PREPARE FOR MORE INFLATION

By David L. Markstein*
New Orleans, La.

THERE IS AN OLD TALE told of the Duke of Wellington. The great man, fresh from his Waterloo victory over Napoleon, was strolling down a London street when a nondescript passerby stopped him. "Mr. Brown, I believe?" said the little man, raising his hat. "If you believe that, you'll believe anything," sniffed Wellington.

Today we are told soothingly from Washington: "The inflationary psychology is being beaten. Price increases have slowed up. Inflation is on the run and will no longer be a part of American life."

If you believe that, you'll believe anything. Instead of believing, ask yourself: "Has there been a single week recently when some cost has not gone up?"

Inflation may be contained—briefly—but it is going to flare out again, and again. It is something you should prepare to live with for a long time because the classic steps now being taken to meet inflation aren't succeeding. They are old medicine. They worked with a classic set of inflation germs. Now inflation is germinated by another set of causes. There may be no cure for this particular inflation.

The idea is frightening, but not necessarily the end of the world if you plan. It is instructive to look at the causes of inflation and at things that have been done to avoid being eaten alive during past inflationary binges.

Classic currency depreciation proceeds first from monetary causes. When the government (through the Federal Reserve central bank) pumps more money into our economy than increases in productivity can mop up, then the additional money bids for the same volume of goods and services. Prices move higher.

There are many ways monetary authorities can expand or contract money supply. They can do this through "open market" activities based upon purchases and sales of government bonds.

(Simplified example: The Federal Reserve decides to pump another $10 billion into the economy. It buys $10 billion in Treasury bonds in the open market. These are purchased from a dealer named Philip Phinance. To pay for the bonds, the Fed credits the account of the bank in which Phinance and Company maintains its account. The bank, in turn, applies $10 billion credit to Phinance and Company's account. Suddenly, there is a $10 billion credit in the economy which, before this action, did not exist.)

The Fed also exercises control over money growth and contraction by governing the amount of reserves that banks must maintain.

(Simplified example: Moneybags National Bank has deposits of $5 billion. It must maintain reserves of $1 billion, or 20%. If the Federal Reserve changes that requirement to permit retention of only 15% reserves, the Moneybags National suddenly has $500 million which it can lend, and those lent dollars flood out through the economy. They are an increase. These dollars may have existed before the change, but did not have the capacity to make purchases before people borrowed the freed $500 million.)

Father of Our Money

In 1969, anxious to cool off inflation and convinced that a tightening of money with an increase in interest rates would bring off the job, Federal Reserve authorities clamped a ceiling on Regulation Q. This regulation sets the top interest rate which banks are allowed to pay for money they borrow. Unable to borrow additional funds to lend, the banks' activities tended to slow.

Thus, the central bank has become the father of our money. No longer do banks merely hold it in safekeeping. Led by the top bank of all, the Fed, they make and withdraw the money. Darryl R. Francis, president of the Federal Reserve Bank of St. Louis, noted this fact in a speech May 12, 1969, before a convention of the Arkansas Bankers Association:

"The Federal Reserve System, through its power to create and dedestroy bank reserves, can control the money supply . . . there are close causal links between changes in the money supply and changes in spending," he said.

Cost-Push Theory

Starting with the middle years of the Sixties, the Federal Reserve expanded money supply at a frightening rate. Money was being pushed into our collective hands at a rate exceeding 6% per year by the end of 1968. Then the monetary authorities became alarmed and turned the spigot to a slower rate. Later, as 1969 moved along, they stopped expanding money supply altogether. And so came the massive money crunch. However, it didn't stop inflation because the cause was no longer monetary. In the second phase of a big inflation, cost-push becomes predominant. That is where we are at present.

