It’s In The Bloodstream
by Don Paarlberg

The accompanying chart shows the wholesale price level of the United States for the past 200 years. It is taken from my forthcoming book titled Inflation.

Why would an agricultural economist, write a book about inflation, considered to be the turf of monetary theorists? Because I am convinced that, contrary to popular belief, the major economic events which affected agriculture during the past sixty years were caused by monetary factors rather than, as commonly believed, by surplus and shortage of farm products.

The Thirties
During the Great Depression, the volume of money in circulation in the United States declined by one-third; seize the volume of money “drives” prices. Prices declined. Prices of U.S. farm products fell 56 percent. The Depression was worldwide; prices fell, whether farm or nonfarm, whether scarce or in surplus. In every country for which price data were available. Worst prices declined an average of 50 percent. An event which could hardly be attributed to a surplus of farm products in the United States. In fact, total agricultural production in this country during the first five years of the Great Depression was 2 percent less than during the five preceding years.

Farm people knew that, other things being equal, high production meant low prices and reasoned that because prices were low, capital is attracted.
production must be excessive. But the overwhelming fact was that other things were not equal: the supply of money plunged downward, pulling farm prices down with it. Farmers didn’t look at the statistics on production, and they didn’t understand the mystery of money. They wanted to believe that surplus was the problem and judged it so. Their legislators accepted the verdict. Such is the power of belief, however, ill-informed. So we launched the Agricultural Adjustment Administration to reduce output and set ourselves up in the crop-control business for the next half century.

Having boosted prices above the equilibrium level, we induced excess production and reduced consumption, creating a surplus as any student of Economics 101 could have predicted. The diagnosis that we had a surplus became self-fulfilling.

The Seventies

Another big agricultural event was the euphoria of the seventies when farm product prices more than doubled, an event popularly attributed to a food shortage. Actually, American farm output rose an amazing 31 percent during the decade. A rising general price level was at the root of the matter. It rose two and a half times, carrying up virtually all prices including prices of farm products, as a rising tide lifts all boats—except those that have sunk.

The Eighties

Then came another roller-coaster experience. The government, alarmed about inflation, boosted the interest rate, reduced the
Table 1 – Inflations of History

<table>
<thead>
<tr>
<th>Country</th>
<th>Beginning</th>
<th>End of</th>
<th>Annual % rate of increase</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>price index</td>
<td>price index</td>
<td>in base year 1913 or earlier</td>
</tr>
<tr>
<td>Ancient Rome</td>
<td>150</td>
<td>301</td>
<td>200</td>
</tr>
<tr>
<td>Black Death</td>
<td>1348</td>
<td>1351</td>
<td>2.4</td>
</tr>
<tr>
<td>Spain</td>
<td>1501</td>
<td>1600</td>
<td>4.2</td>
</tr>
<tr>
<td>John Law</td>
<td>1717</td>
<td>1720</td>
<td>2.0</td>
</tr>
<tr>
<td>American Revolution</td>
<td>1775</td>
<td>1780</td>
<td>32</td>
</tr>
<tr>
<td>Franco Revolution</td>
<td>1790</td>
<td>1796</td>
<td>285</td>
</tr>
<tr>
<td>U.S. Civil War, North</td>
<td>1861</td>
<td>1865</td>
<td>2.1</td>
</tr>
<tr>
<td>U.S. Civil War, South</td>
<td>1861</td>
<td>1865</td>
<td>2.1</td>
</tr>
<tr>
<td>Germany</td>
<td>1910-1914</td>
<td>1923</td>
<td>143/144</td>
</tr>
<tr>
<td>Russia</td>
<td>1913</td>
<td>1924</td>
<td>17/17</td>
</tr>
<tr>
<td>Hungary</td>
<td>1945</td>
<td>1946</td>
<td>100/100</td>
</tr>
<tr>
<td>China</td>
<td>1937</td>
<td>1949</td>
<td>126/126</td>
</tr>
<tr>
<td>Bolivia</td>
<td>1972</td>
<td>1985</td>
<td>108/108</td>
</tr>
<tr>
<td>United States</td>
<td>1933</td>
<td>1987</td>
<td>7.7</td>
</tr>
<tr>
<td>Brazil</td>
<td>1937</td>
<td>1988</td>
<td>800/800</td>
</tr>
</tbody>
</table>

*Most of these inflations were not concluded at the end of the price index.

amount of new money coming into circulation, stemmed on the brakes, and threw farmers against the windmill. From 1981 to 1986, farm product prices fell 11 percent. The perception was that surplus conditions had returned, but this was not so; farm output actually fell 6 percent. It was the price level that changed, falling 14 percent. Carrying down prices of practically all raw materials including farm products. As the price level fell, some sugar beet became visible. Others were stranded on the beach. What really hurt farmers was not just the decline in the prices of what they produced, it was the excessive debt they had incurred and the high interest rates they were paying.

