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Inflation

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THE American citizen is swiftly awakening to the meaning and import of the word inflation in relation to every-day life. Instead of being regarded as "a high-brow fancy of the professors" to be tolerantly ignored by the public and summarily dismissed by hard-headed men of affairs, it is now generally accepted as the glaring evil of our war economy—responsible for high prices, business profiteering, speculative excesses and for the economic injuries and social injustices that make up the popular unrest with which the country is now beset.

There are definite reasons for the delayed recognition of the extent and effect of inflation. On the one hand, governmental authority has systematically obscured the fact and denied the inference. At intervals, inflation has been held forth bogey-fashion as the penalty which would follow non-adoption of the official policies. But measures, frankly inflationist in effect, have been freely resorted to whenever administrative purpose or opportunist convenience dictated. On the other hand, expert economic opinion—barring a few notable exceptions—has been slow in making its influence felt. Reaction from a false scent, concentration upon a specialized formula, absorption in governmental service and perhaps the intricacy and novelty of a new type of inflation have made the economist a less prompt, perhaps a less certain guide than in other popular economic vagaries.

PRIMARY CAUSE OF INFLATION

The indictment of inflation as a consequence of fiscal bungling in our war economy rests squarely upon the doctrine that a relative increase in the volume of currency is the cause and not the effect of rising prices. With this conclusion the great body of theoretical economists and practical financiers in this country and abroad are now in agreement. A few irreconcilables still sanction the dissent which Professor Laughlin and his disciples have so earnestly and so unconvincingly set forth. Something less than this has been invoked by the Federal Reserve Board to justify the increasing note issues of the Federal Reserve Banks. But even here there has been a perceptible weakening in asseveration; and it seems not unreasonable to assume that in about the same interval of time the advocates of the English bank restriction became converts to the doctrines of the Bullion Report of 1810, and the defenders of Secretary Chase's fiat issues yielded to the logic of greenback prices—there will be admission on the part of fiscal stand-patters that our huge creations of bank credit and note currency have been the direct cause of swollen prices.

The facts as to inflation can be set forth in a paragraph: As compared with the spring of 1914—the eve of the World War—the people of the United States are carrying on their business at the present time with practically twice as much circulating medium and

bank deposits. There has been an increase in the actual circulating medium of the country from \$3,402,015,427 on June 30, 1914, to \$5,846,171,213 on February 1, 1920; an increase in the deposits of national banks, state banks and trust companies from \$13,430,000,000 on June 30, 1914, to \$25,731,000,000 on June 30, 1919, and an increase in the individual deposits subject to check of the national banks alone from \$8,470,747,000 on June 30, 1919, to \$9,682,618,000 on November 17, 1919. Altogether it is likely that the country is now transacting its business with \$15,000,000,000 more circulating medium and deposits than five years ago.

This huge addition to the nation's money has been for fiscal convenience and not for commercial requirement. The direct consequence of the attempt to play the business game with twice as many chips has been to cut in half the commodity-buying power of the money unit, evidenced by a rise in general prices to 249 in February, 1920, as compared with 100 in 1914.

COURSE OF INFLATION

There have been three stages in the course of our inflation, each marked by an unsound administrative policy: (a) from the outbreak of the World War in August, 1914, to the entry of the United States into the great struggle, an incoming flood of gold was permitted to serve uncorrected as the basis of a towering credit structure; (b) in the eighteen months of our active belligerency lavish supplies of fiat credit by bank loans through certificate borrowing were created in the interest of fiscal opportunism instead of economic requirement; (c)

from the armistice of November, 1918, almost up to the present the policies of the Federal Reserve Board as to credit control have been frankly dominated by the convenience of the Treasury.

From the Outbreak of the World War to the Entry of United States into Struggle

Thanks to huge exports of munitions and supplies to the belligerents and the sharp decline in commodity imports from the war area, an undreamed-of stream of gold poured into the United States during the period of our neutrality. Largely in consequence, the volume of coin, including bullion in the Treasury, increased from \$2,638,496,956 on June 30, 1914, to \$3,807,161,348 on June 30, 1918. This increase in our stock of monetary gold of more than one billion dollars was magnified by the changed reserves of the banks, consequent upon the operation of the Federal Reserve System and the gold-centralizing amendment of June 21, 1917. Had our financial administrators been more skilled in world banking, prompt attention would have been paid to the significant price movements that followed such changes. Increased reserve percentages would have been urged and higher discount rates would have been imposed to check the inflating effect of the gold flood. Nothing of this was done, and we passed from the uninformed state that marked our neutrality financing to the outright error that marred our war borrowing.

From the Entry of United States into World War to the Armistice

The worst blunder of our war-time financing, in its subsequent effect upon

social well-being, was the Treasury's large reliance upon bank borrowing during the period of active belligerency and indeed for some time thereafter. To supply itself painlessly with ample borrowed funds and to keep the money market artificially within favorable limits, a huge volume of credit currency was created by bank loans, taking the form of issues of Treasury certificates of indebtedness in anticipation of loan proceeds and tax revenues. In another place I have described the mechanism whereby this was accomplished.¹ What could at that time only be proposed tentatively can now be asserted definitely, for events have confirmed the forecast with almost startling exactness.

Through the devices of payment "by credit," redeposit of funds, exemption of government deposits from reserve requirements and preferential rediscount rates upon war paper—anticipatory certificate borrowing from the banks, as practiced by the Treasury, involved the direct creation of a volume of additional bank credit in the form of public deposits dictated entirely as to time and amount by fiscal convenience and entirely unrelated to commercial need. Such emissions of fiat credit were dispersed among individual deposit accounts in the course of public expenditure, producing a direct expansion of credit and currency without succeeding contraction incident to certificate liquidation.

