes in the behaviour of the organisation of Trade Unions, changes in Trade Union power and incidentally change in aspirations of members of Trade Unions arising out of the whole communications revolution where we've become much more aware, all of us, of what other people get.

Andrew Shonfield: That gentleman there.

Tony Christopher: I'm the General Secretary elect of the Inland Revenue Staff Federation. You can understand my anxiety about this tax which members are not being paid for collecting.

LAUGHTER: APPLAUSE.

Professor Friedman: Now there's a pressure group with sensible monetary policy I never dreamed of.

Tony Christopher: I'm really concerned to ask for your comments about the withdrawal symptoms of inflation if your theories are correct. But in doing so can I say that my principal worry is that my feeling is that this discussion, the impression left upon the audience is that in front of you are four gentlemen who believe that really the root cause of all of this is a Trade Union Movement and wage pressure. But there is no doubt whatever that the Trade Union Movement in this country is definitely concerned about the rate of inflation. And anybody who was at the Trade Union Congress this year would have been impressed with the basic sincerity of the majority of delegates there for a social contract. They are quite determined to try to make this work.

Professor Friedman: I think the concept of the social contract is another evasion of the problem. I don't believe it has a ghost of a show of being anything more than a . . . than a window-dressing proposition to paper over a fundamental split between various interests. The fundamental social contract that we have is to let the market work. That is the only effective social contract that will enable us to reconcile our different interests. Now I agree strongly with you, as I said before, I have been appalled at finding the number of

people here who are prepared, I don't mean in this group alone, but I mean in Britain, who are prepared to treat the problem of inflation as if it were Trade Unions versus the rest of us, and I think it is a terrible. . that would be a terrible way to approach it: that is the way to destroy your nation and to tear it apart. So that I quite agree with your expression of distress at that kind of emphasis. On the withdrawal symptoms we have many episodes in history of successful cures for inflation. In some cases the experience has not been good, the withdrawal symptoms have been substantial. I believe that in the case of Great Britain, with a proper, gradual policy, with the widespread use of indexation of cost of living, escalator clauses in interests, in assets, in wages and salaries, in Government taxes, in securities, your withdrawal pains could be very moderate. That over a period of two or three years it would be perfectly possible for you to lower your rate of inflation from its present 17%, its coming 20/25% – it would be possible in the course of two to three years to lower that to a very modest rate with relatively small amounts, relatively moderate – not negligible you are not going to get out of this without paying a price either way. If you go on with your present inflation you're going to have more unemployment too; but you would get out of it, I think, with a fairly moderate price if you had a consistent, steady policy, explain to the people at large, and got the backing of the people for it.

ALL TALK TOGETHER:

Andrew Shonfield: There is an accusation made against the panel and if Peter Oppenheimer would like to address himself to that on behalf of the panel, I think we would be grateful. I mean you accept the point that was made by the last speaker that there is an anti-Union bias in the line that you are taking?

Peter Oppenheimer: No, of course, I don't accept it. LAUGHTER: I think what the, what the panel, I think the panel as a whole, would reject is the notion that there is one simple cause of inflation. They regard inflation, I certainly do and I think all my colleagues do, as a complicated process and not one in which you can simply say, first money and then prices go up. Moreover, in his sly way Professor Friedman would agree, because he says that in the short-run, a period the length of which he doesn't specify in general, or it tends to be a little elastic, there can indeed be lots of causes of prices and it's only in some not terribly clearly spelt-out long-run, that the money supply is necessarily dominant. I think that's what I'd say in

answer to that point. Could I just say, add briefly on the question of escalator clauses which has been mentioned several times, and which links on directly with the point I myself was making earlier to Professor Friedman, when he mentioned the question of, I think it was Japan, saying the workers were entitled to their cost of living increases, and I say you can only say that if you've taken account of the underlying movement of output per head and therefore real wages. Now the same thing happens with escalator clauses: it's no use saying we want escalator clauses. You've got to spell out, the escalator clause must be well devised and well specified. We have done ourselves a great deal of harm with an escalator clause in this country because we had an escalator clause in the past year which purported to guarantee to the workers an increase in real wage which the economy was not capable of putting out; and that kind of escalator clause does a great deal of harm; so the need is not for escalator clause it's for good escalator clauses and that extra word makes quite a big difference.

Professor Friedman: I would be glad to. . if time would permit I would be glad to outline all of the characteristics of good escalator clauses. But since time will not permit let me only say that I have done so in print; that I recognise that you need appropriate escalator clauses; that the place where I think you need them most, it's easiest to spell them out, and that's in the case of Government taxing and Government borrowing. I think it is disgraceful in your country and mine, that the Government should have conducted the kind of bucket-<ill/> shop operation with to borrowing from the public at large that it has conducted. In both of our countries essentially every person who has loaned money to the Government at any length of time has had to pay through the nose for the privilege of doing so.

FOUR OPPONENTS: I think we all agree with that. We all agree.

Professor Friedman: Well then does it, is it agreed, let me make sure we get this point of agreement – it's a rare thing we oughtn't to pass it by. LAUGHTER:

Is it agreed by all concerned that it is the sense of this house, if I may use an expression that is sometimes used in Britain, that the Government of whatever party, should be induced and encouraged at once to substitute for it's present form of borrowing, borrowing in a form which is fully protected against inflation?

Very good, I think that's a very important agreement!

APPLAUSE:

Andrew Shonfield: Having achieved this Professor Friedman. .

