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THIS THING CALLED INFLATION

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MANY READERS OF ARTICLES dealing with inflation are aware of the fact that the term has a wide variety of meanings. Very often better terms could be employed which would avoid the vagaries generally involved in its use. Just why so many of us insist upon using the term "inflation" when, without the least difficulty, we could be specific is not clear. For example, why can't we write or speak simply of a sharp rise in the price level, if that is what we mean, without dragging in that generally meaningless word "inflation"? Of what value is the term when used in this sense considering the fact that it is also used in other senses? In short, we apparently would increase the profitableness of our discussions of prices, money, and credit if we would drop the word "inflation" from our vocabulary and say precisely what we mean.

To be of value, the term "inflation" must be clearly defined. But very often when writers or speakers attempt to define it, many, if not most, of the definitions prove under analysis to be either inconsistent or worthless for other reasons.

If a definition is of value, it will classify clearly, distinguish unlike things, and lead one to useful conclusions. A definition is particularly helpful when it embodies the popular impression of the thing defined. Perhaps the most common notion regarding

inflation is that it is a bad thing. Just why it is bad is usually not made clear. As I define inflation, it is bad because it means losses. These losses provide the measure of inflation. When we ask almost any person how he would measure this inflation of which he speaks, we are rarely, if ever, provided with a clear-cut answer. Talk of inflation is of little value if our concept of it is so vague that we cannot point to some means of measuring it.

// In defining inflation, an *inflationary procedure* should be distinguished from the *condition of inflation*—that is, from the losses directly attributable to the procedure. // Much of the confusion in the use of the term "inflation" today grows out of the fact that this distinction is not made. Probably no watertight definition of inflation can be built which will include both the procedure and the fact of inflation.

// Another mistake commonly made is to relate "inflation" to the price level rather than to the individual commodities and transactions which comprise the so-called price level. // Our indexes of the price level are nothing but mathematical abstractions of the prices of a large number of individual items. A price level can be steady while many of the prices are rising and many are falling. A price level can be stable and yet rest upon a multitude of instabilities which may end in a severe depression, as in 1929-1933.

Furthermore, a rising price level, as when a country is recovering from depression in a sound manner, is not necessarily undesirable, much less a bad thing. Practically everyone may benefit. Prices can rise for various reasons of which an inflationary procedure may or may not be a cause. Consequently, we should not attempt to relate the term "inflation" to the price level if we are to employ the word in any useful or consistent sense.

Some users of the term relate it to an expansion of the currency. Now the expansion of currencies takes various forms. An expansion of self-liquidating gold, or silver, or gold or silver certificates, for

example, should not be classed with such unlike expansions as the issue of non-self-liquidating paper money (such as our greenbacks of Civil War days), or silver certificates issued in excess of the market value of the silver reserve, or bank deposits based upon illiquid assets. Besides the necessity of distinguishing the different types of supply, the important factors of the nature—confidence, speculation, fear—and degree of the velocity of these currencies also require consideration. The common statement that inflation exists when currency is issued faster than production increases is worthless not only for these two reasons but for others as well.

With these considerations in mind, I should define inflation as follows: *Inflation is a condition resulting from an extension of purchasing power, either in the form of money or credit, which is not secured by reserves or commodities sufficient to liquidate it.* Inflation as a fact—that is, the extent of inflation—is not to be confused with an inflationary procedure which results in a condition of inflation. Any extension of credit is, therefore, an "inflationary procedure, but whether or not inflation will as a fact result remains to be determined. In so far as credit transactions are concerned, the answer lies in whether or not the loan can be paid at maturity without loss. In short, when we think of inflation in connection with credit transactions, we are thinking of unpayable debts. The extent to which debts cannot be paid is the measure of the degree to which purchasing power has been overextended to the borrower. These resultant losses are the measure of the extent to which the borrower's purchasing power was inflated. If the credit which was extended could be paid without loss at maturity, then we must conclude that there was no actual inflation of the purchasing power of the borrower, even though the procedure of making a loan was inflationary.

