A Merchant's Appraisal of INFLATION

HUGHSTON M. MCBAIN

IT WAS MIDNIGHT when my cab pulled up at the hotel. I had had the taxi since early morning. I opened my suitcase and counted out 71,250 marks. This included a 5,000 mark tip for the driver. He was delighted and thanked me profusely. How could he know that the total cost to me for his cab, gasoline, and services for that 16-hour day was only 57 cents? Naturally, he could think only in terms of his own money. To him it looked like a fortune for a day's work. The time was October 1922 – the place Berlin. The value of the paper I had given him expressed in terms of prewar marks was about $14,000!

Mr. McBain retired in 1958 as Chairman and Chief Executive Officer of Marshall Field & Company. As a veteran merchant, a world traveler, and a keen observer of economic affairs, he is well qualified to discuss inflation. This article first appeared in two installments in the *Chicago Sunday Tribune*, March 15 and 22, 1959.

I spent three months in Berlin that year. Prices were rising with such rapidity that no merchant could open the doors of his establishment much before noon. He had to reprice each item every morning!

One evening I took some German friends to the Adlon Hotel for dinner. Despite my urging, they would order no meat. I explained that meat would cost me practically nothing. To them I seemed to be paying $900 for a sirloin steak!

I lived through many months of German inflation – and I learned a lot. The German people seemed unable to grasp the fact that the loss in the value of their money was bringing ruin. They thought only in terms of high prices ascending to astronomical new heights every morning.

Years later, another time and

place made an indelible impression upon me. I was having dinner with our Italian agent in Florence. The year was 1947. World War II had come and gone. Another country had been hit by disastrous inflation – though not of such proportions as the one in Germany during 1922-23. This night in Italy our dinner check totaled 6,000 Italian lira. To my Italian guest, thinking in terms of his country's currency before the war, I was spending $1,250 on dinner for two! If in the not too distant future a similar situation develops in America, I am certain most of us will be deploring "high prices" rather than correctly blaming our rotting dollar for the disaster.

I asked this Italian agent what he had done to protect himself from the scars of inflation. He told me he had saved regularly 20 per cent of his earnings during 40 years of business life. I asked him about life insurance. Yes, he had started a program many years ago and most of it was paid up. He told me of his expectation that his life insurance would enable him to retire in comfort. Now that retirement was close at hand, he said, there was no question of default; the life insurance companies were paying their claims in full, as promised, in Italian currency. But – and tears came to his eyes – instead of providing lifelong security for his wife and children, his entire insurance proceeds would now buy a supply of food for only three weeks!

My Italian friend, like my German friends, could think only in terms of very high prices.

I do not pretend to be an economist. But I do know something at first hand about inflation. Personal experiences such as these show how tragic its effects can be. Since my vivid experiences in Europe, I have studied the causes and effects of inflation with compelling interest.

Fiasco in France

Perhaps the greatest story ever written on the subject is entitled *Fiat Money Inflation in France: How It Came; What It Brought, and How It Ended.*[1] It was written by Andrew D. White, the first president of Cornell University. Despite the fact that the French inflation described by Dr. White occurred in the latter part of the eighteenth century, its closeness to our own situation today is startling.

The trouble started in 1789 when France found itself with a heavy debt and a serious deficit

[1]A new edition of *Fiat Money Inflation in France* with a foreword by Henry Hazlitt is being published by the Foundation for Economic Education, Irvington-on-Hudson, New York. About 128 pages; $1.25 paper; $2.00 cloth.

because of an unbalanced budget. There were grave doubts whether the French people would place any confidence in paper money not exchangeable for gold but backed merely by government's promise to pay. Therefore, the government decided to confiscate all the church lands in France and to use them as security for paper moneys. The church real estate formed about one-third of the entire real property in France. It looked like a solid base for a great financial future. (It is now obvious that church lands were a poor backing for currency for the simple reason that no individual could ever obtain these lands or any portion of them in exchange for his money.)

A Vicious Cycle

Against this base, paper money was issued. The new credit caused great joy; the treasury was relieved; a portion of the public debt was paid; creditors were encouraged; ordinary expenses were met. Six months later business slumped again. Politics again prevailed. There was less argument than before against issuing more paper money. A few sound thinkers of that day explained that increasing the quantity of money and credit in any country must soon increase prices, disturb values, alarm capital, and decrease the demands for products and labor.

Nevertheless, the vicious cycle had started; it was politically inexpedient to stop the subsequent issuance of more and more paper money. After each new issuance, business improved temporarily and prices advanced – but the value of all French moneys declined.