The Federal Reserve Bank of Philadelphia had this to say in a study on inflation ("Henry VIII Revisited") reported in its **Business Review:**

"The cost-push theory of inflation rests on the premise that fundamental changes have taken place in our economy during the Twentieth Century. The theory points out that business firms have expanded in size and influence. Labor unions have grown in strength and bargaining power. Indeed, according to the cost-push thesis, labor today is so powerful at the bargaining table that it can push up wages faster than productivity (output per man-hour). Consequently, costs per unit of output increase. And rising costs are a source of great concern to management. "As costs rise, management has two choices. It can absorb the increased cost and thus experience

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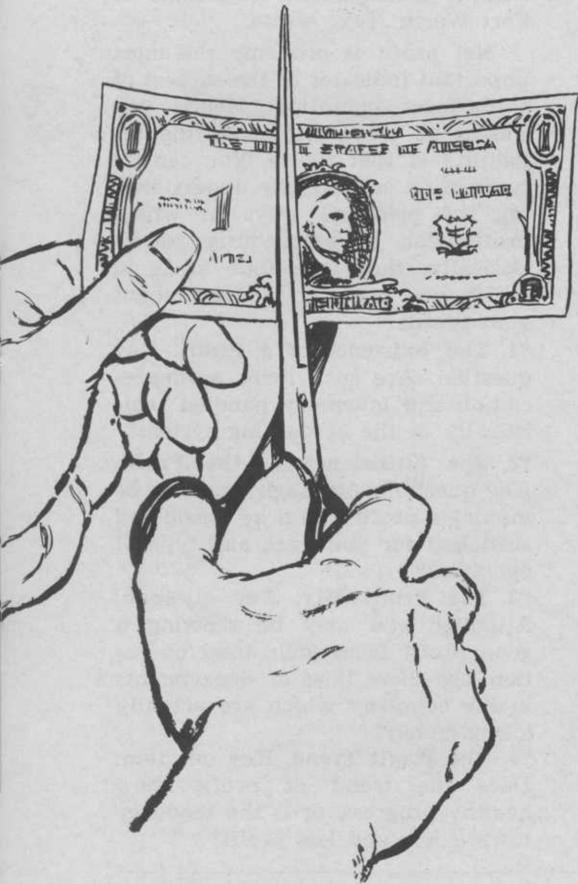

Financial Writer Lists Principles to Insure Your Business Continues to Be Profitable

falling profit margins; or it can pass costs on to the consumer in the form of higher prices if in a market position to do so. Since business has grown in influence and market power, there is a tendency to choose the latter alternative — to raise prices rather than lose profits.

"But what does this have to do with money? Plenty, say the cost-push theorists.

"In 1946, Congress passed a law—the Employment Act of 1946—which, among other things, calls upon the federal government to help maintain maximum employment. To achieve this objective, it is necessary for virtually all goods produced to be purchased, even at higher price levels generated by cost-push pressures. If some goods are not bought, business will lay off workers. There will be unemployment.

"But where will we get the additional money to purchase the same amount of goods at higher prices? Not every salary of every worker will be raised . . . there is a limit to the extent people will spend their hard-earned savings and part with cash. At this point they will decrease their consumption. Then, conclude the cost-push theorists, the federal government is forced to step in. To maintain employment, the state must take steps to increase the amount of money available for spending. In short, it would be forced to manufacture money."

Thus in the United States, the inflation which at first had monetary causes grew a different set of causes. Today's inflation becomes the cause of tomorrow's increased inflation which, in its turn, begets a still greater inflation to come.

Why isn't something being done about all of this?

Throughout the troubled year of 1969, the Nixon Administration grappled with inflation. The Federal Reserve came to its assistance. Yet despite the size, power and prestige of the two mighty forces, inflation seemed to flip aside their best efforts as easily as a judo black-belt would shrug off efforts of a pair of untrained opponents.

Price-Wage Controls Fail

So there may be no permanent cure for inflation in this complicated, welfare-minded, austerity-hating world. A generation has enjoyed an increasing prosperity. People believe that more leisure with less work, and abolition of poverty from the earth, are achievable goals. The effort to achieve that aim can bring about a new breakout of inflation even if the present rounds of it are stopped.

"Sure," say some thinkers, "cost-push is not as easy a force to stop as the direct monetary cause of inflation. But we can bottle up its effects at the source with wage and price controls." Both of these controls have been tried and have failed. Ancient Babylonian kings and Egyptian Pharaohs attempted price-wage controls; the emperors of long-ago Rome tried them. As a result, economic activity of Babylon, Egypt and the Roman Empire stagnated.

