

**INFLATION:
AN ANCIENT CURSE
AFFECTS THE MODERN WORLD**

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Land, other natural resources, taxation, governmental policy, all aspects of life, must now be dealt with in expectation of powerful, pervasive inflation. This curse of contemporary life is no modern creation. Through the broad sweep of history, monetary units have eventually lost purchasing power — always. The chief reason, I believe, has been the sovereign's desire to finance wars. But other objectives of governmental officials — building palaces or living, as did 16th century Spain, on silver and gold from the Americas — have led to the excessive creation of money followed by the erosion of its value. Through much of the world today unduly rapid creation of money and inflation have roots other than fighting wars.

The loss of worth of the dollar or peso or other unit of money is seen as a rise in the prices of things for which money is used. A rise in the *general level* of prices is what I shall call "inflation." The prices of *particular* goods and services — oil or hospital treatment — rise as sellers are able to insist upon more dollars for what they give up. When prices go up on a broad scale — when the dollar loses buying power — we use more money to buy the same market baskets of goods and services. How can the people of a country hand over more dollars? We can do so because more money is at hand.

The crucial factor is an expansion of the money supply.

This elementary principle has been tested time and again in human experience. Of course, in each of history's countless inflations many factors have been intertwined. Any analysis of causes becomes complicated. And today, certainly, the efforts to reduce price-level increases will involve more than money and the Federal Reserve's practical ability to control excessive expansion.

Abandoning Illusion without Certainty as to Replacement

Throughout most of our history Americans could accept the belief that the dollar would have stable buying power. No longer. The "money

illusion" cannot for the foreseeable future serve as an anchor for personal, business, or governmental policy. For a long generation the dollar's buying power has gone only down. The outlook is for more of the same. The uncertainties are "how much?" "how fast?"

Is There Something New in America Today?

Two centuries ago our Founding Fathers knew about money's loss of purchasing power. "Not worth a continental" refers to the loss of value of currency issued during the Revolutionary War. Early efforts of Alexander Hamilton and others to build a sound Federal financial system reflected conviction about the importance of preserving the value of the new nation's money and credit.

Nineteenth century America had its experiences with changes on the purchasing power of the dollar — notably during the Civil War. But at the outbreak of World War I the price level (as measured) was not greatly different from that a century earlier before the Napoleonic Wars. (Obviously, the 1914 dollar could buy many things not obtainable in the early 1800's.) The first World War and its aftermath taught lessons about inflation. The terrible German hyperinflation of the 1920's was in the minds of many American leaders in the 1930's as they resisted expansionary policies to deal with the great Depression after nearly one-third of the money supply had been destroyed, largely by bank failures.

World War II brought inflation, presumably something temporary to be expected as an inevitable byproduct of a massive change in the economy. Then, as a peace-time economy was restored, Americans could believe that essential price-level stability would be the normal state of affairs. (Korean hostilities were relatively short.) True, for almost two decades into the 1960's the dollar lost a little worth from year to year, but in retrospect the average annual amounts were not large. And we heard that improvements in the quality of some goods and services — medicines and TV sets, for example — were not accounted for adequately in the indexes. In fact, therefore, real price-level stability may have been essentially achieved.

President Johnson decided to add a large variety of domestic programs and Vietnam hostilities to the Federal budget without corresponding revenue increases as the economy approached full employment. These decisions are widely believed to have brought a new

and inflationary state of affairs. This conclusion has much validity. Yet it is an oversimplification.

The Federal Reserve was not compelled to expand the money supply on the scale it did. Admittedly, no one can be sure what pressures would have been exerted in the late '60's and early '70's if the monetary authorities had tried with greater determination to restrain the growth of the money stock in the light of Federal deficits and private demands for credit (beyond our willingness to save out of income).

The early '70's included (1) the untying of the dollar from gold and (2) OPEC's multiplying of the price of oil. Widely accepted attitudes came to reflect a belief that a rising level of prices — a falling value of the dollar — would be more probable than our historical experience. The price level had gone up and also down — without much net change over the decades. By 1970 or so people here and in other countries had come to expect one-way price-level change - up, up, up. We have tried to change our behavior to prepare for this new expectation. Something new *has* been added — a pervasive loss of faith in the durability of the worth of the dollar.