Leads to the Guillotine

By January 1793, about 3 billion francs had been issued – all publicly and legally. Prices were constantly rising. Committees were formed to attack and stop inflation. Orators endeavored to enlighten the people by giving every reason in the book for this disaster save the true one. The government blamed the ministry, the nobles, the hardhearted rich, the merchants, the shopkeepers. Today's convenient "whipping boy" – Big Business – was as yet unborn.

In late 1793, the Law of the Maximum was passed – and price ceilings were born. Controls were established on wages, selling prices, profits. The people were overjoyed, but evasion, as always, quickly followed – then scarcities – then rationing. Manufacturers were crippled, agriculture depressed, shopkeepers were ruined if they obeyed the law. Many shops closed – others were looted. Some evaders were sent to the guillotine; others were hanged. (I'm grateful not to have been a merchant in those days!)

At the end of 1795 more than fifty billion francs had been issued. The purchasing power of this paper money (despite the enormous value of the lands pledged behind it) was practically nothing.

On February 18, 1796 – 9 a.m. – in the presence of a great crowd in Paris, the machinery, plates, and paper used to make this "fiat money" were solemnly broken and burned.

Once more, in our own times, the subject of inflation is making headlines every day. We are deluged with newspaper stories, magazine articles, and speeches. Several intelligent articles on inflation have appeared in this newspaper. But it is true, nevertheless, that much of what we read and hear on the subject is complicated gibberish. In some cases I believe it is purposely so. History verifies the statement attributed to Lenin: "The surest way to overthrow an existing social order [government] is to debauch the currency."

High Prices, an Effect

Just what is inflation? "Inflate" means "expand."

To me, "inflation" means inflating the money supply. It is just that simple.

Stated another way, each dollar is a purchase order; that is, it is a claim on goods and services. It is the increasing of these purchase orders – making more of them than is properly justified by the economy – that is true inflation.

People are led to believe, erroneously, that "high prices are inflation." That is putting the cart before the horse. High prices are merely the *effect* of inflation. And quoting Webster's dictionary: "Inflation always *produces* a rise in the price level, in accordance with the quantity theory of money."

Through the Banking System

Our government has a complete monopoly of the "money factory." If you doubt this and care to test it, try manufacturing some money or government bonds yourself! But you had better not: the government's control and monopoly is absolute. Only the government can be a "legal counterfeiter" in the sense of legally creating more money and bank credits. It follows logically that under such control the government, and only the government, can prevent inflation.

How does the government inflate our currency? There are several successful methods, the oldest of which are no longer in favor. They would be too easily detected by the better educated citizens of this generation. In the ancient great days of Rome and Athens, however, inflation was accomplished by "clipping the coins." This was done by the government's taking the coins then in circulation and reminting them so that they contained less gold or silver. The government then represented to the people that they had the same value as before. (Does anyone value our paper dollar of today as equal to a gold one?)

Many centuries later, governments resorted to a much easier method made possible by the advent of the printing press. They simply printed more paper money, thus increasing the government's income much more conveniently than by raising taxes. In our own generation many examples come to mind of the money printing press route – Chile, Germany, France, Italy, Argentina, Greece, Brazil, and China, to name a few. Today, however, we practice a much more subtle scheme to accomplish the same ends. Our government prints bonds and sells them to commercial banks which pay for them by entering deposits (or credits) in the government's bank accounts. Of course, these deposits may be spent by the government (just as you or I may draw on our personal bank accounts).

The Quantity of Money Increases

With its complete monopoly, no matter what method our federal government elects to use to increase the available supply of money and credit, the all-important fact is that it is the government, and *only* the government, that has the power to cause true inflation.

The following table quickly shows the total amounts of usable money available in the U.S.A. at year ends:

1939 –	64.7	billion dollars
1948 –	172.7	" "
1956 –	226.4	" "

It is quite obvious that neither the increase in our population nor the increase in productivity has grown anywhere nearly as fast as the money and credit supply. It is also true, however, that if there had not been some considerable increases in our population and in our productivity, the value of our currency would have decreased much more severely than the approximate 50 per cent drop in the last 20 years.

And People Demand More

Many of our confused ideas concerning inflation stem from oft-quoted statements that labor unions and business cause inflation; the former by gaining higher wages for employees, the latter by increasing selling prices. Since high prices are not inflation; since inflation only relates to money and bank credits; and since only government controls the quantity of both, it is obvious that neither unions nor business can *cause* inflation.

