

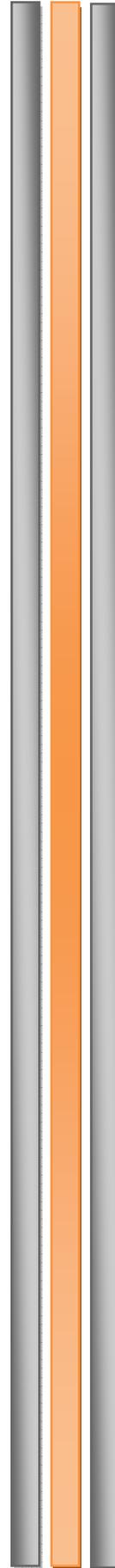
NATURAL COST

AND THE

OWNERSHIP OF MONEY

A realistic examination of the
basic cause of inflation

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Natural Cost And The Ownership Of Money

Before embarking on any course of action a belief must exist that the objective is attainable. At present there is a general belief, encouraged by propaganda from apparently reliable sources, that inflation is an extremely difficult problem with no easy or popularly acceptable solution.

The purpose of this paper is to demonstrate that, on the contrary, inflation is a simple financial phenomenon capable of eradication without social upheaval, once the correct cause has been examined and understood.

To do this it is necessary to understand the importance of the question of ownership of a community's money supply and to introduce the concept of "Natural Cost".

What Is Meant By "Cost"?

When the word "cost" is used by an accountant, economist, business man, or anyone else, it is assumed that the meaning is clear and needs no further definition. But is it clear? The dictionary definition of "cost" is no help because it is simply equated with "price", while "price" in its turn is equated to "cost".

As the term is used in accounting, it is simply the addition of all the money expended in the production of the article under consideration, irrespective of when the expenditure occurred or what has happened to the money in the meantime. If "profit" is considered to be one of the components of "cost", then "cost" and "price" would be the same figure, but there is a vital difference between this figure and "natural" cost.

What Is "Natural" Cost?

Natural cost is the real, or physical, cost of producing an article or a service. It could be expressed in symbolic form by listing the individual items in terms of weight, volume, energy units, etc.—and such lists could be used to compare the relative costs of two articles, or of the same article produced at different times or under different conditions.

But comparisons of cost expressed in such a multiplicity of units are unnecessarily difficult, and can be simplified by combining them using one common symbol—money. This has one other important advantage by enabling us to observe differences between the figure thus obtained for "natural" cost and what accountants simply refer to as "cost", but which should be described as "financial" cost.

These differences will be items included in financial cost but not in natural cost, and they will all have one common feature—they will relate to items which were physically completed at some time in the past.

If price is based on financial cost, as is inevitable under our present financial system, cost inflation is unavoidable. It is the primary theme of this paper to demonstrate that prices MUST be related to natural cost before inflation can be eliminated.

What Is Inflation?

Inflation is considered by both "experts" and the general public to exist in two forms—demand inflation and cost inflation.

Since all inflation results in a rise in both prices and the amount of money available to match them, much discussion occurs on the quite unimportant question of which is the cause and which the effect. In other words, do we have demand inflation in which "too much money chases too few goods" or do inflated costs, and hence higher prices, cause the demand for more money? The question, in that form, is both futile and unanswerable.

Demand inflation is a relic of days of physical shortages and is not important today. It did, however, give rise to the so-called “law” of supply and demand, which is the only basis on which present-day economists try to build their explanations. They have no explanation for cost inflation.

But inflation, no matter what adjective is used to qualify it, is in reality only the effect of a fundamental fault in the way our money symbols are used.

Examination of the so-called “cures” for inflation shows that they are based on the erroneous belief that the problem is simple demand inflation, while the occasional references to “cost” inflation, and the need to reduce “costs”, shows that there has never been any attempt by economists to look at the question of “natural” cost. It is therefore not surprising that these “cures” have all failed—they simply ignore the real problem.

But whatever form of inflation is to be considered, there is one characteristic which is always present, and is most important—inflation always concerns the relationship between money, which is symbolic and entirely man-made, and the real goods and services on which our lives depend. There are many other similar relationships which we encounter in our daily lives, between various symbols and the real world, and there is much to be learned by an examination of some of these relationships.

