HOW INFLATION TOUCHES EVERY MAN'S POCKETBOOK

Primer in H. C. L., Prepared by Expert, Shows Why Dollar Does Only Half as Much Work as Before War—Remedies Are Difficult

The writer of this article is Professor of Political Economy at Johns Hopkins University and has been commissioned by the Government on many occasions as an expert in fiscal affairs and taxation for service in our territories and island possessions. He is the author of various books, including "The Abolition of Poverty," and is commonly regarded as one of the foremost American authorities on currency inflation. For that reason he was asked to write this article in a way understandable to the layman.

By JACOB H. HOLLANDER, Ph. D.

POLITICAL economists often use a language of their own instead of every-day speech. Sometimes this is only a bad habit. More often, like the jargon of the baseball fan and the slang of the schoolboy, it is a sort of verbal short-cut, easy enough for those who follow the game, but very hard for those who do not.

It is unnecessary that this should be so. Economic laws can be made plain to any child of 12. It is just as easy to show an average man or woman of common sense, who is willing to listen and to think, why the cost of living is high as it is to explain how lightning comes with a thunderstorm or why gasoline makes an automobile move. We are not born with such knowledge, but we gain it readily. So, too, instead of merely bemoaning the High Cost of Living, we ought to be willing to spend a little time in finding what has caused it and how we may hope to see it reduced. This is what I shall try to do. If I fail, it will not be because the thing cannot be done, but only that I have not been able to do it.

In the first place, let us make sure that we are clear as to what is meant by the High Cost of Living. Higher prices for the things we buy—of course. But something more than this. If our earnings and savings grew just as much and just as quickly as prices rose, we should be no worse off. There would be some grumbling that a fatter pay envelope meant no bigger market basket, and it might be thought unjust to be left merely standing still while the rest of the world moved on, especially for those who have worked harder and with better result. But there would be no real harm done.

The situation is much more serious, however, if over and above this disadvantage, the prices of the things which we are in the habit of buying have risen higher than have our earnings—to say nothing of our savings—so that we can buy less, even though we seem to be receiving more. Not to move ahead is a very different thing from actually slipping back. The high cost of living means this kind of slipping back.

Our 50-Cent Dollar.

We are not left to guess as to just how high prices have risen. Every one feels from personal experience that things cost more—just as he does that April days are milder than December weather. But a general impression of this kind would not carry us very far. So, just as we turn to the thermometer and the Weather Bureau records to learn how much warmer May day is than Christmas, we should consult the Index Number of Prices of the United States Bureau of Labor to find out how much higher prices are today than, say, five years ago. The Index Number is an average of the prices of a great many different things, arranged to show the movement from month to month and year to year. We may use it with as much confidence in talking about rising prices as we do the thermometer in speaking of hot or cold weather.

The Index Number tells us that between 1914 and 1920 wholesale prices have risen from 100 to 253, and retail food prices from 100 to 200. In other words, retail food is twice as high, and wholesale goods two and a half times as high as five years ago. The high cost of living thus reduces itself to the cold hard fact that a dollar spent on the ordinary things which we are accustomed to use will buy only one-half of what it would have done five years ago.

It is certain that a swift, sharp rise in prices such as this must have had very grave and far-reaching effects. In the first place, every man's savings have been cut in half, as far as their real worth is concerned. This is true of savings banks deposits, paid-up or part-paid insurance policies, building and loan association funds, mortgages and securities of all kinds. It is true that both rich and poor are hurt in this way, but the man of means will feel it very much less than the man in moderate circumstance. Should prices fall again to their old-time level, those who have been able to hold on to what they have saved will come out even. But to the extent that low prices do not return, and in so far as actual use must be made in the meantime of what has been put aside for a rainy day, a cruel loss will have been suffered.

In the second place, those who are supported wholly or in part by fixed allowances, such as war pensions, retirement and service grants, annuities, old age benefits, compensation awards, have been hit very hard. Receiving each year or each month a certain number of dollars and no more, they find such dollars, as far as buying power goes, are worth no more than 50 cents.

Finally, come the great army who receive salaries and wages, or at least that part of them whose earnings have increased less rapidly than prices have risen. The salaried classes—clerks, teachers, Government employes—have suffered the grossest injury, for they have been in the main unorganized and unable or unwilling to make a stand for increased pay.

As to wage earners, the evidence is not as complete as it should be. In certain industries and in favored localities wages have not only kept up but have gone beyond prices. Elsewhere it has been either nip and tuck or wages have actually lagged behind prices. But even at best, the workman has been in the position of having to fight and struggle to keep from merely slipping back.

