Balanced Deflation, Inflation, or More Depression

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THE DAY AND HOUR SERIES

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L. D. Coffman, President.

Balanced Deflation, Inflation, or More Depression

BY

JACOB VINER

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This lecture is the second of three in a series entitled Proposals for Economic Recovery, arranged by the University in cooperation with certain representative citizens of Minneapolis and St. Paul. It was delivered in Northrop Memorial Auditorium on February 20, 1933, by Dr. Jacob Viner, professor of economics in the University of Chicago, special expert for the United States Tariff Commission and United States Shipping Board, 1916–19; consultant economist for the United States Tariff Commission, 1919–20; visiting professor, Graduate Institute of International Studies, Geneva, Switzerland, 1930–31 and 1933–34.

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That the existing economic situation is desperately bad is not subject to question. Whether it is holding its own or getting worse; whether there is anything that can be done about it and if so what; what will be the outcome if conditions do not improve in the near future; these are questions that everyone is asking, but to which the most competent persons can give but partial and qualified answers. Nevertheless, public opinion, the man on the street, will play, and has already played, an important part in deciding whether anything shall be done, and if so what. The crowd, it is true, never works out a definite and detailed program, but in a democratic country, and especially in the absence of great leaders, it does, by its favorable or hostile pressure, influence the direction policy shall take.

There is no shortage of advice, either for the government or for the public. The difficulty is rather that of choosing from among the multitude of counsels. Economists should be best equipped to give sound advice, since almost alone of all groups they have no special axe to grind, and since also almost alone of all groups they have specially devoted themselves to the task of studying economic phenomena from the point of view of the general public interest. The economist, however — unfortunately, I believe, for this country — has little prestige with the American public, even on those subjects on which he alone has expert knowledge, and the public prefers to take its economics from newspaper editors, politicians, bankers, and men who in happier days were able to accumulate or inherit a million dollars or more. I concede that the economist is not wholly without a
share in the responsibility for this situation, but it is never
less a regrettable situation. In any case, I ask you to be gen-

erate enough to listen without prejudice to a lecture on econ-
even though the only qualification which the lecturer has is t
he is an economist by profession and training.

Intelligent prescription for a depression is impossible with
knowledge of the nature of the disease. A business depres-
is a mob phenomenon, and the individual as such is helpless
to stem its tide and, as a rule, is unable to insulate himself
its effects. Until the downward tide ceases, he is carried al-
with the rest. But granted that once a depression is under
there is nothing which the ordinary individual can do either
to end it or to escape it, the question remains: Is there also no
which individuals acting in concert or which their govern-
can do, to abate its severity or even to restore some measure
of prosperity? It is to this question that I will specially direct

There can be distinguished five conceivable lines of policy
that can be followed in dealing with a depression, which I
label as: (1) the “do-nothing” or “let nature take its course”
or “painful waiting” policy; (2) the hortatory or incantation
policy; (3) the “do the wrong things” policy; (4) the induced
balanced deflation policy; and (5) the inflation policy.

Our policy during the last three years has been an uncoor-
ninated mixture of all of these methods. Inertia, painful wait-
for a turn of the business tide, has been the chief ingredient,
resort also to incantations, to errors of commission, and to
homeopathic doses of inflation—and in recent weeks, with a
trend of induced balanced deflation.

I

THE “DO-NOTHING” POLICY

For the “do-nothing” policy, there is, in ordinary depres-
much to be said. Experience seems to support it. We have
many depressions before; nothing was done about them, and
we not only successfully emerged from them but went on
ever-rising standards of economic well-being. This policy, mo
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ever, is naturally adapted to the democratic organization of
society, where diffusion of authority, conflicting counsel, and the
clash of opposing interests, tend to make inertia the rule of life.
There is a curative, a self-corrective process, in the economic
mechanism which does tend to bring depressions to an end, and
which has always hitherto succeeded in doing so.

The central characteristic of a depression is a more rapid rate
of decline in the use of spendable funds than in commodity
prices. The rate of decline in the use of spendable funds is di-
rectly due to two factors: a contraction in the amount of spend-
able funds in existence, and the immobilization or non-use of
such funds as still exist, which manifests itself objectively in a
decline in their velocity of circulation. The primary cause for
this contraction and immobilization of funds is to be found in
the normal response of business men to a declining excess, and
still more to a deficit, of prices as compared to costs. This ad-
verse price-cost ratio is itself the product of two factors: first,
a more rapid decline in the prices of the things the producer
sells than in the rates at which he can hire or buy the factors
of production, and, second, a decline in volume of sales, which
operates to decrease the number of units of product per unit
of the productive factors employed and thus to raise unit costs.
When costs exceed prices, the business man will not use funds
he owns or borrow additional funds from the bank or the invest-
ment market to conduct current productive operations, to main-
tain inventory, or to extend plant; and the bank would not
lend to him under these conditions even if he were willing to
borrow. The process, moreover, is cumulative or contagious. If
one business man contracts his operations, his expenditures con-
tract; this reduces the flow of spendable funds to others and they
contract their expenditures in turn; this compels other business
men further to contract their expenditures and production, and
so on indefinitely, in a vicious spiral.