The Use Of Symbols

Mankind is unique amongst all living creatures in his use of symbols to represent various characteristics of his environment. Some symbols have very specialised uses in advanced science, while others are well known to everyone—temperature is represented by degrees C, distance by metres, time by seconds, and so on. These symbols are also combined to represent speed, volume, pressure, and many others which help us to understand our environment, and also help us to make use of the way things behave to produce the results we want.

The accumulated experiences of many generations have firmly established the fact that, in order to make effective use of our symbols, they must be so arranged that they behave in the same manner as the real things they represent. Failure to arrange symbols in this way renders them useless for predicting the results of proposed actions. The accumulation of knowledge consists primarily of the progressive refinement of our systems of symbols to bring them into line with reality with increasing accuracies.

To illustrate this point, consider the example of a communication satellite which is considered commonplace today but was only science fiction a few decades ago. Such a project has always been physically possible, but required a degree of precision only recently achieved in the symbolic representation of the properties of the various materials used to build the satellite.

Any errors in calculations, whether based on ignorance or any other cause, would result in failure to produce the desired result, and would immediately demonstrate the absolute necessity to adjust the symbols until they agree more accurately with the physical realities of the situation.

This obligation to arrange symbols in correct relationship with the real world is the most important lesson to be learned from subjects such as engineering, but it is an obligation which has never been acknowledged to be applicable to the symbols we call money—with the result that we live in a world of financial chaos and disasters of which inflation is just one example. The application of this principle of conformity between symbols and reality to the subject of money could well be called “Financial Engineering”.

But important though it is, it is not the only lesson to be learned from an examination of a project such as a communication satellite.

The Impossibility Of Physical Debt

Imagine a project to build and launch a communication satellite being undertaken by a community which does not use money.

Many different skills would be used in the tasks of finding a wide variety of materials in the natural environment, converting them into component parts for the satellite, and finally assembling and launching it into space to provide the required communication facility. At the same time other sections of the community would provide the essential food, clothing and shelter for the satellite builders, as well as the less vital but nevertheless desirable luxuries which make up the general living standard of the community. It would be, in every sense of the words, a true community effort.

If any essential materials could not be found, the project could not be completed because of the obvious impossibility of using material in anticipation of it becoming available at some future date. Nature does not permit us to incur what would be a physical debt.

Another illustration of this principle is the obvious impossibility of a farmer watering his drought-stricken crops today with the rain which will fall next year.

It should also be observed that Nature does not impose any conditions concerning the ownership of the materials which are available, or require that they be “repaid”, other than the insistence that the effects of removing them from the environment shall follow certain laws which it is our responsibility to discover and understand.

Once the satellite is completed and launched, the effort required to provide the communication service consists entirely of what has to be done at that time, and does not include any portion of the already completed work of building the satellite. If the community which built it were to vanish, and their place be taken by a new group of people, the newcomers could use the facilities provided by the satellite without being obliged to contribute anything to its construction, or indeed being able to do so even if they wanted to because it would be inaccessible out in space.

This is essentially what happens as one generation progressively takes over from its predecessors.

If the satellite failed to operate the community would have wasted the materials used to build it, but as these had been provided during construction with no obligation to “repay” them, the matter would end there—with no remaining “debt”.

Another point to be considered is that even after a successful project the satellite will eventually cease to operate, and it would be desirable to have a replacement ready for launching when that happens. The building of the replacement is equivalent to depreciation of the one in use, and is a legitimate item of cost of the communication service. The total of all these operating costs is the “NATURAL COST” of the service provided.

Using Financial Symbols

If the community decided to use money to facilitate the building of the satellite, and they realised the need for their symbols to agree with physical facts, their financial arrangements would correctly represent the various stages of the project itself.