I have spoken thus far of the injury done to earnings and savings. But there is injustice of another kind caused by high prices, and that is the excessive profits which business men of all kinds —manufacturers, jobbers, wholesalers and retailers—are able to reap, indeed almost compelled to take in a period of swiftly rising prices. In these last five years a business man could grow rich by merely keeping his goods on the shelf while the market price continued to rise. This is the real story of "profiteering." It is not a vicious habit which has suddenly come over the business world and which can be stopped by putting men in jail. It is a symptom of the disease, not the disease itself. Profiteering is the effect, not the cause, of the high cost of living. Those who have been trying to make the American people believe that profiteering causes high prices are in a class with the quacks who would tell a consumptive that his loss of weight is due to his high color instead of saying that both are the symptoms of the tissue-destroying bacillus.

As Cause of Unrest.

The largest, and perhaps the most serious, consequence of the high cost of living is what we have come to speak of as social unrest. The minds of many thousands, perhaps hundreds of thousands, of decent God-fearing men and women in this country are disturbed that such things as have been described above should have been permitted to come to pass. It has made them ask whether there can be anything out of joint in our economic system or grossly wrong in our political order. It is not only anarchists and Reds who say or think these things. Advantage has doubtless been taken of the unsettlement by firebrands and malcontents. But it is burying our heads ostrich-fashion not to realize that conditions have been favorable to such propaganda.

Now, what is the cause of this tremendous rise in prices? Probably a number of things have something to do with it, and there may be a grain of truth in each of the forty-odd explanations that have been given. But we should distinguish between the one great cause that is directly responsible and the host of minor influences that have had a later effect.

This one great cause is that the amount of money which the Government and the banks have supplied the country for the purpose of carrying on its business is twice as great as it was five years ago. The business of the country consists in producing goods and services and in exchanging them. To make this easier and more convenient we use money—pieces of gold and silver, bits of engraved paper, checking deposits in banks. It is necessary to remember that the largest part of the country's real money is not that which is carried in wallets or kept in cash registers, but consists of deposits in banks created by the banks' loans. These loans become checking accounts for purchases and payments. If, for instance, a clothier borrows $10,000 from his bank, this becomes an addition to his checking account and his checks serve instead of gold or bank notes. Such a loan, so used, is as real an addition to the money of the country as newly minted coins or freshly issued notes.

If the Government borrows from the banks on certificates of indebtedness, in this same way, or one of the buyers of Liberty bonds borrows from his bank to pay for them, there is the same trend of addition to the country's real money. Such units of money serve exactly as counters or chips in a game; each one commands a certain value.

Now, if the number of chips or counters be suddenly doubled two will be needed where one before had served. This is what has happened in the business world.

The amount of things to be exchanged —goods and services—is practically no greater than it was before the war. But we have been supplied with twice as much money to do this exchanging. Consequently two dollars are worth no more than one was before; or, what amounts to the same thing, prices have doubled. This condition of having twice as many money units with which to carry on the country's business is what we mean by inflation.

How has this inflation come about? And was there no way of escaping it?

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INFLATION AND LIVING COSTS

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It is right that we should try hard to answer this question, not only to place responsibility where it belongs, but also to avoid further error; and, most of all, by retracing our steps to undo all or some part of the mischief.

The answer is that inflation is due to the financial mistakes of the Administration at Washington (1) while we were getting ready for war, (2) while we were at war, and (3) after war was over. During each of these periods the Treasury permitted and, indeed, encouraged an increase in the country's money supply, with the certain prospect of rising prices. This statement calls for some further explanation.

(1) From the outbreak of the war in August, 1914, until the United States began to fight, we received a great flow of gold from the Allies to pay for war supplies. This in itself would have been a dangerous addition to our stock of money, and unless corrective measures had been taken, a certain cause of rising prices. No such corrective measures were taken.

More than this, important changes were made in our banking system by which the new gold, as well as that which we already had, was transferred to the banks for use as the basis for creating huge additional amounts of credit or bank money. This was made possible by allowing the banks, in the first place, to use smaller percentages of reserve against the credit which they provided, and, in the second place, by permitting them to use other forms of security than gold as reserves. In other words, from 1914 to 1917 the United States added largely to its money supply, and arranged to pyramid on the increase whenever it desired.

Where Treasury Erred.

(2) This pyramiding power was used by the Treasury during the war as a means of supplying itself cheaply and easily with funds. It was done in two ways: First by placing certificates of indebtedness with the banks and receiving in payment new and additional credit, and, second, by selling bonds at an artificially low interest rate, with the aid of cheap borrowing facilities at the Federal Reserve banks, so that bond buyers found it easier to obtain additional credit from the banks to pay for their bonds rather than use their savings or such bank deposits as they already had.