Another change has profound significance. The belief that the Federal budget should be balanced gave way to toleration of deficits year after year. For a time, there was a belief that budget deficits of slack periods could, should, and would be off-set by surpluses in good times. Yet surpluses have not been achieved even when the economy boomed; deficits have appeared year after year, sometimes very large ones, in times of unprecedented prosperity and even as inflation has grown. Spending increases will not be kept at budget-balancing levels. Today's acceptance of deficits represents a contrast with attitudes of, say, two decades or more ago. Deficits invite money creation ("easy credit").

Many other factors bearing upon inflation have changed. Some probably have not. For example, it is sometimes asserted that growing monopoly has added to forces of inflation. Although measuring monopoly is difficult, there is little or nothing to support a belief that union or industrial monopoly grew in the '70's. But even without any *growth* of monopoly power — electricians in the community, the local newspaper, industry-wide wage settlements in major industries — enough monopolistic power *exists* to complicate enormously the efforts to slow price-level increases without loss of output (employment).

Time does not permit mention of various private and governmental actions which have been alleged to contribute to inflation. Many, it is true, do aggravate the total problem.

For present purposes we must note a factor of great importance. There is a feeling held deeply and broadly that large declines in the worth of the dollar lie ahead with no assurance of any ending. The attitudes toward land and other real estate may be influenced especially by *expectations* of inflation.

Measuring the Worth of the Dollar

Americans and others using the dollar buy goods and services of enormous variety. Some prices change much more than do others. Many different "market baskets" of actual household (or business) purchases would be disclosed if we could identify them. A measure of prices adapted to one such package would not be well suited to many others.

The purchases differ significantly from family A to County C, school board H, corporation Y, hospital Z, and millions of other buyers. Today we hear that the Consumer Price Index tends to overstate the loss of purchasing power of the dollar for most families because the index includes interest on new mortgages whereas most of us are not borrowing in today's market. This position has merit.

We also hear that quality changes — improvements and deteriorations — are not adequately represented in any price index. Moreover, changes in relative prices from year to year — chicken relative to beef — will induce changes in patterns of buying. The weighting in the "market basket" ought to have more frequent adjustment than is generally provided.

Inevitably, measuring the worth of "the" dollar which is used for myriads of different sets of purchases will defy any solution likely to become available in the foreseeable future. (Hence, "indexing" wage rates or taxes or rents can give erroneous results if the wrong price index is used.)

Although there are differences, indexes all show that the loss of worth of the dollar — i.e., the rise in prices generally — has been large.

At 10 percent a year compounded, the dollar would lose half of its buying power in less than seven years. At "only" 6 percent a year, 10 years would wipe out nearly half.

A World-Wide Phenomenon

Inflation — at widely varying rates — is essentially world-wide. The “command economies,” including Russia, have not been successful in preserving the purchasing power of their currencies. Money-creation (“easy credit”) offers an easy process for governmental officials.

In the modern world the banking system creates most of what we use to make payments — money — virtually out of “thin air.” (Note the contrast to mining gold!) Digging and refining gold require tough effort — but no longer limit money-creation and inflation. So very easy indeed is the creation of today’s money that doing so *excessively* has become the world-wide practice.

Causes — and Causes of the Causes

Increase the supply of potatoes and, other things remaining the same, the worth of each potato goes down. The same applies to dollars. The value of each dollar depends upon the number of dollars outstanding.

Yet there *is* a difference between dollars and other things. When a dollar is used, it is not used up. It continues to exist and to be available for use again and again. Therefore, increasing the stock of money does have results which differ from those which follow increases in the output of goods and services. The speed of use — velocity of circulation — of money as well as the quantity will affect the dollar’s buying power, i.e., the level of prices. Inflation psychology (including the high nominal rates of interest which appear) will tend to increase money turnover, but time does not permit examination of this aspect of our topic.

Inflation flows from “too rapid” increase in the stock of money. A “normal” increase would be the amount appropriate to the rise in output of real goods and services (a relationship not easily measured.) Most of today’s money consists of checking accounts in banks, with currency being of moderate importance. Trying to define and measure “money” does present troublesome problems because of the existence of close substitutes for checking accounts; “near monies” have grown rapidly.

The monetary authorities — Federal Reserve officials — control the ability of banks as a group or system to expand their lending, i.e., to accept borrowers’ IOU’s and in return create new deposits on which

checks can be written. The precision of control is debated. Problems do arise as Fed officials try to decide just how much response will follow one or another alternative course of action. The general outlines, however, are clear.

The money stock would not grow significantly without Fed "permission." So it is far more correct than misleading to emphasize — to underscore, to repeat — that the actions of the Federal Reserve are a major — "the" — immediate cause of expansion of the supply of dollars. It is this expansion which leads to the dollar's loss of worth (inflation).