Having assessed the material requirements and ascertained that they were available, their money equivalent would be issued and placed at the disposal of whoever had been made responsible for the project. As goods and services were purchased and consumed, the money used to purchase them would be cancelled as it cancelled the attached price tags. In this way the essential relationship between money and reality is maintained. When the satellite is complete and launched, the money issued for its construction would be reduced to zero, as also would be the case with the stock of materials which had been allocated to the project.

If the satellite failed to function and had to be abandoned the matter could end there, as it did when no money was used—no materials, no money, no satellite, and, most important, no remaining debt. The ability of the community to start again would be an entirely new question based on the availability of more materials.

If the satellite functioned correctly its capital cost would never appear in the price of the service it provides because there is no debt to be repaid. The service would be priced at the equivalent of its natural cost, which would include depreciation costs actually incurred, thus maintaining the correct relationship between financial symbols and reality.

Financing Through Debt

Under present financial rules the only source of money is the banking system*, and a condition always attached to the money it provides is that it be regarded as a debt which must be repaid. This fact could be considered from two viewpoints, but we are only concerned with the process itself, and not with the question of who performs it. The banking system provides an extremely efficient accounting service which is not in question in any way, while its present ability to create and cancel money would be the subject of criticism as long as it was done according to present rules no matter what organization was doing it.

*See “The Creation And CONTROL Of Money”.

Looking again at the satellite project, but this time financed according to present rules, we observe how it differs from the previous case. The organization responsible for the project would incur a debt equal to the estimated cost of the project, and as it proceeds and the material resources are consumed, the money used to purchase them would be cancelled in much the same way as before. On completion both the money and the materials would have been used. However, the debt still remains, thus violating basic principles.

First, since no obligation exists to “repay” the physical resources as far as the community as a whole is concerned, the obligation to repay the financial debt, in the way which is at present demanded must be wrong. Secondly, the real credit of the community, which is their ability to carry out the project, is represented by the financial credit issued in order to permit them to do so, but they are not regarded as the owners of this financial credit. It is regarded as the property of the banking system which created it and issued it. It is this insistence that money thus created must be repaid by the community which implies its ownership by the banking system, and denies its ownership by the people who provide the real credit without which it is useless.

This claim of ownership of money, and the demand that it be repaid to the banking system is equivalent to a demand by the printer of a book of bus tickets that he is the rightful owner of the transport service the tickets represent, and that he is therefore entitled to repayment of the face value of the tickets.

Compare this situation with the previous one when money was issued for the satellite project as a credit to the community possessing the ability to carry out the project. In that way it was automatically implied that ownership of the real credit and its financial equivalent go together, irrespective of how either may be subdivided within the community.

This question of the ownership of the community’s money supply is absolutely vital to an understanding of the subject of inflation. It is safe to say that without a clear understanding of it, the phenomenon of inflation can never be seen in its true light, and the way to eliminate inflation will never become clear.

Debits And Credits

The equality of debits and credits in normal double-entry accounting is usually advanced as an explanation of the unimportance of the question of debt. It is usually pointed out that a debit in one account is always matched by a credit in some other account, and this claim is obviously correct. However, under existing financial rules it is the banking system which accumulates the “credits” and everyone else the “debits”. It is no defence of the arrangement that everyone involved is part of the same community as this

merely demonstrates that effective control of everything must progressively pass to those in control of the banking system, and away from those who own the real credit of the community.

That is the logical and inevitable result of a financial system which permits the creators of the money to claim ownership of its face value.

Debt Recovery Through Prices

Consider the costs of the communication service provided by the satellite financed under present rules. Legitimate components of cost are included in the price as in the correctly financed project—running costs and depreciation. But, in addition, the price must include the initial cost in an attempt to recover the money needed to repay the debt.

However, the money used for the project has already been cancelled, as already explained, and is therefore no longer available to meet these prices. This gives rise to two problems—first, the price is inflated by the incorrect inclusion of capital charges and, secondly, this same cost inflation causes demands for more money in the form of higher wages to meet the higher prices. But the only source of this additional money is the same banking system which is demanding repayment of the original loan. The effect of this is that a debt once incurred can never be cancelled—it can only be transferred to some other part of the community. The result is the all too familiar “cost-price” spiral which can now be seen as an effect of inflation and not its cause as is so often claimed.