In the meantime, however, the prices of the factors of produc-
tion are under pressure, and after a time they break. The prices
of raw materials and especially of agricultural products are usu-
ally first to give way, followed next by wages. Bankruptcy and

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Industries, selection for retention of the ablest and most conscientious workers on the staff, and technical improvements, still further in reducing costs to a level where they are once more below prices. A profit margin thus eventually reappears for producers; they resume use of their own funds and borrow more from their banks and the investment market; the increased flow of spendable funds raises the price level again and increases the volume of sales; and industry is again on its way to prosperity.

As in the downward trend, so now in the expansion phase, the process is contagious and cumulative, and the resumption of activity by one producer works to entice other producers into like resumption of operations.

This curative process has not been wholly absent during the present depression. But factors peculiar to this depression, in degree if not in kind, have so far made it insufficient to bring about recovery. The disturbed state of international relations has intensified the feeling of uncertainty as to the future. The pressure on currencies and budgets of the great and rigid bloc of international debt obligations, governmental and private, long-term and short-term, and the strangulation of world trade by skyscraper tariffs, import quotas, and exchange controls have contributed to a sharper decline of world price levels than ever before and to a great disturbance of currency and budgetary stability.

In the domestic sphere, taxes have been an increasing burden on industry and have, moreover, had a perverse flexibility, rising during the depression period when it was peculiarly urgent that they should fall. Of equal, if not of greater importance than the tax burden, utility rates have also grown in relative importance to the national economy, and in the main have remained unadjusted to the general fall of prices. Railroad freight rates have not only not decreased in the face of a fifty per cent decline in wholesale prices, but unbelievable though it should be, they have actually been permitted to rise since the beginning of the depression, and are pressing down as a crushing weight on all industries requiring long-distance hauling of bulky commodities.
or with the aid of raids on depreciation reserves, or as expressions of hope in the future rather than as manifestations of satisfaction with the actual state of affairs. I still believe that even if nothing is done costs will eventually probably fall sufficiently to restore a profit margin. But I am becoming more and more convinced that there is serious risk that they won’t do so quickly enough to forestall wholesale economic collapse, if reliance is placed wholly on the self-acting processes of recovery.

We have already had three years of patient waiting, probably three years too much. It is arguable that even dangerous remedies now threaten less risk of disaster than does continuance of inaction. The advice so widely offered that we should avoid all risky or costly procedures, with its implication that we can do so simply by doing nothing, is under prevailing circumstances absurd advice. It would be comparable to advising a man in a burning building not to risk his life by jumping, but rather to follow the safe and conservative policy of waiting for the rain to put the fire out.

II
THE HORTATORY METHOD

I come now to the hortatory method. President Hoover has long been a convinced exponent of resort to incantations as means of exorcising social evils. During his war-time role as food administrator, he relied on slogans and appeals to patriotism where in other countries mandatory rules and regulations were applied. Again during the depression President Hoover and his staff of soothsayers with extraordinary persistence insisted that prosperity was around the corner, if nothing were done to frighten it away. As a substitute for prosperity he gave us organs, just as a substitute for government relief of the unemployed he asked the public “to give until it hurts.” Businessmen and the press have become infected with the same delusion and the public has been burdened with appeals to “Buy Now” and to “Buy American” and told, in thousands of dollars of advertising space, that “It’s up to you, women” to end the depression.

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It is by no means certain that full response to some of these appeals would have been aids rather than hindrances to recovery. Even if there were no ground for doubt on that score, it is one of the characteristics of a depression that the types of action which would be beneficial if followed in concert by all are suicidal for the individual who follows them alone. Mankind cannot be induced by exhortation to do en masse what is patently injurious to individuals if done singly. You can’t socialize rugged individualists by waving a wand at them, and the chief effect of the hortatory policy is undue postponement in the formulation and execution of a program of genuine action by the only agencies who have the power to do so.

III
DOING THE WRONG THINGS

Sane persons, of course, would not deliberately adopt a policy of doing the wrong things, but they may do so through errors of judgment. To give and defend a detailed list of the errors of commission of which the government has been guilty would require more time than is at my disposal and probably would serve no useful purpose. I will concentrate, therefore, on two major errors of commission of the Hoover Administration in dealing with the depression—its treatment of agriculture and its campaign for maintenance of the boom level of wages.

The most important contributions to recovery from past world-wide depressions were made by farmers and workers in quickly reducing their charges for agricultural products and labor. These reductions, of course, were not made out of public spirit but from necessity, but we need not worry about motives if only the actions to which they give rise are commendable. Agriculture has in this depression been the only major portion of the national economy which has continued to operate and to produce to the limit of its capacity. There could be no business depressions if all sections of the national industry were as readily to adjust their demands to the level at which the market would absorb their full output.