The Money Illusion

At heart in the misunderstanding is the widely held money illusion. This is the belief that the dollar has constant value, the same today as it was in the past, and the same as it will be in the future. This belief is obviously wrong, as an examination of the chart will show.

Inflation is the world's greatest thief.

The law behind the money illusion. It writes “Paid in Full” across the face of a loan, that has returned to the lender only half the real value of what was borrowed, and it forecloses property on which the full real value of the loan has already been repaid. It is as hard to build a financial structure with a dollar of changing value as it is to build a house with a rubber yardstick.

Jekyll and Hyde

Inflation is the world’s greatest thief. It extracts more real wealth from the public than do all thieves, liars, and embezzlers combined. Inflation: a Jekyll and Hyde character, is also the world’s greatest benefactor. It transfers more real wealth to the debtor class (those who have borrowed money) than do all charities, contributions, and donations put together to provide for poor people and others in society.

If this seems incredible, consider the facts. The total debt, public and private, as of 1990 was $4.5 trillion. On this amount of debt an inflation rate of 4 percent per year (the average of the past half century) in 1981 is equivalent to a transfer of $200 billion from lenders to debtors. Compare this with $4 billion, the total amount of all theft during 1987, and with $154 billion, the total of all donations in 1984.

Inflation is the reverse of inflation. It steals from those with fixed obligations and gives to those with fixed incomes. The monetary authorities are quite happy to accept shortage and surplus as the explanations for inflation and deflation. It appears to relieve them of blame for a fluctuating price level.

For nearly 160 years prior to 1913, the chart accompanying this article shows practically no trend in prices. There were fluctuations: prices approximately doubled with every major war and thereafter declined to prewar or lower.

The Age of Inflation

Beginning with 1933, prices rose irregularly, and by 1980 had increased to almost nine times their earlier level. What caused this abrupt change? What launched us into the Age of Inflation? In the opinion of this writer, the following institutional changes were responsible:

• Abandonment of the Gold Standard: instead of digging our money from the earth, a costly process, we learned to create it, in large amounts, at near zero cost, with the printing press. • Keynesian Economics: this new idea rationalized deficit spending. • Growing Debt: debt is unceasing to bear. Both the government and the private borrowers learned to repay with cheaper dollars. • Attitudinal Changes: instead of saving and waiting, we turned to spending and consuming, pushing up prices. • Full Employment Policies: we overestimated the economy in an effort to put people to work. • The Rise of Particular Interest Groups (PIGs): with Political Action Committees, specific interest groups demanded and received more benefits than could be supplied at a stable price level: with inflation we appeared to confirm the benefits, but by inflation we reduced the real value of each claim. • Government Itself: public officials found that, contrary to popular belief, when they opted for inflationary policies, they were returned to office. These institutional changes, which produce inflation, are deeply imbedded in the economy and the prospect of dissolving them appears to be minimal. Inflation is the bloodstream: short of a major transfusion, headstrong we can expect the price level to be tilted upward. One thing to remember. Despite the likelihood of continued general inflation, there can be short-run periods of price decline that can wipe out the person who bets on inflation. This we found with a vengeance during the 1980s.

Restraint Inflation

If we were serious about curtailing inflation, we would need to effect the following policy changes:

• Reduce the rate of growth in the money supply.
• Check the growth of debt.
• Tax ourselves adequately.
• Give the President the line-item veto.
• Abolish Political Action Committees.

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• include price stability as an objective in administering the
Unemployment Act of 1946.

It will be said that these things are difficult to do, and they are.
But until and unless we do them, we have no legitimate basis for
complaining about inflation.

Cop ing With Inflation

Inflation is not just a macroeconomic problem; it is at least as
much a problem for the individual. How can a person cope?

If people are wealthy, young, ambitious, venturesome, anxious
to pass on goodly estates and able to withstand temporary set-
backs in incomes, such people should invest in enterprises in
which they have competence. Real property is a good inflation
hedge. Common stocks, though variable in price and earnings, are
likely in the long run to ride the inflationary trend. One should be
wary of bonds, life insurance and certificates of deposit, which
pay back dollars at a rising rate and fall to reflect inflation.