Interest Charged On Debts

When a debt exists between individuals or organisations within a community, and there is no question of the creation or cancellation of money, the question of interest is unimportant as far as the functioning of the financial system is concerned. But if interest is charged on money at its point of creation, irrespective of where that point is in the community or the rate of interest charged, it is inflationary. But this effect is additional to the far more important questions of debt finance and the ownership of money.

Undue emphasis is often placed on the question of interest, even to the extent of regarding it as the sole cause of inflation. But, as has been shown, inflation is an inherent characteristic of any money system which includes the fundamental error of separating the general ownership of money from the ownership of the real credit it represents.

If this fundamental error were to be corrected, interest charged on loans arranged through a bank would become a form of fee for services rendered, and provided it was accounted for correctly would be no more inflationary than a fee for any other service.

Essential Steps To Recovery

A brief look at some of the steps which must be taken to end inflation shows that there are two essential elements without which inflation cannot be eliminated. Unless they are both in evidence it is certain that there is no real desire to eliminate it on the part of those with the power and ability to do so.

The first is the establishment of some National accounting system whose primary function would be the operation of a National Credit Account. This account would handle the creation and cancellation of money on a National scale, and would provide the means by which the community would receive credit for the financial equivalent of their real credit. This account, which could well be administered through existing facilities of the Reserve Bank, would be the source of money from which funds could be allocated for public works, defence, etc., as well as for the implementation of the second of these two essential elements.

This second element in itself has two aspects — a National price subsidy to bridge the gap between the natural cost of an article or a service and its financial cost, which will always be higher, and secondly a National Dividend payable to every member of the community. In a community which demands the possession of money as a condition for access to the necessities of life, a National Dividend is a recognition,

in financial terms of the universal right of every person to maintain his life as long as possible.

The amount of either the subsidy or the dividend would be dependent on the success or otherwise of the community's efforts. To use the satellite project as an illustration—if it fails to work and must be abandoned, the dividend would be reduced. Thus the community, by the results of their total efforts, would control their financial affairs as well as their physical activities.

Checking The Theory Against The Facts

Although the presentation may be different, the basic explanation of inflation contained in this paper is not new—it has stood the test of time for well over 50 years. It has often been challenged but never proved wrong.

On the other hand the officially sponsored explanation, on which has been based every so-called “cure” for inflation over a period of far more than 50 years, has never agreed with observable facts, has never led to the elimination of inflation in any country of the world, and cannot be supported by sound mathematics.

Which of the two explanations is correct? And what are the implications of accepting either one?

Why Inflation Remains

If the “official” explanation was correct, and the professed desires of politicians and economists to find a cure were sincere, any plausible explanation which appeared to be better than ones which had failed, would surely be worthy of study. But such is not the case—they are resisted and ridiculed, leaving the only possible explanation that a cure is not really desired.

The reason is not difficult to find. Debt finance, with its inevitable inflation, has existed for centuries and has provided the ideal tool for concentrating power - without responsibility - in fewer and fewer hands. It is a characteristic of human nature that the possession of power creates a desire for more power, and that power is not surrendered willingly. Thus we see that, while it is not difficult to eliminate inflation, nothing will be done to eliminate it because it would result in a loss of power. Unless there is much more pressure exerted on our political representatives than exists at the present time, social problems generally and financial chaos in particular, will only get worse.

In other words, inflation remains solely because we have permitted this concentration of power to go on unchallenged, have meekly accepted as inevitable the social problems which stem from inflation, and have not been sufficiently insistent that we want it stopped.

Conclusion

Returning to the opening statement of this paper, action is only likely when there is a belief in the possibility of attaining the objective. It has been shown that inflation can be eliminated, and logical argument has been provided in support. Additional supporting evidence can be found every day and in any walk of life, once the signs can be recognized.

Any problem seems complicated if we ignore the real cause, and inflation is no exception. But once the real cause is understood it is a simple phenomenon, and its elimination poses no special problems.

The missing element is an insistent demand from individuals and small groups that effective action be taken, backed by the certain knowledge that the objective can be **attained**.