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There are many who argue that it would have been better for the community as well as for the farmers themselves if they had responded to falling prices by allowing their lands to lie idle, which is what, in effect, manufacturers do during a depression. They overlook that if farmers followed the urban model, depressions would mean not merely distress but wholesale starvation. They fail to see that you can't increase the prosperity of a nation, even though you may increase the wealth of selected individuals, by sabotage, by deliberately restricted production. When one section of industry keeps on operating at full steam, while other sections lay down their tools, the section that continues to operate may be keeping the whole economy from going to smash but thereby assumes a disproportionate portion of the depression burden. That section of the community is not only morally entitled to relief, but it becomes in the general interest that it receive it before it also is forced to stop production.

But instead of relief the farmers were given the Farm Board Act and the Smoot-Hawley tariff; the former disorganized their markets and got them more deeply into debt, and the latter, through inciting retaliatory and defensive measures abroad, deprived them of their foreign markets. There was no excuse, except unworthy political excuses, for either of these measures. There was no lack of warning as to how they would operate. It is true that the farmers themselves were largely responsible for the enactment of both measures. But a competent government's duties do not consist merely in giving to its citizens what they think they want, but also in restraining them from making fools of themselves.

In past depressions wage reductions have contributed to recovery by making possible a restoration of profit margins for industry in spite of the fall in commodity prices. During the New Era, the Hoover Administration became apostles of the high-wage fallacy, the doctrine that high wages are a guarantee and an essential of prosperity. At the beginning of the depression, Hoover pledged industry not to cut wages, and for a long time large-scale industry as a rule adhered to this pledge. There is not time for an adequate exposure of the errors of economic analysis from which this high-wage doctrine derives its plausibility. But its basic fallacy, to which, unfortunately, many of my professional colleagues have succumbed, can be made clear in a few words. All that is guaranteed by wages higher than employers can afford to pay and still give employment to the available supply of labor is unemployment. The doctrine asserts that high wages mean high purchasing power, but an unemployed laborer has no purchasing power at all, however high may be the wage rate he would get if he had a job. Large payrolls do mean high purchasing power, but high wages may and often do reduce rather than increase the size of the total payroll. Moreover, $100 in a pay envelope constitutes no more purchasing power than $100 in dividend coupons, unless the poor hoard a smaller proportion of their income than do the rich, which I doubt. It would be very nice if simply by doubling or tripling all wage rates overnight we could end the depression, but its effect would be rather to make unemployment complete instead of partial. President Hoover would have rendered a service instead of a disservice to labor if instead of pledging employers to maintain their wage rates he had obtained from them a pledge to maintain their total payrolls, with freedom to reduce wages as circumstances made necessary.

IV

INDUCED BALANCED DEFLATION

Next for the policy which I have labeled induced balanced deflation. If costs fell as rapidly as prices, there would be no depression in the sense of unemployment and impaired national real income. If prices were stabilized at their present level and costs were to decline in the same proportion from their pre-depression level, the depression would end, as the result of what I would call balanced deflation. Assuming that there are no means, or no adequately safe means, of raising price levels, and assuming that costs had not fallen sufficiently to offer inducements to business men to carry on their operations on something approaching to normal capacity, is it not possible to force or
induce costs to fall until there is again a balance between costs and prices? In other words, cannot the rigidity of the element entering into costs be broken down through governmental action? This question can best be approached by dealing separately with the major items constituting costs of production: raw materials, wages, interest, rent, freight and utility charges, and taxes.

In the main the prices of raw materials, and especially of agricultural products, have fallen in greater degree than have the prices of the more advanced products into which they enter. The problem for these is how their prices can be raised rather than how they can be further lowered. But there are some important raw materials, notably steel and steel products, anthracite coal, cement, and brick, which through the quasimonopolistic organization of their industries have succeeded largely in resisting the general downward trend of prices. They have been aided in this by the deliberately slack enforcement of the anti-trust legislation by the federal government during the depression. There are valid criticisms to be made of the anti-trust legislation, especially in so far as it presents an obstacle to reduction in costs of production through mergers, elimination of competitive expenses, and so forth. But when the government during a depression lends its moral support to price maintenance and output-restriction, it is operating indirectly to lengthen and intensify the depression. Price maintenance through restriction of output means price maintenance through intensified unemployment. There should be vigorous condemnation and prosecution of all concerted endeavors to restrict output.

With wages I have already dealt somewhat. The post-depression wages have given way to a considerable degree in the last eighteen months, and in small-scale industries and small towns they have frequently been drastically reduced. Except here and there in the few industries in which trade unionism still retains an influence, or where employers with more sentiment than wisdom are showing a preference for high wages over full employment, there are visible to me only two important groups of labor whose wages should be further reduced in the interest of economic recovery, namely, the wages of railroad labor and of government employees. If freight charges and tax rates are to come down, it is necessary that wages of these groups of labor be further reduced. Without a reduction of freight charges and tax rates, and in the absence of a general rise in prices, there is no reason to expect early recovery from the depression. In both instances the government has a deflating rôle to play, since it stands as protector of railway wage schedules and is of course directly and immediately responsible for the level of salaries and wages paid to its own employees.

