GEORGIST JOURNAL – SPRING 1979

# THE BASICS OF INFLATION

By OSCAR B. JOHANNSEN (Roselle Park, N.J., USA)

Inflation is the nation's No. 1 problem, so we are told. And the government, much like Don Quixote, has mounted its white charger and is riding off in every direction tilting with miscreant windmills (businessmen and labor barons), in its mighty crusade to slay the dragon of inflation.

But what is inflation? The Germans found out the hard way in the early 1920's. They took their money to the store in a huge shopping bag and brought home their purchases in their pockets. They learned that inflation is too much money chasing too few goods.

But we are told by eminent authorities that inflation is rising prices. From the government's viewpoint this definition has a signal advantage. It makes people angry primarily with businessmen for obviously they raise the prices of the goods they sell. To a lesser extent, it makes the people also angry with labor barons for they are always calling out their members to strike for higher wages, which translates subsequently into higher prices for goods.

For the government, to define inflation as rising prices has the advantage that it takes the government off the hook. It makes it look as though business and labor are responsible for inflation and not the government.

Actually the government is the villain for it has made money its monopoly. By means of the Federal Reserve System, the U.S. government, in effect, is constantly printing more and more money. The money of a nation may be likened to a huge pond. As ever-increasing streams of money flow into the pond, t he level rises. This risomg level constitutes the rising prices which we all experience.

To stop inflation is simple. Just stop increasing the money supply. If it is that simple, why isn't it done? Because the result would be a serious depression, and no politician wants to be blamed for a depression. All one needs to do is to look at the figures to get some idea of the problem. The so-called money supply, which is classified as $M_1$ which consists of currency plus demand deposits of commercial banks, is the enormous sum of $360 billion. In the past five years, it has been increasing at an average rate of about 6.6% annually, whereas production of industrial goods has had an average rate of increase of about 2.6% annually. Consumer prices on the average have increased by about 8½% annually.

Prices tend to parallel the increase in the money supply. However, when people become aware of inflation, prices will tend to increase at a faster rate than the money supply because people anticipate. Since they expect prices to rise, they do not defer purchases which they really do not need. Instead they adopt the motto: buy today what you need tomorrow. It is believed that many people bought in 1978 the cars which they would have bought this year.

What is the likely scenario for the future? Alternations of increasing and decreasing the rate of additional money into the money pond. Right now, the government has been, in effect, slowing the rate at which money is printed. The result is that interest rates tend to rise for with demand remaining the same or increasing, and with supply diminishing, interest rates rise. This may affect such industries as housing, causing a slowdown. This snowballs downward as related industries are affected. Unemployment tends to rise, and with it comes an insistent cry to the government to do something. (contd.)

It does. It will increase the speed of its printing presses, that is, increase the money supply. This will temporarily reduce interest rates, and presumably encourage businessmen to build more capital and houses, and so prevent the depression from worsening, and possibly induce a boom. The government will try to time these events to the recession period occurs in an off-election year, as is the case this year, with the boom occurring next year.

Of course, with the inflated money supply, prices will continue to escalate. The government will blame business and labor and after asking for voluntary wage and price restraint, will institute mandatory controls. This is equivalent to putting a ceiling over the money pond while at the same time pouring more money into the pond. Something will have to give way. What will happen is that the price controls will have to be eliminated or at least raised.

This alternation of increasing and decreasing the rate of increase of money will go on until the dollar becomes worthless. How long that will take is anyone's guess. One can make one's own guess, however. It is said that today one has to pay $1.00 for what in 1939 would have cost 21¢. Thus the dollar has lost about 80% of its value in forty years.

Can one protect oneself against the ravages of this inflation? It is possible if one is lucky and smart enough to invest in things, as gold, which will be desired as the inflation worsens. However, inflation should be looked upon much like an epidemic. In an epidemic even as knowledgeable a person as a physician may be among the first to succumb, while another person who takes little or no precautions may live through it quite well. Similarly, in an inflation those who have studied past inflations and try to protect themselves by investing in foreign currencies, real estate, or gold and silver may wind up losers while someone who by sheer luck does the right things may be a winner. No two inflations are alike, although there are similarities. But the differences may mean a person may come out well or may not.

Inflation is worse than a depression, but only those who have lived through one knows this. We in America fear depressions more than inflation, so we are going to learn the hard way, as did the Germans, the agony of having too much money with too little goods.