Why, then, have Fed officials done what they know will be inflationary? In other words, what has caused the immediate cause of inflation? No correct answer will be simple. We can, however, identify elements of importance. Many of the causes of our troubles result from the desire of "good people to do good things."

Federal budget deficits — to pay for "good things" without "bad taxes" — are often cited as causing inflation. Deficits require Treasury borrowing, and doing so next week is easier if the Federal Reserve expands the lending capacity of the banking system for next week. Big deficits could be financed in non-inflationary ways, but financial markets would be strained as the Treasury used some of the supply of new savings and kept them from industry and construction. Political and other objections to restraint may be overcome by creating money. How tempting to resort to money creation instead of absorbing funds that would go for housing or utilities or factories.

Concern for employment plays a key role in inflationary finance. Over-simplifying, we say that wage bargains which boost hourly employment costs will lead to a drop in hours purchased "unless" Unless more money is available to pay the higher dollar wage bill! If the wage (plus fringe) cost goes from \$8 to \$8.50 an hour, consumers cannot buy the same physical output (and thus the person-hours to produce it) unless more dollars are available. I speak here of the economy in a broad sense as distinguished from a particular type of good; a rise in price from \$80 to \$85 might not cut my purchasing of that product but would leave me with \$5 less for other things.

As workers and their bargaining agents see prices rising, pressure to get more dollars per hour will be powerful even though productivity per hour may not have improved. As a result, labor is being priced out of the market although in ways not fully identifiable — shorter work weeks

occasionally, more frequent or longer layoffs, a drop in new hires. An upward move in unemployment of humans and machines, perhaps merely at a creeping rate, obviously involves loss of real output. Such a loss seems to be a waste. This result, the loss, can be avoided by "validating" the wage rate increase through monetary expansion. Much the same can apply to land for development in higher use. New money injected into the economy provides dollars that pay for products at higher prices.

Let us restate: The hard realities of mining gold no longer restrict monetary expansion. Thus the money-creating mechanism can be brought in to validate wage increases. Rising prices lead us all to desire higher wages. Many union and organized employees get wage boosts. Officials are reluctant to tolerate unemployment when wage costs rise. The Federal Reserve and central banks in other countries pump up the money supply. The process can cumulate and feed on itself. The modern world, it is said, has an inflationary bias.

A related factor adds to this bias. At any time the economy can be given a boost by monetary stimulus — probably called "credit" liberalization or expansion. Almost always some areas and industries will be lagging (and unable or unwilling to adjust by reducing wage rates and prices). Unutilized labor, idle machine-time, and contractors not presently building houses can get help by the cranking out of more loans (money) from the banking system. If funds are made available by means of easy credit stemming from monetary expansion, the lagging sector will benefit. *The economy gets more of the cause of inflation.*

Political pressures mobilized behind what seem to be worthy objectives — more housing but at higher prices — are not easily resisted by the argument that inflation, general price-level increase, will be injurious to most of the country. Preventing spot unemployment which seems avoidable invites one after another of short-run stimuli which will have longer-run effects. (Money used is not used up but continues to circulate.) The practice of meeting sore-spot situations seems certain to continue to bias the economy toward inflation. How easy to induce monetary expansion which in its particular elements may seem small and incidental. A fraction of a percentage point extra next month does seem insignificant. Over time, however, these can cumulate to significant amounts.

A vicious cycle is established and reinforced.

Moving Toward Preservation of the Dollar's Worth (No Inflation)

Breaking the cycle of inflation and turning it around can, I believe, be accomplished. But not easily. Any convincing turnaround will itself require considerable time. Then the process of cutting the rate in half and then half again may take years.

Short-run adjustments will be painful if, as seems to be the case, through much of the labor force, wage rates (adjusted for productivity) are inflexible downward and are often dominated by powerful forces for increases — increases which cut some of the demand for employment. A minimum, permanent, core, or basic rate of perhaps 5 or 6 percent a year seems to me a horrible prospect but one often now assumed likely if only because of existing commitments to wage increases that will lead to more and more.

Specific union policies or other restriction (zoning and environmental or speculative reductions in the availability of land) may lead to increases of prices of specific things — construction, autos, trucking. The *price level*, however, depends upon something more. Policies that raise the costs of labor will prevent the achievement of acceptable levels of employment — unless more dollars are made available to finance employment at higher hourly costs. Unemployment follows inappropriate prices of labor.