During the seven fat years 1923 to 1929, industry in general freed itself largely from bonded indebtedness, and in this respect was in a favorable position when the depression began. The reverse was true, however, of agriculture, of urban real estate, of the railroads, and of state and local governments, which during these years accumulated a great load of fixed bonded and mortgage indebtedness, a load which has become intolerable with the decline in prices and in volume of business, and which leaves those struggling under it without adequate credit for bank loans with which to finance current operations. Assuming as before that prices will not rise, this debt load must be drastically reduced. For farmers and private business, provided no net equity remains or such equity as remains can be concealed from or is not insisted upon by the creditors, a remedy lies through bankruptcy or receivership proceedings, and this remedy, while costly, is salutary. But as long as some equity remains, and sometimes long after it has all vanished, the debtor struggles to avoid the stigma of bankruptcy, and thus merely postpones the inevitable and increases the damage done.

There should be little stigma attached to bankruptcy proceedings in a time like this. Some of our best citizens have survived them without loss of caste. In the urban real estate field, the situation would in large measure have been cleared up by this time if the legal profession and the politicians, often in collusion with the courts, had not grasped the opportunity to fatten, like vultures, on the distress of their fellow citizens. In the case of
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the railroads and of farm mortgages, the situation remains to be dealt with. In other countries, less costly procedures and remedies are possible which, by deflating but not wiping out the creditors' claims, render reasonable justice between debtor and creditor and permit the debtor to resume operations with lower interest and capital charges, and with rehabilitated credit for new borrowings. In this country, constitutional provisions stand in the way, unless voluntary consent is given by both parties, but the governments can, and apparently are about to, aid the process of mutual agreement to deflate indebtedness. The Reconstruction Finance Corporation, by its loans to railroads, has postponed this necessary task of deflating debts, and has thereby served to lengthen and deepen the depression rather than to shorten and moderate it. Unless prices rise, time will in due course take care of all these private debts, through bankruptcies, foreclosures, receiverships, defaults, and compositions. But speed is urgent, and it is urgent, therefore, that governments—and especially the federal government, which is so hostile to measures tending to raise price levels—should hasten the process of debt deflation by every means, legal or nearly so, at their disposal.

Government debts are important as a factor in the depression chiefly through their contribution to the tax burden, and here there is no easy remedy of a deflationary type. Reduction of federal debt or interest by fiat is to most Americans unthinkable, and would undoubtedly for some time seriously disturb confidence. Reduction of the federal interest burden by conversion at lower rates of interest is possible to some extent, but it would require skillful management and whole-hearted cooperation by the banking system. There is little ground for anticipating substantial relief to the federal budget therefrom unless a patriotic appeal such as the British for voluntary conversion at lower rates were made and were successful. The experiment should be tried, however.

The state and local debt burdens are less manageable than the federal, and I see no means of relief. The credit of local governments is already sadly impaired, and successful conversion operations are out of the question. There are no legal barriers to state repudiations, but in most states local governments must continue to carry out the letter of their bond contracts as long as taxable property still exists within their jurisdiction, and as long as there remain schoolhouses which can be closed, and school teachers who will work without pay. Local governments have found it necessary to pay the interest on their bonds even after they could no longer find the funds with which to provide relief for the unemployed. Under the American legal code, local governments have sacred obligations to their bondholders but apparently to no one else.

The rent problem is closely similar to the private debt problem, but apparently there is less sacredness about a rent contract than a bond, and rent contracts, moreover, usually have shorter terms than do bond contracts and therefore are more quickly adjustable to changed circumstances. In any case, there have been wholesale rent concessions irrespective of the terms of the leases, and it is only corporations of great wealth who find landlords obdurate to appeals for rent concessions.

In the case of freight and other utility charges, governments are in a position to act without need of new legislation or powers. Freight and utility charges should be flexible, should be reduced during depressions, and should be permitted to rise during prosperity. The utilities should expect a "fair" return on their investment on the average over the good years and bad, and not in every particular year whatever the consequences to the rest of the community. Rate reductions now should be accompanied by pledges of rates during the next prosperity period sufficiently high to offset any losses resulting from present reductions. The freight rate structure is so absurd that it would be amusing were its effects not so tragic. The notions of railway executives that they can survive the depression and the new competition by charging rates so high that they are patently strangling industry and agriculture and suppressing traffic only serve to heighten the common impression that the difficulties of the railroads are not wholly unrelated to the quality of their management. But if the railroads cannot survive lower rates
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without assistance, it would be much better for both the roads and the public if government subsidies were devoted to rate reductions rather than to liquidation of ancient debts. It is curious that the metropolitan press, which is so convinced that the high tax burden is the chief obstacle to economic recovery, shows no interest in the high utility rate structure, which falls more directly on business operations, and is, dollar for dollar, an equal burden with taxes on whomever it falls.