It should be observed in connection with this definition and analysis that the definition of inflation is related to individual transactions. It also should be clear that there can be inflation regardless

of whether the price level is steady, or is rising, or is falling. Those people who relate inflation to a rising price level find themselves embarrassed when one reminds them that since the price level, as commonly computed, did not rise in 1923-1929, therefore one must suppose that we had no inflation during that period. That in itself should be sufficient to demonstrate the great carelessness which prevails in this use of the term "inflation." All of us realize, on second thought, that a large proportion of our prices during the period 1923-1929 was bolstered by a huge volume of inflated credit which finally collapsed on us in 1929-1932, and that the wholesale price level, as computed, did not provide the key to the form and extent of the inflationary procedure then at work.

Since an inflationary procedure means the creation of purchasing power in advance of repayment, the tendency is to bolster or raise prices, but this does not mean that the price average will necessarily rise. But it is a fact that some of our most outstanding periods of inflationary procedure have been marked by rising prices—sometimes by a very sharp rise in prices. In other words, an inflationary procedure can be a most potent factor in causing a rise in prices. But this does not mean that we may not have a tremendous volume of inflation without a rise in prices or that we cannot have a sound rise in prices.

This definition of inflation reveals what is important for us to recognize at the present time, namely, that for some years we have been engaged in a very pronounced and far-reaching inflationary procedure. This shows itself principally in the extent to which the government has led banks to create deposits against its deficit—a banking asset which could not possibly liquidate the deposits resting upon it. The inflationary procedure is apparent, but the extent of the inflation—that is, the extent of the losses which will grow out of this procedure—has not become apparent and may not become apparent for many years. Because the price level has not risen as a

consequence of this inflationary procedure, we hear it frequently said, therefore, that we have not had inflation and that all the warnings regarding inflation which we have listened to since 1933 have been demonstrated to be false warnings. The simple answer to all this is that we have been engaged in a tremendous inflationary procedure, but that the extent of the losses which will result from it has not yet been determined. There should also be lessons in the fact that while we have had an unprecedented expansion in money and deposit currency, the velocity of demand deposits fell to the lowest levels on record in February, July, and August, 1940.

When we apply this concept of inflation to inconvertible currency issued by the government, we are dealing with a more generalized inflationary procedure. Instead of the procedure being a loan made by a bank to an individual borrower, it is diffused throughout our whole social structure. In other words, the government is creating purchasing power which goes into general circulation. This purchasing power is payable on demand, and yet the government has no good assets with which to liquidate it; the assets are merely shifted and demand for liquidation is not pressed. Any losses which may result from this procedure will be diffused throughout society. They may grow out of the fact that prices rise and the real purchasing power of the great mass of people declines because their wages and salaries do not rise in proportion; or they may be found in our tax burdens, impaired incomes of our great institutional investors in government securities at the prevailing low interest rates, and impaired profit margins growing out of lack of confidence and economic maladjustments. There is nothing about this definition that cannot be applied to any inflationary procedure regardless of whether it involves money or credit.

It is worth noting that a great number of people really like the inflationary procedure, their thought and hope being that they may be able to liquidate without loss—as many of them can—and that

the final losses will fall on other shoulders. Should our inflationary procedure result in rising prices, a great proportion of our people would profit for a time by the procedure, provided they liquidate before a collapse in prices, or other misfortunes, overtakes them. It is the painful settlement under adverse conditions that people dislike; and it is because of repeated experiences with this consequence of an inflationary procedure that so many people fear it. All that this means is that they are afraid of sharply falling prices and of lagging incomes when prices are rising. When the inflationary procedure is generalized—that is, when it is the result of the expansion of currency by the government—the great mass of people after awhile will begin to fear it because of the increased cost of living and the lag in their real purchasing power.

It is for these reasons that it is necessary, when dealing with "inflation", to separate the inflationary procedure, and people's reactions to it, from the losses resulting from it—that is, from the actual condition of inflation. People are made aware of this actual condition when they attempt to buy and to pay debts under adverse conditions.

Once we learn to apply the term "inflation" to individual transactions, to the situation of individuals, to specific types of money and credit transactions of the government and banks, and to cut it loose from the behavior of the price level and the mere expansion of currency, then our analysis of an inflationary procedure and of the losses directly attributable to it will begin to approach reality, and we should escape much of the confusion which now surrounds the term. As it is generally employed today, it is practically useless and should be avoided.