

CHAPTER X

Inflation and Prices

WHEN DEMAND (OR SUPPLY OF MONEY) EXCEEDS PRODUCTION (OR GOODS ON THE MARKET), PRICES RISE AND WE HAVE INFLATION. THE ONLY SOUND WAY TO CORRECT IT IS TO BRING SUPPLY AND DEMAND INTO BALANCE BY INCREASING PRODUCTION OR BY CURBING DEMAND GENERALLY BY RESTRICTING CREDIT.

Even before the establishment of our Republic the American Continental Congress, by formal resolution, declared:

"It hath been found by Experience that Limitations upon the Prices of Commodities are not only ineffectual for the Purposes proposed, but likewise productive of very evil Consequences to the great Detriment of the public Service and grievous Oppression of Individuals."

You find for many centuries the attempt to fix the prices of almost everything, and of labor too . . . It lasted for centuries and centuries, and it was only under the influence of modern political economy that the principle that it was possible to fix prices of commodities was utterly eradicated from the English mind. And you hardly get it out of England before it reappeared in the United States. You find the newspapers commonly talk about fixing prices as if it were something utterly unheard of. It is on the contrary as old as almost any legislation we have." And then, with an optimistic belief that the lesson was learned, he adds: "In no state of our forty-eight states is any one so unintelligent as today to propose that the price of a ton of coal or a loaf of bread shall be so much . . . All such legislation has absolutely vanished and probably no one need know that it existed, but when efforts are made by our more or less uneducated members of legislature to introduce bills of such a kind, it is very important for us to know that these experiments have been tried and have failed, having been proved to be either impracticable or oppressive or not for the general benefit.

—FREDERICK JESSUP STIMSON
in *Popular Law Making*—1910

AT LAST the American people are beginning to realize the gravity of inflation, although few have even the most rudimentary understanding of what it is. Soaring prices of everything, notably of the necessities of life, are bringing inflation home to the average man, and yet we do little about it. We do not know the disease from which we are suffering, and, thinking that the disease and the symptoms are identical, we treat only the symptoms.

Inflation, as the term was originally used, meant the increase—

literally, the blowing up—of the quantity of money. Increasing the quantity of money nearly always brings higher prices; for, unless production increases in proportion to the increase in the amount of money, prices necessarily rise. All buying and selling is essentially an exchange, like swapping in a country store; we trade for the thing we want a fixed quantity of money, supposedly gold if that is the standard. As the quantity of gold or money increases, we will give more for what we want; and prices go up. If the quantity of gold is reduced, prices fall. It is like a farmer trading eggs for goods: the more generously his hens lay, the more liberal he is in trading eggs.

The average man confuses this price-rise with the cause. We can, perhaps, visualize it if we think of it as an old-fashioned scales having one pan of the balance filled with what we call production, and the other filled with demand, with the arrow pointing to prices. If demand is heavier than supply, the arrow goes higher: if supply increases more rapidly than demand, the arrow swings in the opposite direction, pointing to lower prices, and the only way to bring it back into balance is to add to the side that is light or to subtract from the side that is heavy. If we seek to hold the arrow by force, trying to fool ourselves into thinking that an arrow held where we want it will tell the truth, we get into trouble and are going to wreck our economic scales. Arbitrary forcing down of prices by law will not and cannot work as a permanent policy.

To talk and to argue about how prices are to be controlled, who is to control them, and whether we should control wages as well as prices, is as futile as King Canute's ordering the tides to stand still. The natural laws of economics are basically as inexorable as the laws of physics or of mathematics, and to defy them is as idiotic as it was for Ajax to defy the lightning. It is true, we can ignore and flaunt them, but we do so at our peril, and, though the penalty of our folly may be staved off for a time, sooner or later nature always exacts her penalty. These things are beyond control, and the only hope lies in correcting conditions and underlying evils. Furthermore, since buying and selling is essentially trading, any interference with a free market, or attempting to dictate prices or terms of sales, is an unethical infringement of man's liberty to enjoy the full use of property which is his.

