

INFLATION

Inflation is a complex subject which is made even more difficult to understand because a welter of myths and distortions surround it. A currently popular myth is that wage demands of labor or price increases by greedy, "monopolist" businessmen are exclusively responsible for it. In reality wage and price increases are *effects* of inflation, not causes of it.

Defining inflation by merely pointing to its *effects*, rather than seeking causal explanations contributes to the myths and misunderstandings. That these myths are encouraged in high places suggests that admission of the truth would be a hazardous political course no politician would wish to take.

What Inflation Is

Inflation is any increase in the *supply of money* greater than the increase in the production of goods.

It is important to keep in mind the relationship between money and goods. Each instrument of currency represents and is a claim to some tangible good in an economy. At any given time we have a limited supply of goods and a limited number of money-claims to those goods. Terms like "stability", "inflation" and "deflation" describe changing relationships between money and goods.

An increase in the supply of money in excess of any increase in the supply of goods is what we are really concerned with when we talk about inflation. If money and goods both increase in the same proportion, then each unit of money retains its purchasing power and no significant price changes occur. When the supply of money increases and the supply of goods does not, the people causing inflation are changing property values and ownership claims *involuntarily* and outside the marketplace. Why does this occur?

The Cause of Inflation

Inflation is not a natural occurrence uncontrollable by man, like an earthquake, flood or storm. It is a **planned** and deliberate government policy. (Private, artificial increases in the currency supply, known as counterfeiting, have a comparatively insignificant effect.) Inflation has many unjust and destructive consequences: it wipes out savings, reduces people on fixed income to poverty, pushes people into higher tax brackets, and makes economic planning difficult or impossible.

Why then has inflation been a standard government policy for more than half a century? Because, while its economic consequences are disastrous to a society and grotesquely unjust to the individual and to the poor, it is politically beneficial to the government, to social planners and to certain favored industries, unions and social groups. Consider the political benefits of inflation.

Inflation is one of the single most effective methods of guaranteeing the continued expansion of the State. By artificially pushing people into higher tax brackets, inflation insures that government tax revenues increase and thus the government is able to control more and more of the wealth of a country. Inflation coupled with the graduated income tax assure that the government gets ever-more of our income. Consider how this works.

Inflation and Taxes

The government decides to tax income as follows: \$5,000/yr.—10%; \$10,000—15%; \$15,000—20%; \$20,000—25%.

The government then increases the money supply each year so that it doubles every ten years. If there is no real growth in production during the same period (a not unreasonable assumption in today's regulated economy), as the money supply doubles, so will wages, profits, dividends, etc.

Note what happens to an individual's (or corporation's) income and taxes as time passes. In twenty years one's money income may go from \$5,000 to \$20,000. *Real* income (i.e., purchasing power) hasn't changed at all as a result of inflation, but real taxes have.

The person originally earning \$5,000 now surrenders 25% of his real income compared to 10% before the 20 years of inflation. And tax rates haven't changed!

It was no accident that the Federal Reserve Act establishing the Federal Reserve ("Fed") and enabling government to inflate the currency supply and the 16th Amendment authorizing the modern income tax were passed by the same Congress in 1912. Through the Fed, the government can employ a variety of subtle and devious refinements of the tax-increasing scheme cited above.

What has permitted the government to get away with much past inflation has been the great productivity of American business. Now, however, the inflated dollars are coming home to roost. Such an enormous portion of America's capital is now con-

sumed by the government and allocated to political favor seekers (rather than to efficient producers) that production is falling more and more, and government is accelerating the rate of inflation in a futile attempt to compensate for the effects of past inflation.

Inflation has also resulted in a tremendous centralization of power in Washington, D.C. at the expense of the viability of state and local governments. Since most state and local taxes are not graduated, as real income falls due to mounting federal taxes and decreased production, real state taxes fall. Thus we see states and cities, hat in hand, lining up in Washington for their "share" of federal grants, further increasing the power of the federal bureaucracy.

Inflation and Politics

We have shown how the government, as an institution, benefits by inflation, but individual power seekers can also use it to help *them* to achieve public office.

Because government-created inflation has such a devastating effect upon the economy, government has a powerful tool to manipulate the overall economy of the country.

While government actually has nothing to do with the prosperity of a country, use of monetary policy gives *the appearance* that government is in control of things, creating the illusion of government as the great economic manager and planner.