However – and this is fundamental – when wages are arbitrarily forced above the market level that would have reflected the existing relationship between the supply of labor and the demand for it, we have the starting point of a vicious cycle:

1. Wages increase.
2. Prices increase.
3. Products lose competitive position in world trade.
4. Unemployment results.
5. Pressure on government to make more money available tends to become irresistible.
6. Government gives in to political pressure.
7. The government creates more money.
8. The value of our money drops – and we have inflation.

Pressure-group Procedures

In emphasizing the government's complete responsibility for *causing* inflation, I do not intend to imply that unions and business are blameless – quite the contrary. When a union or a business or an individual is responsible for raising wages and/or prices faster than the market allows, they are fanning the flames of inflation. They are creating the very conditions that eventually bring such powerful political pressures on government that it will surrender its responsibility to keep our currency good.

People spark inflation. Demands made by "people" for federal funds (no matter what group name they use), when excessive and beyond reasonable limits, cause a breakdown in the normal laws of supply and demand. Such demands lead to property destruction, unemployment, and eventually irresistible pressures on government to extend its power beyond its competence.

Business tends to put the whole blame on labor unions because of their demands for higher and higher wages. But is business – and other so-called moderate groups – blameless? I doubt it. When "great conservative leaders" representing chambers of commerce, churches, slum clearance projects, agricultural "security" groups, hospital building programs, foreign aid devotees, and countless others all demand that their pet projects be included on the "federal gravy train," I believe they are just as guilty as the unions.

Individuals Can Resist

In all these areas – people – you and I – are responsible. The next time I am asked to lend my name and support to any project which aims to pressurize government for more federal funds I am sure my answer will be an emphatic "No!" The federal government is already committed to spend far more than it can properly afford.

The recent appointment of a cabinet committee headed by Vice-President Richard Nixon to draft plans for combating inflation is encouraging. It will have no difficulty in ascertaining the facts. The announced intention "to strive to build a better *public understanding* of the problem of inflation" is all important. I hope the committee follows through.

Other governments in other years have lacked the courage to reveal the truth about the real cause of inflation. They have lacked the courage to explain that all inflation is bad – no matter how small or creeping it may be. Once started and not checked, I firmly believe that inflation always leads to disaster—and it always takes the greatest toll from those who can least afford it. • • •

IDEAS ON LIBERTY

How To Kill Trade

LONG BEFORE the close of 1791 no one knew whether a piece of paper money representing a hundred livres would, a month later, have a purchasing power of ninety or eighty or sixty livres. The result was that capitalists feared to embark their means in business. Enterprise received a mortal blow. Demand for labor was still further diminished; and here came a new cause of calamity: for this uncertainty withered all far-reaching undertakings. The business of France dwindled into a mere living from hand to mouth.

This state of things, too, while it bore heavily upon the moneyed classes, was still more ruinous to those in moderate and, most of all, to those in straitened circumstances. With the masses of the people, the purchase of every article of supply became a speculation – a speculation in which the professional speculator had an immense advantage over the ordinary buyer. Says the most brilliant of apologists for French revolutionary statesmanship, "Commerce was dead; betting took its place."

ANDREW DICKSON WHITE, *Fiat Money Inflation in France*

Socialist Propaganda

The result is increased taxes on the people it impoverishes.

REGINALD JEBB

TO CURTAIL the freedom of a people so that the lazy or inefficient members of the community should be enabled to remain lazy and inefficient is not only to impair the most precious attribute that mankind possesses, but it is also bound in the long run to destroy the economy of the country that practices it.

When the State curtails individual freedom, it defends its action by saying that it is helping the weak against the strong, that its motives are selfless and therefore impartial, and that it is preventing the exploitation of man by man.

The fallacy in this statement of aims is seldom pointed out. Personal freedom is not oppressive. It is a God-given human right that holds oppression at bay. The first thing that a tyrant does is to deprive his people of freedom. So long as they remain free, he cannot succeed. Those who support the State's claim to restrict freedom of action to itself are equating personal freedom with injustice. That there is injustice in the world and that undeserved hardship exists, all will agree; but remedies of these evils are not to be found by confining freedom to a ruling clique. Nor will any of the State's arguments bear examination.

What, for example, is the State's attitude as regards the weakness or strength of members of society? It assumes that the wage earners of organized labor are the weak members that need help, and it sets itself to nationalize industries and pour money into them, to boost wage rates whenever the cost of living rises, and to solicit popularity by deferring to union demands. But

---

Mr. Jebb is a British educator, editor, and journalist.