The elderly poor and those living on pensions can do little about
inflation. At best they are forced to live within their pensions, disad-
nanced by inflation, and cannot expect to leave money to their heirs.

Admittedly, there is every combination of age, wealth, health,
ambition, venturesomeness, and family responsibility. And, how
to cope with inflation is an intensely personal matter. However,
these are the general recommendations.

The Historical Record

Inflation is not limited to the United States nor to the last 60
years. There have been instances of inflation throughout history, as
Table 1 indicates.

Some of the inflations were prodigious, especially during the
twentieth century. The inflation in Germany in 1923, if it were

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Prices in 30 Countries

Wholesale price increases from 1937 to 1944 were computed for
30 countries, with 1937 as a base. The 30 comprises all countries
whose price series were continuous, or nearly so, for the 20-year
period. The source was the United Nations Monthly Bulletin of
Statistics Eighteen have unbroken series. The unweighted geo-
metric average increase for the 18 countries was an amazing 79-
fold. Switzerland had the lowest amount of inflation, in which
country prices nevertheless increased by a factor of about four.
The United States was the next lowest, with prices increasing by
a factor of about six. Table 2 reports price increases for the 30
countries.

tests of the economy, chiefly businessmen and farmers. Helped by
disturbances are the salary classes, whose incomes are admin-
istered, and those on pensions and annuities.

With inflation, labeling people have found more jobs, but histori-
ically their hourly wages were lagged.

People in subsistence economies, who lived largely outside the
exchange economy, were little affected.

A chief obstacle to restraining inflation is the fact that, on bal-
ance, people like a certain amount of it.

Table 2 – Inflation is Worldwide

<table>
<thead>
<tr>
<th>Country</th>
<th>Multiples of wholesale price increases since 1937</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia, pound</td>
<td>25</td>
</tr>
<tr>
<td>Belgium, franc</td>
<td>11</td>
</tr>
<tr>
<td>Brazil, cruzado</td>
<td>113,000,000</td>
</tr>
<tr>
<td>Canada, dollar</td>
<td>9</td>
</tr>
<tr>
<td>Chile, peso</td>
<td>26,400,000</td>
</tr>
<tr>
<td>Costa Rica, colon</td>
<td>64 (to 1985)</td>
</tr>
<tr>
<td>Denmark, krone</td>
<td>14</td>
</tr>
<tr>
<td>Egypt, pound</td>
<td>28 (to 1966)</td>
</tr>
<tr>
<td>El Salvador, colon</td>
<td>65 (from 1957 to 1985)</td>
</tr>
<tr>
<td>Finland, markka</td>
<td>124</td>
</tr>
<tr>
<td>France, franc</td>
<td>132</td>
</tr>
<tr>
<td>India, rupee</td>
<td>26</td>
</tr>
<tr>
<td>Ireland, pound</td>
<td>12 (to 1976)</td>
</tr>
<tr>
<td>Israel, Israeli pound</td>
<td>372 (from 1963 to 1983)</td>
</tr>
<tr>
<td>Italy, lira</td>
<td>552</td>
</tr>
<tr>
<td>Japan, yen</td>
<td>175</td>
</tr>
<tr>
<td>Mexico, peso</td>
<td>360 (to 1985)</td>
</tr>
<tr>
<td>Netherlands, guilder</td>
<td>10</td>
</tr>
<tr>
<td>New Zealand, pound</td>
<td>25 (to 1987)</td>
</tr>
<tr>
<td>Norway, krone</td>
<td>14</td>
</tr>
<tr>
<td>Portugal, escudo</td>
<td>52 (to 1968)</td>
</tr>
<tr>
<td>South Africa, S. African pound 9 (to 1979)</td>
<td>99</td>
</tr>
<tr>
<td>Spain, peseta</td>
<td>98</td>
</tr>
<tr>
<td>Sweden, krona</td>
<td>17</td>
</tr>
<tr>
<td>Switzerland, franc</td>
<td>4</td>
</tr>
<tr>
<td>Thailand, baht</td>
<td>85</td>
</tr>
<tr>
<td>Turkey, Turkish pound</td>
<td>2060 (to 1947)</td>
</tr>
<tr>
<td>United Kingdom, pound</td>
<td>24</td>
</tr>
<tr>
<td>Venezuela, pound</td>
<td>17 (to 1987)</td>
</tr>
<tr>
<td>United States, dollar</td>
<td>6</td>
</tr>
</tbody>
</table>

*In terms of their respective currencies, 1937 to 1938.

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