Reduction of taxes, and especially those taxes which press directly upon production is, however, an essential part of a program of balanced deflation. The difficulties are great, and should not be minimized. During a depression the tax base, whether it be income or property or commodity sales, shrinks, and to maintain the same tax revenues it is necessary to increase the tax rates. But an increase in tax rates operates further to compress the tax base, and from this vicious circle there is no escape except through a drastic cut in government expenditures or through financing a large fraction of the expenditures during the depression through borrowing. For state and local governments, impaired credit and constitutional debt limits are obstacles to recourse to borrowing. For the federal government, the campaign for balancing the budget has made it dangerous to increase the debt substantially, because of the adverse effect it would have on the morale of a scared public taught to measure the stability of government by the financial record for a single year or short period of years.

Had it not been for this campaign of fear, however, it would have been sound policy on the part of the federal government to deliberately permit a deficit to accumulate during depression years, to be liquidated during prosperity years from the high productivity of the tax system and from increases in tax rates when they would do no harm. The outstanding though unintentional achievement of the Hoover Administration in countering the depression has in fact been its deficits of the last two years, and it was only its own alleged fears as to the ill effect of these deficits, and the panic which the big business world prop-

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posed to foresee if these deficits should recur, which have made this method of depression finance seriously risky. Had the government and the business magnates retained their mental balance, there would have been less cause to fear net ill effects during a depression than during the war from even a ten billion dollar deficit.

Given the necessity, however, for reducing government expenditures, it is much more desirable that this should be done through temporary reductions of salary and wage scales to a level with prevailing conditions than by cutting down important government activities. Both methods have the same beneficial effect on the taxpayer as such, but the latter method adds to the number of unemployed, deprives the public of the benefit of valuable governmental services, and disorganizes and demoralizes governmental working staffs much more than would reasonable wage reductions accompanied by assurance of continued employment.

In order to have its maximum beneficial effect, it would be necessary that a program of induced balanced deflation should be pursued vigorously and simultaneously along the whole front of undeflated costs. Such deflation would inevitably involve hardships and inequities in individual cases. It is to be regarded, however, as a surgical operation, effective only if done quickly and to the full extent necessary. Procrastination in executing it or its execution in a half-hearted way might well result in its failure to accomplish its purpose. In several respects, it could be so managed as to deprive it of its harshest features. Wage reductions could be made temporary in form; in bankruptcy settlements and compositions of debts there could be included provisions to the effect that, in the case of early business recovery, the surrendered claims of the deflated creditors would become reinstated in part. Such contingent provisions would not lessen the degree of immediate relief to business and agriculture and would give some basis for hope to creditors and wage earners that the impairment of their economic position would not be permanent.
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V

INFLATION AS A MEANS OF RECOVERY

I come finally to the policy of inflation as a means of bringing about a recovery of prosperity. Here peddlers of nostrums in a promising field for their operations, and here also apostles of inertia, dispensers of chloroform, tend to rely upon ridicule as a substitute for reasoned argument and find that it works well. "Inflation" is an old word and during its long history has accumulated a wide range of meanings, many of them contradictory. I will use the term inflation to mean an increase in the total amount of spendable funds, whether consisting of gold, paper money, or bank deposits subject to check.

The basic argument for inflation is that it would operate to raise product-prices more than cost-prices, would in this way restore a profit margin for business, and thus would bring about an increased volume of production and of employment. Against inflation many things are urged. It is said, for instance, that: (a) it can't be done; (b) if attempted, it would drive us off the gold standard; (c) all previous attempts at inflation have ended in disaster; (d) inflation involves a violation of contract and is morally reprehensible.

I can see little force in most of these objections. Inflation has been accomplished many times, especially in times of war. Inflation as I have defined it has more often been practiced under the gold standard than off it. We had a generation of inflation on the gold standard after the discovery of the Californian and Australian gold fields in the middle of the nineteenth century, and again twenty years of it after the discovery of the Klondike and the invention of the cyanide process for extracting gold ore at the end of the nineteenth century. Inflation, whether or on the gold standard, is much safer, much more easily regulated, if practiced on an international scale than if brought by a single country, and if practiced internationally all of the inflation anyone could reasonably ask for would be possible without dangering the gold standard in the slightest.

There have been a few previous attempts at inflation which were conducted without restraint and under abnormal circumstances.

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ended in disaster. There have been dozens, perhaps hundreds of cases, however, where it was kept within bounds, and while not necessarily beneficial, did not have disastrous effects. As far as I know, it has never until the present depression been used deliberately as a means of ending a depression, and has generally been unintentional, or has been used to help finance a war, a use against which much can be said, since in war time what is ordi-

narily needed is not an artificial stimulus to business, but rather restrictions on over-expansion in directions not contributing to the attainment of military victory. There is no lack of knowledge as to the technique of controlling an inflation, and if it involves risk, the risk lies not in ignorance as to methods of control but in lack of determination on the part of government, central bankers, or the public, to exercise such control.