Thus politicians can convince people that it is possible for them to "create" a prosperous economy. Whenever possible, incumbent politicians plan monetary booms and easy credit to coincide with election years, aiding their reelection. The inevitable disastrous "busts" and crippling inflation come later, and when it does it is blamed on "greedy" businessmen and labor unions. In every single presidential election year except one (1944) the Federal Reserve Board has expanded the money supply.

Now consider the precise mechanism of inflation.

How Inflation Works

Most of the country's banks are members of the Federal Reserve System. The Fed is, in fact, a State banking cartel. Keep this in mind, for it is in direct opposition to the type of system needed to halt inflation and soothe business cycles.

When a bank joins the Fed, it agrees to deposit a certain legally fixed percentage of its demand

deposits. All banks keep reserves but member banks deposit theirs at one of the 12 Federal Reserve banks.

The Fed sells government securities to member banks getting checking accounts in return for promises to pay. Any bank may own these promises but member banks *only* can include them as part of their reserves. The effect of this is to provide banks with additional funds to lend to prospective borrowers.

The government pays off the interest on such securities when they fall due by simply cranking up the printing presses and providing new "securities" to replace the old. Between 1939 and 1963, for example, when the production of goods and services tripled, the money supply quadrupled, providing the various political benefits previously described for the state and the politically favored.

Now some people may honestly ask: "Didn't these inflationary policies contribute substantially to the tripling of production?" While the government securities did allow banks to make more investments the answer must still be NO.

Banks make lending decisions on the basis of profitability. The most productive and profitable ventures would have been financed by the banks anyway. The additional lending permitted by the Fed's policies go to finance those investments that are more marginal. At the first sign of economic troubles, such marginal businesses go under, bringing unemployment or worse.

The Cure For Inflation

What is the cure for inflation? It is obviously not to be found in treating the mere symptoms of inflation such as rising prices.

The government must halt expansion of the money supply, cut taxes and reduce spending. In short, it must move toward a laissez faire monetary system. However, this involves much more than a few changes in monetary policy.

Basically it is this: a great many gullible people have been duped into thinking that the judgments, values and interests of government and politicians somehow take precedence over their own lives and values. Only when these people learn to de-canonize and de-heroize the politician and his "solutions" will inflation, and a great many more problems, be solved.

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SIL DECLARATION OF PRINCIPLE

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As Advocates of Individual Liberty We Affirm:

That every person has an inalienable right to their own life, liberty and property;

That the only proper use of force is in retaliation against those who violate human rights;

That the basic violation of human rights consists of the initiation or the threat of the initiation of force against the individual;

That all proper social organization can only be a consequence of voluntary association between individuals;

That the only economic system consistent with human prosperity and happiness is laissez-faire capitalism;

That the ideologies and instrumentalities of coercive collectivism are the basic threat to human rights and the existence of moral human societies;

And that both moral individuals and moral societies have the obligation to act in their own rational self-interest to protect themselves from those who seek to coercively control, direct and enslave them.

With the apostles of coercion increasingly predominant in the councils of man, it is the duty of all those who value their life, liberty and property to take appropriate action—intellectual and social—to preserve and extend their freedom.

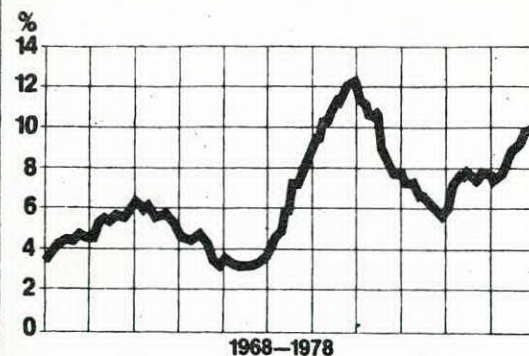
We as libertarians resolve to resist all forms of involuntary collectivism and all programs and activities of government which violate our rights and attempt to take from us the ability to set our own goals and to determine our own destiny.

We work for the day when all individuals are free, and we look forward to a society of peace, plenty and freedom where the individual's rights are truly politically inalienable. As advocates of reason and liberty we seek and will settle for no less than:

FREEDOM IN OUR TIME

INFLATION AND ITS CURE

Joseph P. Morgan



**SOCIETY FOR
INDIVIDUAL
LIBERTY**