The folly of trying to fix prices has a long history of failure. We had experience during the war which showed its futility: block market trading, in complete disregard of regulations, often

put the regular market out of business; and it was only at illegal prices that there was any buying. Experience then and in subsequent years after controls were abandoned showed up the unreliability of government statistics and the futility of the whole program.

John Fiske in his account of the *Famines in Bengal* shows what makes price-fixing impossible. In a period of famine, the government compelled the sale of grain at what bureaucrats regarded as a fair price, with no reference to supply and demand. Keeping down prices in this way, in a period of scarcity and famine, meant a brisk demand for grain and promoted consumption, and, what officials never thought of, it discouraged the grain producers, unable to sell at a fair price. This led to curtailment of future planting and resulted in far worse famines and terrible starvation in later years.

But we do not have to go to Bengal for an example of this folly. The government has attempted to fix "rents," which are no more than the price of occupancy of buildings, perhaps because tenants constitute a more numerous and probably a more vocal element than landlords. For such a policy it is hard to find any justification in the Constitution; and, if such folly must be perpetuated, it would be wiser to leave it to the states. This is, however, aside from the point, that rent control operates in precisely the same way as did the fixing of prices in Bengal.

The fixing of rents has so eaten into the earnings of buildings and so discouraged their erection, that the housing problem continues unsolved, despite the exaction of billions of dollars in taxes to pay for "public housing." This housing, being granted complete tax exemption, which private building does not have, results in most unfair competition with private enterprise, thus discouraging private building. Some students of housing say that nothing whatever has been accomplished by our public housing programs; for, combined with rent fixing, it has so discouraged private enterprise that we have lost as much, through reduced voluntary building, as has been gained by public building. The building has been far less satisfactory too; for free enterprise, based on a hope of profits, means a far wiser meeting of demand than bureaucratic planning.

What we say about the price of goods applies to the prices of nearly all commodities including labor, for wages are fixed by natural laws just as are the prices of what we buy in the shops. The story of these twin brothers of legislation, the attempted regulation of prices and wages, is a wearisome one, and those

who think they are trying something new must be disheartened when they look into past history—if they ever do. Diocletian tried to fix prices some 1700 years ago. Julian took a fling at it. Lycurgus in Greece had a whack at it, and so did Colbert in France and Good Queen Bess in England. In 3000 years we have never succeeded in making it work, and we are still at it. Will we never learn?

Only two centuries after the Norman Conquest, England passed the "Assize of Bread and Beer," the first statute drawn in that curious old Norman-French which displaced Latin. This was an attempt to regulate prices of bread and beer according to the price of wheat. Our British progenitors, with typical British tenacity, kept experimenting with such follies for hundreds of years, in spite of the monotonous futurity of trying to defeat natural laws. Apparently the lesson was finally learned and the fallacious schemes abandoned; but just when we think we are done with them, they crop up again with a new generation determined never to learn by any experience but its own.

Consider a practical example showing inability to control prices. The federal government is continually telling us that we must hold prices down: they tell workers for what wages they shall work, employers what wages they must pay, manufacturers at what prices they shall sell, retailers what margin of profit they should be allowed, and those who build and lease houses what rent they shall receive. In spite of all this exhortation to "hold the price level," we have a glaring case of a sharp advance of prices by the government itself in the price of postage. Letter postage has increased by fifty percent and will probably again be raised. Postal cards have doubled in price. Charges for all other postal services have been increased materially, and further increases are threatened. Why does not the government practice what it preaches to the people? Why does not it keep the prices down? The answer is that the government can no more do it than can you or I.

The cost of the services of the post office department has increased tremendously. How these costs might have been kept down is another story. But they have gone up, and must be met somehow, as long as two and two make four. Too often we camouflage problems of this sort, and, instead of charging the user of the mails what the service costs, we give it to him for less than cost and then tax him to make up the shortage. It all comes out of our pockets, either in postal charges or in taxes, and somebody must pay. If price-fixing can be made to work, it

should be made to work in the post office, because here all the operations are under direct control of Congress; and if Congress cannot fix prices for the services of its own government, how can it hope to fix them in the business world? If we have conditions that produce inflation, we shall inevitably have inflation and high prices. It cannot be avoided.