Deliberate inflation may involve violation of the letter or of the spirit of contracts, but the only visible alternatives are similar modification of contracts through forced deflation or through bankruptcy, or else economic collapse. Under inflation there is no need for reduction of the real income of the creditor class below the level that they had cause to anticipate when the contracts were made, and even creditors would be well-advised to prefer inflation with its reduction from present nominal purchasing power to inability to collect anything because the debtors were breaking under an undeclared debt load.

It is often said that the federal government and the Federal Reserve system have practiced inflation during this depression and that no beneficial effects resulted from it. What in fact happened was that they made mild motions in the direction of inflation, which did not succeed in achieving it, did not succeed even in accomplishing "reflation," but which probably did slow up somewhat the rate of price decline. The loans of the Reconstruction Finance Corporation, in so far as they involved new credits instead of substitution of sound for unsound credit, the open-market purchases of the Federal Reserve banks, have been in the main but two different aspects of a single operation. The Recon- struction Finance Corporation obtains its funds from the federal treasury. The treasury obtains its funds mainly by sale of short-

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term securities to the banks. The banks recover the funds which they have thus lent to the treasury by sale of government securities in the open market to the Federal Reserve banks. The loans of the Reconstruction Finance Corporation and the open-market purchases of the Federal Reserve banks are not to be added to each other, therefore, as is often done, in order to estimate the extent to which government and central banking agencies have pumped new funds into the credit market. At no time, moreover, since the beginning of the depression has there been for as long as four months a net increase in the total volume of bank credit outstanding. On the contrary, the government and Federal Reserve bank operations have not nearly sufficed to counteract the contraction of credit on the part of the member and non-member banks. There has been no net inflation of bank credit since the end of 1929. There has been instead a fairly continuous and unprecedentedly great contraction of credit during this entire period.

Many of the methods of inflation currently advocated would not, or would not necessarily, accomplish it. Increase in paper money would increase the total amount of spendable funds only if they were not offset by corresponding decreases of bank deposits subject to checks. In any case, an increase of paper money in greater proportion than that in which the public wished to hold its cash balances as between currency and bank deposits would rapidly be converted into bank deposits, and conceivably its only effect would be to increase the cash reserves of the banks or decrease the indebtedness of the member banks to the Federal Reserve system. The initial form of the inflation has a special significance and would soon change if not in accord with public customs and habits.

Similarly, proposals for periodic stamp taxes on paper money in order to speed up its rate of circulation, sound sensible—they do—only because it is overlooked that if there is a specific tax on holding cash balances in one form but not in another, everyone will learn to use the taxed form of money in making payments and to do his hoarding in the untaxed form. Such measures would increase the velocity of circulation of the tax money, but only by decreasing to a corresponding degree the velocity of circulation of bank deposits and coin. To have the desired effect, such taxes would have to be levied on all forms in which cash balances can be held, including coin and bank deposits. What would thus be accomplished would be a backhanded form of inflation, where the velocity of circulation of spendable funds would be increased, but not its amount. The difficulties of administering such a measure would appear to be enormous.

Another common proposal, namely, to devalue the dollar or reduce its gold content by, say, 25 per cent would, in the absence of other concomitant measures, operate to raise the price level in two ways. First, exports would be stimulated because of their lower prices in foreign currencies, and imports would be restricted because of their higher prices after conversion into the devaluated American currency. This would result in higher prices for the export industries, and in larger gold reserves for the banking system. Second, the devaluation of the currency would increase the dollar value of the present gold reserves of the banks without increasing the dollar value of their present demand liabilities, would thus increase their gold reserve rates, and would enable them to increase their loans with greater safety in so far as adequacy of reserves was concerned. But tariffs and the depression have reduced our foreign trade to a small fraction of its former proportions, and it now seems to be insufficient to be an important short-run regulator of our price level. Countries on the gold standard, moreover, would be likely to apply import quotas and administrative restrictions on our products in order to protect their domestic producers against increased inflows of American goods, and countries off the gold standard might further depreciate their currencies to counteract the effect on their trade of our devaluation. Our banks also might welcome the additional liquidity which the measure gave them, without hastening to use it as a basis for expanding their loans. Finally, the gold clause which appears in a great part of our bonds, mortgages, and long-term leases, and is now being included in even ordinary short-term promissory
notes, would present an embarrassing legal problem for which no satisfactory solution has yet been suggested.

There are many advocates of remonetization of silver at a mint price greatly in excess of its current market price as a means of raising the price level, but there is even less to be said for it than for most inflationary proposals. If the government wishes to inflate, there is no reason why it should not retain the immediate profit from the fiat currency for itself rather than give it to the silver-mine operators. The total available stock of free silver in the world is not sufficient to make any great impression on the price level unless silver were overvalued many fold for currency purposes. The rise in the market price of silver would operate to extend to the silver-currency-using countries the destructive deflation from which the gold standard countries have been suffering, but from which they have largely escaped because of the decline in the gold price of silver.