Michael Lipton: Institute of Development Studies at Sussex University. I felt that while all this argument is very interesting it's somehow unreal. We are living in a country which has a balance of payments deficit of 10% of our annual consumption. We're living flagrantly off the rest of the world and show absolutely no sign of putting it right. Now it seems to me that if you are dealing with open economy, whether, and one can argue endlessly about the relationship between the money and prices curve in a closed economy, when the Government prints money in an open economy there is nothing to stop that money leaking across the exchanges. And the reason both Japan and Britain have this enormous gap between money growth and price growth, in your graphs, is exactly that that money has leaked across the exchanges leading to an enormous worsening in their balance of payments positions. Now this is not swiftly curable even by floating, you suggested earlier it might be. You simply cannot float down anything like quickly enough, as we've experienced here, to correct that balance of payments. And that suggests to me that the simple link which you suggest exists between money and price simply doesn't work in an open economy, even if one accepts all the other assumptions of your monetarist position.

Professor Friedman: One must distinguish sharply between two problems. The problem of your real level of living, and the problem of prices or inflation. You are of course entirely right that so long as you are having a foreign deficit of 10% of your national income, of your consumption, you are living beyond your means. You are drawing on your wealth; you are in a very – in terms of thing that are real and important – mortgaging your future and a very uncertain future, for present consumption. That can only be rectified by cutting your consumption: there is no way you are going to get out of that by any magic at all. That's a real problem, and you are quite right, it's a very serious problem. But it really has nothing to do with inflation
INTERRUPTION. . because, excuse me for a moment, excuse me for a moment. The question of the price level at which you run that deficit is a problem of inflation, and that price level can be almost anything at all as illustrated by the fact that the deficit in Japan is in Yen and in Britain it's in £'s, and who's to say how

much a Yen is in terms of the £ – that's the market. And with a floating exchange rate, with a free market exchange rate, between the £ and other currencies, if you run, if at stable prices, you run a large deficit of this kind, then that means you will be living in a higher level of living, your output as it were in this graph will be higher, you can maintain the same level of prices with the higher quantity of money, than if you cut down on your overspending, meet your deficit by insisting on not running it. You don't have to run the deficit; nobody forces you to run the deficit: you are doing that because it's Governmental policy again of trying to avoid facing up to the real problem of financing your current level of consumption and particularly your current level of Governmental expenditures.

Andrew Shonfield: I must take it on.

James Barker: I'm a simple business man and not an economist, and Professor Friedman has persuaded me that one of the causes of inflation is monetary policy. The opposition has persuaded me that it's only one of many causes, and I'm very persuaded for instance by Professor Neild's comment about the enormous increase which has taken place recently in the demand for goods all over the World particularly by the developing countries which has caused us, and incidentally Japan, countries which have a very great need to import raw materials, to suffer from inflation. Now, Professor Friedman's graphs demonstrate that inflation is worse in Japan and in the UK than it is in other countries. Now he says that this is demonstrated to be caused by monetary policy. It could equally well be caused by the fact that these are two countries which have a very real need to import raw materials, and raw materials have gone up in price very substantially during the period of our recent inflation.

Andrew Shonfield: I think that's a comment that doesn't absolutely need a reply because there are various people who want to make their comments.

Hermione Parker: I'm surprised that nobody in the British panel has seen fit to refer to the enormous increase in the rate of Government expenditure in this country which has taken place since 1960. I would have thought that there must be a limit to the rate of growth in public expenditure which any country can sustain without generating inflationary pressures. And I notice in the new, in the recent, blue book on income and expenditure that Government expenditures in this country now accounts for 55% of national

income. It's grown 3½ times in real terms since 1960. And national income, which of course includes Government expenditure, has only grown by 2½ times. APPLAUSE:

Professor Friedman: I'm delighted to have this comment because it puts real substance into the argument about hidden inflation as a method of hidden taxation. It is precisely for the reasons you are citing, that Governments have been induced to resort to inflation as a method of hidden taxation which will enable them for a time to meet this. But you are quite right: that cannot continue. And what you have described is in many ways, if we get to the fundamental problem of your country and my country, to the fundamental problem of preserving a democratic society over the next 30 – 40 years, it is the problem you have raised. In the past 30 or 40 years, well let me take my country, in my country in the past 40 years Governmental expenditure as a fraction of the national income has gone from 10% of the national income to 40% – that's expenditure at all levels. In your country it has now reached something like 50 – 55%. One thing we know for sure: that cannot be repeated in the next 30 years it is not arithmetically possible for you to spend 200% of your national income, and, up to now, the pressures, the political pressures which were being imposed upon Government to do this, that, or the other thing, for a moment I'm not questioning whether these expenditures are good or bad. I personally think most of the expenditures of Government are pure waste, but that. . That's beside the present point. Let's suppose that they are the purest of pure gold in the figurative sense. You have been able to meet the conflicts between groups in the community, the pressures from Governmental expenditure, by increasing the fraction of income which is taken by Government, that is to say at the expense of the politically impotent and not vocal silent majority. But that possibility is over, and that conflict is out in the open, and if you really want to talk about the fundamental social issues of which the inflation we are talking about is partly a manifestation – it's an attempt to get out of that bind – you must – you and we must – somehow in the next several decades find a way to resolve the, the excessive demands which people have been encouraged – encouraged by us the intellectuals, not by anybody else – have been encouraged to put upon their Government. We must find some way of reconciling them; and I must confess I'm not optimistic that there is an easy way.

Andrew Shonfield: Thank you very much, Professor Friedman.