Even from the standpoint of the Treasury this was a shortsighted, mistaken and costly economy. During the civil war Secretary Chase obtained money cheaply, as he supposed, by issuing greenbacks, but we know now that the higher prices which the Government had to pay in consequence for its supplies cost the country more than the greenbacks yielded, to say nothing of the further inquiry they caused. In the present war the printing presses could probably not have worked fast enough, so instead of making and issuing additional paper money the Treasury made and used additional bank credit. Just as we speak of the greenbacks as fiat money, so it is right to speak of Government bank deposits made in this way as fiat credit.

(3) We can understand that mistakes may have been made before we entered the war, because our Federal Reserve System was new and the facts that we had to face were new. Even more, while we were in the war it might be said that we could take no chance in the matter of raising funds for ourselves and our Allies, and it was right to use those means which would give quick results, even though the after effects may have been uncertain. But neither of these excuses can serve to explain or justify what we did after the armistice, and particularly from last Summer on.

Our Government came out of the war with a big floating debt, that is, with nearly three billion dollars of unpaid bills over and above the Liberty and Victory Loans. Now, instead of meeting this squarely, the Treasury kept the fact steadily in the background, and extended and renewed its bank loans by further short time borrowing of the same kind, that is to say, the Treasury sustained and renewed its floating debt by having the banks create additional credit, which it might draw upon and spend, and which when so spent would find its way into the bank account of others and so swell the total amount of money in the country.

This was inflation pure and simple. It meant that the country was being provided week after week with more money, not because our trade and business required it, but because the Treasury found it easier to supply itself in this manner rather than to get what it must have by taxes or by real borrowing from investors.

It ought to be added that the banks were always willing although not enthusiastic to make such credit advances because they could in turn borrow from the Federal Reserve Banks at rates cheaper than the returns which the Government paid them.

Other Factors are Minor.

Is inflation then the one and only cause of the high cost of living? Have such things as high wages, excess profits taxes, lessened production—to single out the more prominent—had nothing to do with it? Of course they have. But they have been contributing, not primary causes. Our country is too vast and our business life too complex for a sudden change to come about in one part without starting a host of other changes. Throw a stone in a pond and the shore line will be disturbed not only by the first swell but by the series of ripples that the back-wash causes. I contend that inflation is the primary cause of high prices, and that such things as excessive wages, burdensome taxes, restricted production are secondary causes that would have had little effect but for the primary cause.

But interesting as it may be to know the cause of high prices, and important as it is to consider this effect, the real question in which we are all concerned is—the remedy. Assuming that inflation has caused the mischief, what are we going to do about it.

I believe firmly that a considerable part of the mischief can never be undone. Much of it has already happened; more of it is certain to come before relief will be afforded. If we try a short-cut treatment we shall certainly bring on a business crash in which the operation may be successful but the patient will die.

But, on the other hand, we should certainly not sit by with hands folded and wait piously and resignedly for things to improve, as long as there is a chance that by wise and intelligent action we can contribute to that end.

Remedial Possibilities.

There is such a chance and here are the particulars: First, the Government at Washington should stop, first, last and all the time, adding to our money supply. This means that our $3,000,000,000 floating debt should be cared for, not by having the banks manufacture more credit for the Treasury, but that the deficiency should be met by reducing expenditures or by increasing tax revenue or by issuing debt obligations which investors would absorb from their savings.

In the second place, having seen to it that no additional credit money is made we should try wisely but bravely to reduce that vast amount which is in existence. The way to do this is to encourage and support the Federal Reserve Board in the policy, which they were slow in adopting but are now steadily following, of making it more costly by means of stiffened discount rates and penalty charges for the banks of the country to create such additional credit. The result may be to reduce speculation in goods and real estate as well as in securities, and, to some extent, to burden and restrict legitimate business. The first is a good thing in itself; the second is an unfortunate penalty of our past mistake. It is the bitter tasting, unpleasantly acting medicine which we must take to recover from a credit orgy.

In the third place, we should do everything in our power to increase production. If the amount of money and credit in the country as compared with the amount of goods and services is so great that prices are high, the way to correct matters is not only to reduce the money supply, but to increase the mass of goods.

In the fourth place, our faces should be set firmly in the direction of greater public economy and greater private thrift. Only if the Government spends less, can public debts be reduced and heavy taxes be lowered, and the danger of still further inflation be averted. Only if we save more will it be possible for our industrial capital to be renewed and our national production to be increased.

Finally, our war system of taxation should be changed to meet peace conditions. I am unable to agree with those who speak and write of the income and excess profits taxes as the prime cause of high prices, to the neglect of the greater factor of a doubled money supply. But on the other hand, our war taxes are clearly operating as a drag upon peace time industry, and there is great need of change and revision.

This then is my final word: Stop wailing about the high cost of living and do a little hard thinking of your own as to what has brought it about and how it can be helped.