Assuming for the moment that a deliberate policy of inflation should be adopted, the simplest and least objectionable procedure would be for the federal government to increase its expenditures or to decrease its taxes, and to finance the resultant excess of expenditures over tax revenues either by the issue of legal tender greenbacks or by borrowing from the banks. It will be remembered, however, that this would not actually result in inflation as I have defined it, if the new greenbacks were hoarded, or if the new borrowings were of private funds which would have been used in any case, or if the banks in their continued search for liquidity reduced the amount of their loans to others to an equal degree. In order to bring about inflation it would be necessary to increase government expenditures sufficiently to more than offset for some period of time any counter-measures of a deflationary character by banks or individuals.

Can this be done, and what would be the consequences?

Theoretically, it is clearly conceivable that it would take extraordinary amounts of government expenditures to accomplish this end, if banks continued to liquidate their loans and private individuals to hoard their bank funds as a reserve against future needs and to hoard government money as insurance against bank closures. This procedure could work only if it did not cause general fear of an early departure from the gold standard and therefore a flight from the dollar into foreign securities and foreign currencies, and if upon the first signs of an impending price rise business men actually began to buy commodities and to resume productive operations in order to profit from the low prices while they still continued to be available.

I cannot see any justification for confidence that an aggressive inflationary policy of this sort would not immediately result in a flight from the dollar, in panicpy anticipation of the effects in business circles of a grossly unbalanced government budget, and therefore in more injury than good, at least as long as we remained on the gold standard.

But what if we went off the gold standard? Once off, individuals would have nothing to gain by fleeing from the dollar to foreign currencies, since the exchange market would probably immediately over-discount the prospective fall in the internal purchasing power of the dollar. There would still be an incentive to flee from the dollar internally, but the internal flight from a paper currency does not take forms restrictive of business activity such as hoarding of money, but on the contrary leads to rapid expenditure on commodities, building, and so forth, in order to profit from the anticipated price rise.

If going off the gold standard were as simple a matter for us as for England and Canada, I would not only advocate it, but if the mere cessation of gold payments did not suffice to lower substantially the internal purchasing power of the dollar I would recommend its accompaniment by increased government expenditures financed by the printing press or by loans. You have no doubt been told that unemployment has not decreased and production has not increased in England and in the other countries which went off the gold standard in 1931, and that these countries as a result of their departure from the gold standard have lost in prestige and have suffered from an unstable currency. But these countries made one mistake when they went off the gold standard. Their mistake lay in their too restrained use of the freedom which the departure from the gold standard gave

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these religious convictions, but I nevertheless am firmly convinced that, because of special circumstances prevailing here, for the time being at least it is impossible for us to consider deliberate abandonment of the gold standard or even any serious tampering with it. The actual process of going off the gold standard, while it is under way, is extremely painful, costly, panic-breeding. England was able to go off over a week-end. In this country, it would undoubtedly require weeks, if not months, of public and congressional debate, during which utter confusion would be likely to prevail. The gold clause in contracts, peculiar to us, would be an additional complication persisting even after we had formally abandoned the gold standard, and even if the gold clause were eventually nullified by judicial decision to the effect that it was unenforceable, or that it was not binding during an emergency, it would in the interval before a final decision could be rendered cast doubt on the solvency of all railroads and other corporations having such clauses in their bonds. Many persons also would question whether we can safely trust our legislators to exercise with due caution, sobriety, and intelligence the power of price regulation which they would have if our currency system were no longer tied to gold.

If we are to have inflation, therefore, we must have it within the gold standard and without resort to budgets badly enough unbalanced to terrify Wall Street. These two conditions suffice to make impossible any policy of deliberate inflation on a large scale through unilateral action on our part. If it is to be accomplished at all, it must be accomplished by international agreement, as a part of the general economic settlement which we must hope and pray will be the outcome of the International Economic Conference. If all, or even a substantial number, of the important commercial nations will agree that they will endeavor to raise their internal price levels within twelve months by say fifteen per cent, will pledge themselves by pegging operations and international loans to maintain the exchange values of their currencies at approximately their then prevailing levels, will contribute to the process of balanced deflation by writing down pre-depression international debts, public and private, and

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them. Instead of attempting to raise prices, they tried instead to stabilize them at the then prevailing level, relying upon stimulus to their exports of the fall in the foreign exchange value of their currencies to bring them an increased measure of prosperity. They failed to foresee that the progress of the depression, the continued deflation in the gold standard countries, and the multiplication of tariff and other restrictions on foreign trade, would more than neutralize the tendency of the deprecation of their currencies to increase their exports. Although, therefore half the world went off the gold standard with England, none of it has actually inflated, has actually increased its total amount of spendable funds.

