Facts and Fiction About Inflation

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I

For more than five years the American people have been consistently confused as to the true causes of inflation and high prices; the trouble being that the cause has gotten all mixed up with the effect and vice versa.

It is high time that the truth be known and that the responsibility be placed where it rightfully belongs.

If the truth is not made plain, and if the policies that cause high prices are *not* understood, there is danger that the American people will start demanding anti-inflation miracles from the politicians; and, in the field of economics, there are no miracles.

We do not have to be political scientists to understand what has been going on; we merely need to discard the ten-dollar words and the technical phrases that are now hiding the truth from us.

The truth is that prices are high for a very definite and simple reason, and no political party can do very much about it for a long time to come.

II

We can figure out this inflation thing together.

To get off on the right foot, we must think of inflation, not in terms of increased prices, but in terms of increased supply of money.

The story of our inflation starts in year 1933.

We all remember now—in 1933, at the bottom of the depression—the government announced its policy of driving up prices, and there are only two ways of doing that: creating a scarcity of goods or creating an abundance of money.

The method used was imported from England, devised by Professor Maynard Keynes, and the idea was to increase prices by having the government spend more money than it had: that is, *the idea was to create new, unearned money, add it to the money already in circulation and thus raise prices by reducing the purchasing power of all the money.*

This, in technical language, is called currency inflation.

If *you* or *I* did this, we would be arrested for counterfeiting, but the government can do it legally by causing banks to create, and turn over to the government, *new, extra* money in exchange for government bonds.

This method of adding to the money supply, when the method is explained in simple words, is not difficult to understand.

For example, the checking banks could easily create some new money for you or me: all we need to do is take to the bank something of value, or give the bank a mortgage on something we own.

The bank would then give us what is called a deposit against which we can write checks.

When the bank does this, the money supply of the nation is increased by the amount of our deposit or, put another way, by the amount of our debt to the bank.

Most of this new money of ours circulates in the form of checks, but is just as real as if it were paper or metal money.

III

This new extra money created for us, as individuals, for our private use is short lived: it disappears from the nation's money supply as soon as we pay our debt to the bank and, if we don't pay our debt to the bank, the bank can sell the thing we put up as security and use the proceeds to wipe out the extra money.

So the new money created for private citizens disappears pretty promptly.

But this is not the case with the money the banks create for the government.

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When the government wants money, it gives the bank what amounts to an I. O. U.; that is, a government bond.

The check-book money the government receives in return does not represent the production of anything or a mortgage on anything.

New dollars have been added, but nothing has been added to the supply of things for sale.

So when the government spends the money, there is not enough goods to go around, so up goes the price of everything, and up goes the cost of living.

To make matters worse, this extra, unneeded, and unwanted money created for government, stays and stays and stays in the economy.

Today there is more than 100 billion dollars of it in our system, and it would take many years of strict government economy to get rid of it.

To be specific, the nation's money supply in 1933 was about 38 billion dollars; in 1947, it was more than 138 billion dollars.

IV

The point most often forgotten is that high prices did not cause the issuance of this money: it was the issuance of this money that caused the high prices.

The reason that this extra money increased prices is that it did not represent the production of any extra goods or services for which the money could be exchanged; the people simply used more dollars to produce and exchange the same quantity of goods and services.

Let's put it simply.

In 1932, when we used to work for 50 cents an hour, a loaf of bread cost 5 cents.

In 1940, when we used to work for a dollar an hour, the same loaf cost 10 cents.

Today, when most of us work for about a dollar and a half an hour, that loaf of bread costs 15 cents.

So in terms of the real cost of living, that is, in hours of work, the cost of a loaf of bread has remained the same: six minutes of work.

We now have an epidemic of demands for some sort of political or economic magic that will bring back the 5 cent loaf of bread without reducing the number of dollars in the pay envelope.

This wishful thinking ignores the fact that the flood of new unearned money has forced the worker into chasing his own tail in an endless effort to keep his wages abreast of living costs, and that every raise he got was almost immediately taken from him by still higher prices.

These higher wages are called "social gains for labor," and the higher costs are called "greediness of the selfish interests."

As it happens, neither of these definitions is true.

V

One of the most frequently asked questions is: *What is the reason that prices rise every time wages and salaries rise?*

The reason is that selling prices, and wages and salaries, are practically the same things.

To prove this point, take an average manufactured product selling for $10.