From Armistice to Present Day

The inflation due to the gold flood from warring Europe in the period of

¹ War Borrowing: A Study of Treasury Certificates of Indebtedness. (Macmillan, 1919.)

our neutrality and to the reliance upon fiat credit in connection with war borrowing in the period of our belligerency may perhaps be explained, though insufficiently, on the score of the ignorance of our financial administrators as to the potency and far-reaching effect of the great economic forces they were invoking. Not even this justification can be found for the amazing renewal in our post-war financing of the fiatism of the war period, by the resumption of certificate borrowing eight months after the armistice in accordance with Secretary Glass's program of July 23, 1919. At the time the Treasury so resumed its policy of bank borrowing the inflationist effect of such procedure had been established to the point of outright demonstration by analysis of banking operations in the United States during the period of war borrowing and thereafter. Further, such conclusions, although ignored by our financial administrators, were accepted in every particular in this country and abroad by the great body of financial experts not actually engaged in banking operations or identified with governmental financing.

Expansion of Fiat Credit

Since August 1, 1919, the Treasury has emitted issue after issue, first of "loan" (to be distinguished from Liberty Loan or Victory Note certificate) and later, of tax certificates. These were absorbed by the banks under a form of administrative compulsion and were paid for almost entirely "by credit," that is, by the creation of additional deposit currency. Enabling the Treasury to sustain its floating indebtedness only at the expense of mortgaging prospective rev-

enues and of deflecting the policies of the Federal Reserve Board, the harmfulness of such fiat financing has been even greater in monetary than in fiscal influence. With each succeeding issue there has thereby been injected into the deposit currency of the country a very considerable body of fiat credit, in the form first of government deposits, and thereafter as liberated and dispersed in public expenditure, in the form of ordinary individual deposits. Such additions to the effective circulating medium of the country, let it be emphatically restated, have not been in response to the country's business needs, but have come into being because the Treasury has elected to provide itself with funds in this comfortable way rather than undergo the effort of additional funding or taxing operations. It was much in this way, for example, that for the year ending June 30, 1919, the deposit liabilities of the national banks increased by the amount of \$948,920,000 in excess of the increase in loans and discounts—an increase which the Federal Reserve Board itself recognized as "a pure credit expansion, not called for by increased industrial activity, but occasioned by the use of the banks' credit for government financing."

In commenting at the time upon the wisdom of the foregoing policy, the present writer wrote in terms which in the light of succeeding events may, at this time, be reasonably repeated: "A bitter sequel of war dislocation is that long after armies and fleets are demobilized inflated currencies and expanded credit fabrics remain. Deflation is hard in practice and painful in effect and a democracy is not likely

to have strength or to show courage enough for heroic operation. But if the Treasury be not willing to enter upon the hard, straight course of currency contraction and credit restriction, let it at least avoid the treacherous ease of further bank borrowing. At a time when corporate flotations have been crowding in swift succession and foreign governments are standing queue-like at our financial gate, it is an incomprehensible thing that our own public borrowing should revert to a form which only the desperate exigency of wartime need should have tolerated. If to this anomaly be added the fierce quest of public and private leaders for the cause of high prices, the picturesque array of culprit elements and the soft-peddling as to an obvious and indubitable factor—one may venture that the next-century New Zealander will musingly recognize that the lamented Phineas T. Barnum plumbed the depths of the American mind."

EFFECT OF INFLATION ON ECONOMIC CONDITIONS.

The bitter penalty of inflation is that its evils are, in the main, beyond remedy. Like some tissue-destroying malady of the human body, it changes the whole functional life of the society which has suffered its ravages. We can never completely recover from the credit orgy of the past five years, nor return to the economic condition from which it has dislodged us. In the sense of a complete and final antidote, deflation is an academic term. In actual practice, the business world would never stand the stress of crumbling markets, the debtor class would never bear the burden of falling prices, the public treasury would never

endure the load of heavier debt burden.

Methods of Recovery

But if complete deflation be a counsel of perfection, there are certain wholesome things that can be done, and it is upon these that present effort should be centered. In the first place, there should be no further recourse, under any warrant or pretext to those fiscal methods and banking practices which have up to this time encouraged or permitted inflation. To tolerate an ill is one thing; to aggravate it is another. The doctrine of practical necessity may do yeoman service in defense of unsound war-time policies; it may not be as securely invoked in the calmer years that follow.

In the second place, there should be no placid acquiescence in the existing state of affairs and no tolerant unconcern as to the courses which have brought us here. Responsibility for inflation should be definitely and specifically assigned to persons and policies—this in no vindictive sense,

but that there may hereafter be complete avoidance of like error. It was the effective indictment of Secretary Chase's greenback policy that, more than anything else, has since saved us from descent to inconvertible paper. It is only by full clear recognition that the fiscal methods of the past five years have brought us to our present pass that sure protection will be afforded for the future.

Finally, though we may not fully retrace our steps or undo the largest mischief that has been done, yet our faces should be set in the true direction. The great evil of inflation has been social injustice. To atone in part for this by a gradual but courageous contraction of bank credit, with its reasonably certain consequence of an appreciating money unit as speculation is checked and production increases—is a wise and just policy. If we neglect this, under the influence of financial convenience and business advantage, we shall be dropping back again into the old vicious cycle of class exploitation and social reaction.