Under the discussion of money, we said something about conditions increasing the quantity of money in circulation. Many are the expedients which have been resorted to by those in power who profited by dishonest tricks. In the old days, when all money was metallic, generally either of silver or gold, there was a simple way to do the trick. Snip off a bit of metal from each coin, or "sweat" some of the metal off by scraping or melting it a trifle, and use the stolen metal to make more money. This was a common trick, and soon it became the custom not to count gold coin but to weigh it, which is still the practice in large transactions. Then, there was another and more subtle way: adulterate the gold or silver using a little less of the precious metal and more of the cheap alloy.

These frauds explain the phrase long found on bonds, promising that all payments are to be made in gold "of the present weight and fineness," supposedly safeguarding the holder against clipping, "sweating" and adulteration. And then, of course, there is the simple way which we adopted in direct violation of this pledge, changing our standard by reducing the quantity of gold which a dollar represents. In our case the gold value of the dollar was cut to fifty-nine percent of the former weight. This resulted in a paper profit of nearly three billion dollars to the government for, by decreasing the amount of gold held in reserve as a guarantee of our paper currency, the government was enabled to issue that much more paper currency, which the public was compelled to take as legal tender. Regardless of the pledges to meet our bonds in gold of the established weight and fineness, made when the bonds were sold, they compelled bond-holders to accept payment at fifty-nine cents on the dollar.

But the government did not just pocket this money nor even use it to pay its debts. It spent it, and a great deal more besides, in an effort to "prime the pump" as we phrased the attempt to promote business, plunging the nation ever deeper in debt. This debt was handled in a way which directly promoted inflation, for practically it was represented by bonds, and a large proportion of these bonds were sold to banks. When we say they were sold to banks it is a figure of speech, for generally no money passed.

The bank takes the bond and credits the government on its books with the amount "paid" for the bond, against which the government draws checks. Obviously, this increases the amount of money in circulation if we define money as a medium of exchange, for bank checks and bank credits serve exactly the same as would gold. Two great causes of inflation today are this devaluation and tremendous increase of the public debt.

Often we hear something about another factor influencing inflation, namely the speed at which money circulates. This is of secondary importance and more adapted to an advanced course. We just mention it so that you will know what is meant by it when you hear it mentioned.

Naturally, a dollar which is spent a dozen times a day, will do more to increase buying power and to take goods off the market than a dollar which is put away by a miser and may not be spent for years. To illustrate: Jones, Smith and Brown each owes a dollar, Jones to Smith, Smith to Brown, and Brown to Jones, and they must all pay their debts. Each has a dollar; so there are three dollars in circulation, and each goes to his creditor, parts with his dollar, and squares his account. It has thus taken three dollars to settle these debts. Now suppose that instead of each one having a dollar, Jones is the only one whose purse is not empty. He pays a dollar to Smith, who, being an honest man, hurries around to Brown's and pays him the same dollar, and Brown, being equally desirous of wiping clean the slate, pays Jones forthwith the same identical dollar.

All these debts have been settled with a single dollar, which has accomplished just as much in the trade of the world as three dollars in the first case. If, however, Smith had been "slow-pay," or if he had been doubtful of the permanent value of his dollar, and had harbored a hope that by writing to his Congressman he could have the dollar devalued and pay his debts with a debased dollar worth fifty cents, he would have been in no such hurry to get out of debt. Jones' dollar would have stuck in Smith's pocket, and trade, business, the balancing of accounts would have been delayed and hampered by just that much.

Therefore, the prospect of inflation slows down the circulation of money in settlement of obligations. It is said that, at the height of German inflation, one American cent would have bought enough German marks to settle all the debts of every kind, public and private, throughout all Germany—loans, bonds, mortgages, current accounts, personal debts and everything else.

Then why be in a hurry to pay the debts today if the future may bring such a situation?

But, if money is falling in value every day, or even every hour as was the case in Germany, there is a mad rush to spend it just as soon as possible for practically anything on any terms, in the hope of exchanging something of only a token value, growing smaller every minute, for some commodity of at least some value or usefulness.