Price and wage controls tend to turn men's energies and assets into channels which are not controlled. If rents are covered by a ceiling, people invest in stocks instead of rental property. Next, nobody tends the real estate store and soon properties deteriorate; owners cannot afford to fix them up at fixed prices. Good quarters grow scarce. It works that way with buildings, butter, neckties, automobiles or button hooks. Clamp on a price lid and suddenly—no service or merchandise at any price.

Said Mr. Francis: "Direct controls, like a new paint job over a termite-infested house, hide the evidence but do nothing to eliminate the cause of the problem."

How Others Survived Inflation

It is instructive to look at ways in which smart people survived severe inflations of the past. In France during revolutionary times, the government had to supply troops fighting on all fronts against combined foes who were determined to eradicate the infant democracy from monarchist Europe. It did so by printing paper money called **assignats.** These were backed by nothing except the hope of loot gained from foes not yet beaten.

Assignats declined in purchasing power. Every month it took more to buy the same goods, then every week. Finally, assignats declined almost daily. But people who used dwindling assignats to buy **things** prospered. They purchased whatever assignats would buy at the time—land, castles, cattle, jewelry, furniture — and found that when Revolutionary France awakened from its funny money binge their things were worth much more in real value than the assignats used to purchase them.

In defeated Germany during the Twenties, a story was told of two brothers who divided an inheritance. One was thrifty. He put all of his money into interest-bearing bank notes. The other liked to whoop it up. He had an idiosyncrasy: To keep track of his drinking, he saved the old bottles from which his joy water had been poured. When marks of the Weimer Republic were at length repudiated, the thrifty brother found himself with worthless paper in his safe deposit box. The drunken brother was able to sell empty bot-

tles. The brother with **things** instead of money survived.

Plan to Co-Exist

It is not likely that we will reach the sad financial plight of the Weimar Republic—not soon, at any rate. But it is not likely, either, that inflation will be stopped, no matter how sincere the efforts or how stringent the monetary steps. Sound planning at this point should take into account inflation's probable continuation.

A Bureau of Labor Statistics release shows that from January, 1967, to January, 1969, the consumer price index for urban wage earners rose from 114.7 to 124.1. Ten years ago, using the same months (January, 1957, compared with January, 1959) the rise was from 99.7 to 102.2. In two years during the decades of the Fifties, inflation, measured by the BLS Consumer Price Index, went up to 4.8%. But in two comparable years of the decade of the Sixties, it went up 8.2%. Inflation is indeed picking up its rate of increase.

Consider where extrapolation of these basically conservative cost of living figures might carry us in another ten years, assuming that inflation won't abate but might accelerate its pace. Say that the rate doubles in ten years as it did in the last decade and the rate of every two-years' increase will stay at 8.2% for the next four years. For the four years that follow, it will be at 1.5 times that rate (12.3%) and for the final two-year period will be at double the 1967-1969 rate.

That would raise the Consumer Price Index to a lofty 213.4. At that level, the dollar would have depreciated in purchasing power by a further 72%.

Invest in Your Own Business

Probably the most resultful "thing" in which you can invest to counter the probability of this devasting further inflation is your own business. But the problem in an inflationary era will be to keep it profitable and not merely tinkle cash register bells. If you keep in mind that you seek only contracts and orders that will pay off on the last line of the profit-loss statement; that you are in business to generate lettuce of the kind that goes into a bank account and not merely to serve people with produce — then you have the key to keeping on the top side of further inflation.

In a Small Business Administration **Small Marketers Aid** of August, 1962, reprinted January, 1967, and as valid in 1972 as 1962, Frederick G. Disney, management consultant of Fort Worth, Tex., wrote:

"Net profit is probably the most important indicator of the success of a business operation. Hence you should be concerned about the reliability of that figure. You can be surer of its accuracy by understanding the principal ways in which profits can be erroneously stated. Basically, there are four areas in which you can kid yourself about your profits.

"**1. The Existence of a Profit.** Key question: Are such items as depreciation and inventory handled realistically in the accounting system?

"**2. The Sufficiency of the Profit.** Key question: Although you may be making a profit, can it be considered sufficient for your size and type of operation?

"**3. The Profit Mix.** Key question: Although you may be showing a good profit from your total operation, are there lines or departments in the company which are actually losing money?

"**4. The Profit Trend.** Key question: Does the trend of profit show healthy progress, or is the tendency toward less and less profit?"

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