Employment has quite properly been high among the goals of governmental policy. It should remain there. What has been missing has been the explicit recognition of the relationship of employment costs to the quantity of person-hours purchased. When employers and union leaders agree on a wage increase (fringes included), little or nothing may be said publicly about the effects on employment. Do we need new thinking? Not really, because the essence has been stated time and again. What is in short supply is frankness. Even the Federal Reserve, somewhat removed from politics, rarely makes explicit reference to the relation between labor cost and unemployment.

More on Causes

Monetary expansion, *the* cause of inflation, results from more causes than yet noted. To identify them is easier than to rate their relative importance and to separate the various elements that are interrelated.

The 1971 action “devaluing” the dollar raised the price of imports and made easier the purchase by foreigners of American products (tending to add to dollar demand here and to reduce quantities available for domestic consumption.) The process continued as later declines in the price of the dollar relative to many other currencies have aggravated our price-level difficulties, albeit in complex ways. When dozens of independent lands have currencies more or less free to move, the world-wide buying power of the dollar is subject to innumerable forces.

OPEC’s actions have been cited time and again as causing inflation here. One price of major significance — petroleum — rose dramatically. To have kept the average of domestic prices — the level — from rising, other prices would have had to go down. Rigidities, contracts, union agreements, customary relationships, all such things would have prevented “adequate” declines in “enough” particular prices to offset the rise in the price of oil. Monetary buying power here would have dropped as dollars went from our pockets to those of OPEC lands. Unemployment of American men and machines would have followed. Federal Reserve and other officials saw that this wasteful result could be prevented by the creation of “enough” new money. Facing a choice of avoidable unemployment, of losses in the short run of otherwise achievable domestic production, authorities opted for monetary expansion. Here, however, was another turn of the inflation screw. It reinforced the vicious cycle.

Are interest rate increases a cause of inflation? Certainly, as rates have risen, they have entered the costs of borrowers. One apparent result — further impetus for cumulation of the price-raising process! Yet interest rate changes result from broad forces of demand and supply for loanable funds. They do not have the *independent* causal power popularly assumed. *Real* interest rates — the nominal rate of, say, 10 to 15 percent minus the inflation rate of, say, 12 percent — have been negative or low.

Effects: Distortion of Price Relations

The forces making for *price-level* change do not affect all prices equally. As a result *price relations* are changed; witness housing in some areas. A price system is a marvelously effective agency for relating myriads of economic elements to each other. Supplies and demands constantly shift for countless reasons. Economic efficiency requires that

relations among factors of supply and demand adjust to changing conditions. Prices are a major mechanism for facilitating the millions, the billions, of changes in human desires and possibilities each period of time.

When monetary forces intrude as more than neutral facilitators (when money is more than a mere passive medium of exchange), some elements are influenced more than others. In such circumstances the underlying *real* elements of life do not determine fully the results available to us. "Artificial" monetary factors enter. The operation of the economy suffers but in ways rarely seen. Eventually, there must be some "correction" because the real forces will press to exert their proper power. But in the meantime new inflationary forces may create new distortions.

Land, art objects, antiques, and other things such as precious metals get bid up in price because inflation adds to the attraction of limited supply.

Decisions about what to do for customers 15 and 20 and 25 years in the future must rest upon estimates of price relations during the period. Forecasting the future will always be difficult. What will be the relative costs of materials and fuel? How will wage expenses change in relation to costs of other inputs?

Making the necessary prediction in planning capital programs is hard enough when managers can assume that the general price level will be stable. When there is reason to believe that powerful forces will alter the level of prices and when there is every reason to believe that some prices will be affected more than others, the planning problem becomes more difficult.

Effects: Expropriation of Suppliers of Capital

Inflation, we know, deprives bondholders, depositors, and holders of mortgage debt of some of the benefits they had expected. Persons who loaned funds did so expecting certain returns. All of us are well aware of the fact that the dollars used for repayment are worth less than those supplied originally and those expected in return. The amount of the erosion — the dispossession, the expropriation — differs widely from case to case. (The Federal income tax, one may note, allows no offset for this *real* capital loss; a capital levy is imposed. As distinguished from the

loop-holes about which we hear so frequently, some owners of capital suffer a sort of strangulation)

Has someone on the other side gained? Yes. In general, the customers of utilities, the homeowner with a mortgage, and other consumers have gotten services at less (real) cost than if current market forces had prevailed freely. Customers of regulated utilities, for example, have consumed some of the capital supplied by bondholders instead of returning it all. Depositors in thrift institutions have suffered erosion of their savings for the benefit of borrowers. How long will such conditions continue?

