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Inflation Is Legalized Robbery, Part 2

by Gregory Bresiger

Whether one believes in the “price stability” policies of our nation’s central bank, or believes such policies have caused countless economic problems, the onus is on the Federal Reserve. It is a strange, quasi-secret public/private agency with little or no accountability.

It is the Fed, which since 1913 has had an exclusive monopoly over the money-making power, that must be held accountable. Its overall record is a sorry one despite all the ballyhoo, whoop-it-up stories, and books about how Alan Greenspan supposedly performed miracles in the 1990s.

Acclaimed as the greatest central banker of our time by Bob Woodward, Greenspan actually practiced legerdemain. He began as a young economist defending the ideas of Ayn Rand and the gold standard, but one of his early political benefactors, President Richard Nixon, broke the federal government’s last link to gold in 1971. Thus, Greenspan ended up running a central bank divorced from the gold standard, which is a key reason that today’s economy may be heading for the double-digit inflation rates of the 1970s, or the recession of the early 1980s, or the bear market crash of 2000–2002.

In 1971, Nixon’s “closing of the gold window” effectively devalued the dollar, causing untold financial losses to foreign investors who had trusted the U.S. government by holding dollars in their reserves.

Even worse, breaking the link with gold was combined with other disastrous economic policies. These included wage and price controls and surcharges. The results brought shorter-term political gain: Nixon was reelected in 1972. But they also caused long-term economic damage, not to mention anger and resentment among foreign central banks that had lost untold amounts of money as a result of the dollar devaluation.

Until 1971, the quasi gold standard — one in which foreign central banks could still redeem dollars for gold — had been one of the few remaining brakes on the Fed’s almost unlimited ability to create more and more new money. Post–1971, nothing could stop the Fed. It could, and did, flood the markets with dollars, which meant less and less buying power for those

holding this diluted currency. In the short term, cheap money tricked Americans into thinking that the economy was strong when it wasn't.

Thirty-five years of failure

The Fed's record since 1971 has been one of numerous recessions preceded by booms. We have had a stop-and-go economy, one that inevitably misleads investors and damages retirees. An example of the former were those investors during the stock market run-up in the 1990s who were led to believe that business cycles were history and that bull markets were now permanent. An example of the latter is the elderly person who, 10 years ago after the beginning of retirement with a seemingly adequate amount of fixed savings, now finds himself struggling to maintain a lifestyle that it took a lifetime to achieve.

"All such savings are prejudiced by inflation. Thus saving is discouraged and extravagance seems to be indicated," wrote economist Ludwig von Mises more than half a century ago. Mises had personally witnessed the horrible damage wrought by inflation during the Weimar Republic.

Thus, the average American who saved for retirement now finds his well-earned lifestyle threatened by the unanticipated pace of price increases that come as a result of inflation. For example, suppose a person retired in 1996 with \$1 million. Ten years later, figuring the damage of relatively "comfortable" inflation, that \$1 million is worth just \$803,748. And imagine how much worse it will be if we return to the high inflation numbers of the 1970s.

Inflation has also brought about adverse structural changes in our lives and in the economy. I speak of the permanent acceptance of inflation at "comfortable" rates by many economists, politicians, and even ordinary people who have lived with inflation all their lives and thus know nothing else. This inflation-can-be-good philosophy appeared at the same time as the post-Great Depression Keynesian encouragement of excessive consumption, especially among lower income groups, as a way of preventing depressions. This is a culture, backed by tax policy, that virtually destroyed thrift in our country and encouraged private debt at the same time that government red ink was hitting record levels.

In recent times, savings rates in America sometimes have been recorded at less than zero. Why save today when tomorrow your money will be worth much less, owing to the inexorable power of inflation? Worse than that is the psychology of never-ending inflation. Few in the financial or consumer markets expect that inflation will ever be stopped. So, again, why save? Saving is difficult. It is denying oneself a higher standard of living in the expectation of a future reward. The Austrian economists call this time preference.

And why save when you can borrow at artificially low interest rates? And why pay off debts when there is plenty of credit around and refinancing is always available? Why not consume now, since everyone "knows" that prices will always rise?