About eight and one half dollars must go for wages and salaries; that is, between the time the raw material is produced and the finished product passes into the hands of a customer, about eight and one half dollars is paid out in payroll.

About one dollar must go for taxes, depreciation, and other unavoidable expense.

Eight and one half dollars plus one dollar is nine and one half dollars, leaving about 50 cents in profit for the people who supplied the tools of production which, incidentally, account for about 90 per cent of the work performed on the product.

What, then, could have been in the minds of the economists who said, after V-J Day,

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that payroll could go up 10 per cent without raising selling prices?

They said that this increase in payroll could be taken out of the profits.

A 10 per cent increase in payroll would mean 85 cents, while the profit was only 50 cents.

To be realistic, we must face the fact that when any substantial increase is made in wages, without a corresponding increase in goods produced, prices will go up.

It follows just as surely as night follows day.

VI

The basic trouble is that we have 100 billion dollars of stage money in our economy and are seeking desperately to avoid the inevitable penalties of its presence.

The administration started out to inflate prices, and did better than they had planned.

During the period between 1930 and 1947, every second dollar spent by the government was new money—added money that represented nothing of value.

America is flooded with this cheap money, much of it resulting from the war expenditures.

The only way to reduce this money supply is to tax the people and take the money out of circulation.

I know of no taxation expert who has any notion that this is going to be done.

VII

There are still many ignorant but optimistic people who want to keep prices down by law; who want to control prices by shackling us once again to the ration book.

What they really mean is that they want to control *the price tag on the product,* which is a very different thing from controlling the *cost to the customer.*

We don't have to guess as to how this economic sleight-of-hand trick works: the late, unlamented OPA is still fresh in our minds.

But let's review the process anyway.

A typical example is to be found on page 10 of the 1947 Report of the Joint Congressional Committee on Food Prices, Production and Consumption.

The subject is round steak—and the analysis is very interesting.

The OPA was controlling the retail price of round steak at 42 cents per pound.

But the meat business could not produce and sell at 42 cents, so the government paid out 11 cents to the producer to make up his losses.

This 11 cents—which is called a subsidy—was taken out of the pockets of the taxpayers—the same people who bought the meat.

And then the butcher couldn't make a fair profit at 42 cents, so he hiked the price by adding under-the-counter charges of about 13 cents.

So, instead of round steak costing us 42 cents, as the law said it should, it cost us 42

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Journal Entries

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discussion. The group has recently completed a real community service during which it trained Community Chest solicitors and Junior Achievement directors. More about those programs in the next issue.

November 18 was the day the Ontario Society met in Toronto to hear W. H. Clark, of Ford Motor Co. of Canada, discuss the training which is conducted in that organization. Mr. Clark is Director of Industrial Relations. Society members are forming three study groups to do research in specific fields of industrial and business training.

Letters

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travel involved we have arranged a 36-hour program which covers the same subject matter. This program is open to out-of-town training personnel and will be held during the week of January 31. We will be happy to make hotel reservations for those who desire them.

Many thanks for the previous mention you gave us which brought gratifying results from readers and members who are interested in our work in this new field.

Sincerely,
Robert O. Love, Director
Intensive Business Training Program
City College of New York

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cents, plus 11 cents in subsidy, plus 13 cents in over-charges, or *65 cents a pound.*

There is nothing unique about the situation in which we find ourselves.

Since the beginning of recorded history, governments have been inflating currencies and then trying to avoid the consequences by passing laws against high prices.

The modern punishments for black marketeering are nothing compared to the historical methods used by desperate governments in their efforts to keep prices from going up as the money supply went up.

The histories of Egypt, China, Turkey, Assyria, Rome, England and Colonial America all bear testimony to the impossibility of repealing the law of currency inflation.

It would seem that the earlier types of punishment would have been effective, because they included nailing the offender's ears to his own door, amputation of hands, skinning alive, tearing in two, boiling in oil, branding and exile.

But the laws of human nature and the laws of economics change for no government.

It would be childish to pretend that we have not violated the law that controls prices, and it is more than childish to believe that we can avoid the penalty of high prices.

Now, Ladies and Gentlemen, people who say that such things as European economic cooperation, government crop purchases and subsidies, and other governmental expenditures are inflationary, either are not telling the truth or do not *know* the truth. Because no matter how much government spends, providing it has first been taken from the people in taxes, it is not inflationary.

The *basic* cause of high prices is the 100 billion dollars of new unearned money that has been pumped into the American economic system.