If our three friends are distrustful of the permanent value of the dollar, not only will they be slow to part with the good money they now have, and will wait until they can settle in debased dollars, but they will also be shy in loaning good money today to be repaid tomorrow in some sort of doubtful currency. And so, any prospects of slippery manipulations of money will both retard the circulation of what we have and reduce the extension of new credits.

If seeking what is loosely called cheaper money, by which we mean a relatively larger ratio of the media of exchange, which would cause an increase in prices, we shall accomplish little by varying the ten percent of the actual money as long as the ninety percent of credit money is unaffected. If we double our money and have twenty dollars in circulation where we had ten before, nothing is accomplished, if, at the same time, we find our existing credits cut from ninety dollars to forty-five dollars. Therefore, the results may be directly the opposite of what we'd hoped, for where we formerly had the equivalent of a hundred dollars in circulation, we now, after doubling our money, have only sixty-five, and we have the paradox of an increase in money practically reducing our circulating medium.

The reason why an increase in money may mean a decrease in credit is obvious. If money is increased by dishonest methods, by devaluation, by inflation, or by any device which jeopardizes its real worth, and particularly if such programs threaten further unsound practices, as they often do, it stands to reason that the prudent man will think twice before loaning real money to be repaid later in what Al Smith called "baloney dollars." The creditors of this country, even those who lent money to Uncle Sam himself, to be repaid in gold of the then existing standard, have already had the experience of seeing, first, the promise to pay in gold repudiated, and then, payment made in the depreciated money which represents less than three-fifths the former value.

Can we wonder that the burned child dreads the fire? Had we

any assurance that there would be no further tampering with money and that the government would keep faith in future, we might, in time, become reconciled to what has gone before; but when there is not even the assurance of fair words for future dealing, and when all indications point in quite the opposite direction, one can't but be a little wary of transactions with one who has trimmed him once. We cannot wonder that credit is "shy."

Inflationary measures are often aimed ostensibly at helping the poor man and relieving the debtor; but do they accomplish that end? Any plan for reducing the value of money must have a twofold aspect. Such measures cannot be framed without someone losing what the other gains, and often the debtor is also a creditor. One is seldom in a position to command credit unless he has property of some sort, and it is impossible to differentiate between two groups which so often overlap. Daniel Webster truly said, "The very man above all others who has the deepest interest in a sound currency, and who suffers most by mischievous legislation in money matters, is the man who earns the least by his daily toil."

To the demagogue, the banker, personifying wealth, is always legitimate prey, but how will he be affected by inflation? Banks hold many bonds, notes, mortgages, and other evidences of debt, but they also owe their depositors enormous sums, represented by the balances of their accounts. If we scale down all indebtedness, how can anyone say just how it will affect the banker who finds his notes and bonds wiped out, while the value of his real estate and common stocks is greatly increased, on paper at least. His debts to depositors, represented by their balances on deposit, will also be scaled down, and, probably the greater loss will fall on them while he comes out ahead. It is all so intricate that one cannot generalize; and even if we study each individual case, the ramification of such frauds is so far-reaching that it is impossible to foresee all the consequences and reactions.

In speaking of a debased currency, John Quincy Adams said, "No expedient ever devised would equal it in efficiency for fertilizing the rich man's field with the sweat of the poor man's brow." A complication lies in the fact that many owing money, and thinking of themselves as propertyless debtors, actually own considerable property in an indirect way. The savings banks of the country are estimated to owe their depositors, the majority people of modest means, nearly forty billion dollars. What happens to them when the bonds and mortgages in which their funds

are invested, and in which they often must be invested by mandate of law, go up in smoke? The insurance policies of the country represent many billions of dollars. What happens to these funds to which many look for support in old age, for the education of children, the support of dependents, and even for their own funerals; when inflation wipes out the assets of the insurance companies?

Others who must suffer are the poorest of all, pensioners and those who look to endowed institutions for education, support in old age, and care in sickness. These endowments, often in bonds, are estimated at about ten billion. Shall we wipe out these funds, close the institutions, and turn the inmates out on the street? Or shall the government be compelled to take over their support, increasing our taxes still more and forcing many, who are now self-supporting and self-respecting, into dependence upon the government?