Here is the triumph of an inflationary policy pushed for generations. It is a policy that has become a virtual article of faith. It can no more be seriously questioned than the supposed benefits of fiat money, or mandatory social insurance programs, or an interventionist foreign policy.

The Fed's easy-money policies also explain why both public and private debt levels have been rising for generations, with fewer and fewer protests. Indeed, spendthrift ways are embraced along with inflationary values. So the average American household today carries a credit card balance of \$8,000.

Inflationary addiction

One of the biggest problems with inflation is its seductive power. In its beginning phases, or when one is in its "comfort" zone, it seems harmless. Like strong drink or other drugs, it produces a temporary euphoria. In fact, in some cases, as Austrian economist F.A. Hayek pointed out, inflation actually seems beneficial to business at the outset. That's because sales in certain sectors rise at a faster rate than they would have if free-market forces were operating. Inflation, Hayek wrote, distorts how the businessman views the economy and his business.

"It is this which creates the general state of euphoria," he warned, "a false sense of well-being, in which everyone seems to prosper. Those who without inflation would have made high profits make still higher ones. Those who have made normal profits make unusually high ones. And not only businesses which were near failure but even some which ought to fail are kept above water by the unexpected boom."

Hayek, who was describing the stop-and-go monetary policies of Britain's central bank of the 1970s, could be explaining any of the boom-bust policies employed by our own central bank. Inflation has a long lamentable history nearly everywhere.

For example, by 1973, after a period of money expansion that helped reelect Richard Nixon and most of a Democratic Congress, the United States went into a brutal period of stagflation. This lasted for about a decade and produced double-digit inflation along with slow growth rates. This included a period in which the Fed battled inflation by raising interest rates.

The Fed, which had ignored inflationary signs in 1971 and 1972, had overexpanded the money supply. By the mid 1970s and early 1980s, it paid for that policy with skyrocketing interest rates that topped 20 percent. These unprecedented rates threw parts of the nation into a virtual depression. Tens of millions of jobs were lost. Certain interest- rate-sensitive industries, such as the housing and automobile industry, went through terrible times. Mom-and-pop businesses felt the ripples. Hardship reached into millions of homes.

This vicious and destructive downward economic spiral ended in the early 1980s. Then, the Fed's stop-and-go economy started all over again. The Fed began to inflate again in the early 1980s.

The Fed's boom-bust cycle has continued over the last 20 years or so. But the cycle of boom and bust seems to be worse every time. The recessions are deeper. The inflation required to continue the boom requires more and more money creation accompanied by higher and higher levels of private and public debt.

Austrian economists describe how inflation pumps up markets, creating a bubble. "One of its consequences," warned Mises, "is that it falsifies economic calculation and accounting." Examples of the latter were the artificial, Fed-induced, bull markets of the late 1990s. While they lasted, they seemed great. But when the bubble burst, millions of dreams went with them.

When I was a student in college in the 1970s, I was told by a Keynesian economics professor not to worry about the U.S. government's Treasury borrowings. "It's only money that we owe to ourselves," he assured me. My professor was ignoring a hard fact. He forgot that one group — the taxpayers — would be in debt to another group — the bondholders — for generations to come. Moreover, today large amounts of Treasury instruments are owned by foreigners, who might be inclined to be less willing to hold dollars than Americans are if the dollar starts rapidly losing value.

But they're not the only ones worried about currency manipulation as well as huge federal and trade deficits that induce the Fed to print money at a faster and faster pace. The illusions created by inflation are not fooling the smart money. For example, in 2002, noted value investor Warren Buffett announced that, in order to hedge his bets, a significant amount of his assets would no longer be in dollars. "If we have the same policies, the value of the dollar will go down," Buffett announced. Nothing has changed since then.

Another successful investor, money manager John Templeton, is also concerned. He has warned that the U.S. dollar is overvalued by 40 percent. Templeton will no longer invest in U.S. stocks. One of the great problems that will face investors in the future will be persistent inflation, Templeton predicted in 1980 in a book called *The Money Masters*.

Templeton, Hayek, Mises, and others who have documented the damage done by inflation and warned against its dangers are unrecognized sages in an inflationary age. Those who ignore such warnings do so at their financial and economic peril.

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This article was originally published in the January 2007 of *Freedom Daily*.