Shareholders (suppliers of equity capital) also suffer very often. Regulation of public utility rates prevents those who have supplied equity capital from receiving returns which have the purchasing power originally expected. Persons who bought the stock that enabled corporations to start and to grow (whether by new issue of shares or reinvestment of earnings) presumably counted on receiving dividends in dollars of purchasing power of the time, not the depleted worth that has come about.

Effects: Growth of Government

With graduated income tax rates governments can grow as more income moves into each taxpayer's top bracket. The process is too familiar to need description. The collective (governmental) portion of life can grow without any explicit vote.

Effects: Future Financing of Capital Investment

Savers with capital to supply will seek protection against erosion of worth of the dollar. New commitments of funds will reflect efforts to protect against inflation risks.

Customers of businesses and buyers of homes must expect to pay enough to attract the capital. Straight interest will be above the level associated with a "pure" rate plus normal risk. Escalation and purchasing power provisions may develop.

The prospect of very high nominal interest rates adds a new risk. The obligation to pay an interest rate with the inflation-hedge element may exceed the expected ability to do so. Borrowers face the risk of inability to continue paying a rate based on inflationary expectations.

Other Effects

Inflation invites attempts at control. How often we hear suggestion for “an incomes policy!” Speakers usually have in mind selective price, and perhaps wage control. Government is to use its coercive power to counteract market forces. The failures of such attempts in ages past as well as within recent memory do not convince everyone today that resort to such means will avoid frustration, failure, and disruption. A control may be enforceable *but not the continuation of supply of the product or service*. The reduction of supply creates hosts of problems.

Do something! “Control” at least what lends itself to direct action. Here is the cry. Perhaps the most probable candidate — victim — of such an attempt will be utilities that are already subject to regulation. Why not postpone rate increases? The supply of utility services relies to considerable extent upon long-lived capital which will be around and available for service for quite a time even though its full costs are not covered. The day of reckoning will be in the future, perhaps long after the next election. Increasingly, however, the supply side will reflect the depressing effects of price controls. International trade is disrupted. And so on. The list of adverse effects makes dismal reading.

The inflation prospect presents more difficult problems than most of us yet recognize. Property taxation presents special problems. Major elements of uncertainty as to proper assessment cannot be brought within the standard methods of valuation with anything like the assurance desirable. How can we find ways to make a property tax work effectively when the dollar figures in the market place result in part from inflationary forces (as distinguished from more normal economic considerations), but when the inflation element can itself differ from place to place, property type to property type, and time to time?

Understatement of *real* depreciation and regulatory lag can depress the *true* earning power of public utilities and hence the value figure appropriate for assessment. Local government finances will become more complicated. Measurement of “unearned increments,” a matter of special concern to Georgists, grows increasingly complex. And so on.

Concluding Comment

One must end on a disturbing note. The dollar has lost buying power at a rate, and for a period, far greater than anyone would have thought

possible only a few years ago. A powerful economy in years of peacetime boom and prosperity, with leadership that must be able to draw upon the best of knowledge, has gone from bad to worse in preventing erosion of its money.

More inflation is certain. But uncertainties lie in doubts about the magnitude. Persistent and determined pursual of Federal Reserve policies initiated last autumn will bring down the inflation rate. Perhaps Federal deficits will get smaller and thereby make the Federal Reserve's task less difficult; perhaps, however, Congressional desire to spend will not be restrained.

If Americans become convinced that the economy is on the right course — that price level increases will get less and less — then we can reasonably hope that new expectations will ease what must be a long and slow process. It is of enormous importance for human well-being. Fundamentally, much depends upon the extent to which rising dollar employment costs price labor out of the market and thus spur (short-run) monetary stimulation.

Through many inflations in many countries during many centuries, land has proved to be a reasonably successful object for preserving wealth. In modern America, it has seemed to me, ownership in productive enterprise should be at least as good — perhaps generally better — for protecting against inflation; but the record has confirmed those who emphasized land. Recent experience with land prices seems to me to reflect substantial effects of inflation expectations. This tendency will most likely continue, but I shall not venture to guess as to how much of the future has already been capitalized in land prices. Inflation has complicated the total of issues involved in a move toward site value taxation (or a shift in that direction and away from heavy taxation of man-made capital). The basic case for financing more of local government by taxing land values seems to me solid and deserving of support.