We have discussed inflation as the word is commonly used, meaning an increase in money, either actual or credit, in relation to supply and production. What we call price inflation, for lack of a better term, has little direct relation to monetary inflation, although both bring about much the same effect. Monetary inflation brings a price rise by upsetting the balance between supply and demand: price inflation, by arbitrary action of government, increases prices. Either one may properly be called inflation, for they inflate prices without increasing true values.

Nearly always taxation is directly inflationary in this sense. Frequently heavier taxation is suggested as a cure for inflation, but the fallacy of this proposal is so evident that one cannot but wonder if it is advocated more for the purpose of increasing tax receipts and to entrench office-holders more snugly in their jobs and privileges, than in any sincere effort to curb inflation. The theory is that cutting down the incomes of our people by higher taxes will compel a reduction in purchasing and thus bring demand and supply nearer together. Fundamentally it amounts to arguing that if we impoverish our people by oppressive taxation, we can keep them poor, thus curbing spending.

Even aside from the callous indifference to the welfare of our people which such a proposal exhibits, it is utterly silly, for taking the money out of the pockets of the taxpayers and giving it to the government will not reduce its purchasing power, though it may direct it to less profitable channels. It is pretty safe to say that almost always the value of money will be more sensibly appreciated, and that it will be spent more wisely, by the earner

than by any political machine. It will be spent just as quickly for building post offices and political monuments as for building homes. Cotton and wool are bought and used for uniforms for soldiers as well as for civilian clothes, and bureaucrats buy and eat quite as well, when paid by the taxpayer, as do employees working in industry. The misrepresentation of these proposals is so evident that it scarcely calls for any rejoinder. More will be said about the inflationary effect of taxation when we discuss specific taxes.

Besides ordinary taxation there are other forms of inflation by governmental action, instituted with the avowed and open purpose of raising prices. Of this we have a striking example in the agricultural program, already mentioned, whereby the general public is taxed to purchase farm products, which are then wasted, destroyed or given away, in order to compel the consumer to pay still higher prices for what he must buy to live.

Another conspicuous instance of deliberate inflation through taxation is the tariff. This merits a chapter by itself, and here we only say that its open and avowed purpose is either to keep foreign merchandise out of our markets, thus reducing supplies and keeping prices up, or to increase the price of foreign merchandise so that it cannot undercut American production. In either event the result is higher prices, and again we are penalizing the consumer to give benefits, which amount practically to bonuses, to a favored class of manufacturers and producers. This too, like the agricultural program, is direct price inflation, aimed at decreasing supplies and increasing the prices of goods.

If we are in earnest in wanting to check inflation and to reduce the cost of living, instead of experimenting with schemes for price control, we should: .

(1) Cut national spending, bring expenditures well below the tax income.

(2) Restrict operations of the national government to those permitted by the Constitution.

(3) Levy taxes only for purposes authorized by the Constitution and never to provide funds to give away to subsidiary governments, to foreign governments or to favored groups.

(4) Free corporations from taxation. Of this more will be said.

(5) Discontinue governmental policies which are directly inflationary.

(6) Respect the Constitutional rights and liberties of states and prevent encroachment by the federal government.

(7) Respect property rights, whether personal in the product of individual life, or joint, in land values created by common life.

(8) Abandon all operations which take from some to give to others.

Carrying out such a program, we shall keep the cost of living down and the standard of living up, and we shall be on our way to financial stability and prosperity.

QUESTIONS

Is a price rise inflation or is it the result of inflation?

How do you define inflation?

What is necessary to control inflation?

Do relations of supply and demand affect inflation?

Does artificial price control correct inflation?

Was the devaluation of the dollar inflationary?

Are comparisons of such figures as the totals of savings bank accounts fair when made in the terms of the dollar of today and the dollar of pre-devaluation days?

Does threat to the financial strength or integrity of the nation affect inflation?

How does inflation affect relations of debtor and creditor?

Is the debtor necessarily a poor man?

Do some taxes inflate prices by increasing without adding to the value of the commodity?

Does such price inflation tend to curtail buying?

Do you think it would be desirable to fix the value of our dollar at a permanent, definite weight of gold, perhaps by Constitutional amendment? (This to start discussion—don't expect agreement.)

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