The countries which went off the gold standard have nevertheless weathered the economic storm much better than we have done. If they did not restore prosperity for themselves by abandoning gold, they at least escaped the further deterioration which we have suffered since the autumn of 1931. In England, for example, prices, production, employment, have held their own since 1931, which is much more than we can say for ourselves. England has even balanced its budget during this current fiscal year, whereas operating under the supposedly conservative gold standard we achieved the greatest peace-time budget deficit in history. I doubt whether in comparison with us England lost in prestige since the autumn of 1931. If so, I would like to know on what grounds. In any case too high a price can be paid for prestige. Nor has our gold standard currency been more stable than the English paper currency. The contrary has been the case. In internal purchasing power, the English pound remained practically stationary, whereas our dollar has, to sorrow, substantially appreciated. On the exchange market, the dollar has of course fluctuated exactly as much in its power to buy sterling as sterling has fluctuated in its power to buy dollars. The only stability our currency has had has been stability in exchange value for gold.

The gold standard is to many men a sacred institution, herence to which rests on faith, on devotion, if necessary on sacrifice, but not on reason and calculation. I do not

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will pledge themselves to restore tariff walls to their 1929 level or lower and to abolish the administrative barriers to trade which have accumulated during the depression, I am optimistic enough to be confident that the prospects of early prosperity seem promising enough to business men and banks throughout the world to lead them of their own accord to put their spendable funds into use to finance production, to restore employment and to bring about the needed rise in price levels without necessitating substantial additional expenditures on the part of governments or abandonment of the gold standard by countries adhering to it.

A full return to the 1929 price level is not essential for recovery of prosperity. The decline in the prices of the factors of production which has already occurred, together with economies and the technological improvements which have been introduced under the pressure of three years of falling prices, will make a moderate increase in prices suffice for prosperity. Even if the important participants in the International Economic Conference should only pledge themselves to prevent further decline in commodity price levels, economic recovery might still take place, although after a longer delay, through the progressive operation of the process of balanced deflation, without the assistance of an artificially induced rise in price levels.

Without speedy balanced deflation or induced inflation, or preferably a combination of both, prospects are extremely gloomy. If the International Economic Conference should fail to produce substantial results in one or the other or both of these directions, then we must fall back on drastic balanced deflation within one's own country as the only hope for relief. If this should also fail, then we must steel ourselves to withstand more depression whose final outcome for our civilization, and especially for present mode of economic organization, no one can foresee.

OPEN DISCUSSION

QUESTION: Is England on the silver basis?

Mr. Viner: No, England is on a paper basis, but has altogether discovered it yet and is still retaining too much.

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the gold standard psychology. I may say in this connection something I intended to say in my talk: although I concede that England has not increased her prosperity, the reason why is that England has not used to full advantage the freedom she got. She has merely held her own. There has been no expansion of paper money or bank credits. The gold reserve requirements are still as binding now as if she were still on the gold standard.

QUESTION: If England is on the paper basis, what is back of it?

Mr. Viner: All that is necessary to give value to the currency is to keep the quantity restricted sufficiently. It doesn't have to have any intrinsic value.

QUESTION: What reasons are there for supposing that any of the proposals for limited inflation now before Congress would accomplish any more than the Bland and Sherman acts of the last century?

Mr. Viner: There are two kinds of history of American monetary experiences. There is the history written by those who believe that strict adherence to that nowadays most profound of our religious institutions — the gold standard — was all-important, and who would put as the great periods in our history the dates when Congress resisted the temptation to tamper with the gold standard. I think myself that a lot is to be said for William Jennings Bryan and his 16 to 1 campaign of the 1890's; and that the country itself would have come to that conclusion if the process which was then crushing the farmers had continued for three or four years. The only thing that has saved us in previous severe deflations has been a series of miracles.

In the middle of the nineteenth century, the discovery of gold fields in California and Australia came after forty years of very severe deflation comparable to what we are suffering now. Again, toward the end of the nineteenth century, came the discovery of gold in the Klondike and the Transvaal and the cyanide process of extracting gold, which itself raised the price level so that the farmers got relief through rising prices. People talk of similar miracles being in prospect now. They may come. But I wouldn't gamble on it.

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QUESTION: Is there any kind of an inflationary proposal involving an expansion of money that would not be discounted by the banks and in a way which would result in a shrinkage of currency?

Mr. Vinser: The banks have no means whatever of countervailing an inflation if you are not on the gold standard. Under the gold standard they can flee from the dollar. Off the gold standard, hoarding doesn’t do any good. Under a paper currency the only practicable mode of insurance against loss of value of one’s cash holdings is to buy commodities, build homes, and so forth—not a very undesirable consequence. Bankers have no personal cause to fear inflation. If they are the greatest stalwarts against inflation, it can’t be because of self-interest, but it is their feeling of what is good for the country.

QUESTION: Is it not likely that most of the so-called inflationary proposals now before Congress, if passed, would have a serious effect upon the bond market and banking system that the effects would be deflationary rather than inflationary?

Mr. Vinser: Under a paper currency there is no particular reason why inflation should have an adverse effect on the bond market unless you expect wild inflation. In England bonds have not fallen in price since England went off the gold standard. On the contrary, they have risen. The British have more confidence in their present economic status. If you mean by inflation wild unregulated inflation—such as has happened in some countries—that would hurt not only bonds but many other things as well. And, as I have already said, the process of going off the gold standard would be very costly altogether apart from accompanying inflation.

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