FINANCIAL PREPAREDNESS

"One of life's most painful moments comes when we must admit that we didn't do our homework, that we are not prepared." ~ Merlin Olsen

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What You Should Know About Inflation

In the past year, there has been an increasing amount of interest in the topic of inflation. In Issue #3 of this newsletter (published 2/26/21), I warned that hyperinflation is coming. I just finished reading What You Should Know About Inflation by Henry Hazlitt, who was a well known free market economist. It was first published in 1960, but its lessons remain timeless.

Hazlitt writes, "The politicians in Washington talk of [inflation] as if it were some horrible visitation from without, over which they had no control—like a flood, a foreign invasion, or a plague....rather than something brought about by [their] own policies....[it] is practically always the result of deliberate governmental policy...."

Nearly everyone believes that inflation is an increase in prices (due to greed, shortages, war, etc.), but as Hazlitt writes: "The rise of prices, which is merely a *consequence* of the inflation, is commonly talked of as if it were *itself* the inflation. This mistaken identification leads many people to overlook the real cause of the inflation—the increase in the money supply—and to think that the inflation can be halted by the imposition of government price-and-wage controls, even while the supply of money continues to increase."

This government scam against its own citizens has been going on for millennia. In ancient Rome, the emperor had to clip the edges off of gold or silver coins, or debase new coins by including less precious metals in them. The Spanish Empire had to force indigenous Americans to mine precious metals and then shlep it back to Spain on galleons, dodging hurricanes along the way.

Hazlitt writes, "Today the method is a little more indirect [and easier, as well as theoretically unlimited]. Our government sells its bonds...to the banks. In payment, the banks create 'deposits' on their books against which the government can draw. A bank in turn may sell its government IOUs to the Federal Reserve Bank, which pays for them...by having more Federal Reserve notes printed...."

Inflation has always been the result of government living beyond its means. Hazlitt writes, "All the great inflations of earlier and modern times have been primarily the result of reckless deficit financing on the part of governments, which wanted to spend far more than they had the courage or ability to collect in taxes....It is next to impossible to avoid inflation with a continuing heavy [government] deficit. That deficit is almost certain to be financed by inflationary means—i.e., by directly or indirectly printing more money."

Hazlitt explains the psychological discounting that occurs for fiat currency: "It is...an oversimplification to say that the value of an individual dollar depends simply on the *present* supply of dollars outstanding. It depends also on the *expected future* supply of dollars....the value of any monetary unit...depends not merely on the *quantity*...but on their *quality*....When a country goes off the gold standard...the value of the monetary unit...usually falls immediately, even if there has not yet been any increase in the quantity of money. This is because the people have more faith in gold than they have in the promises or judgment of the government's monetary managers....Just as the value of a bushel of wheat depends not only on the total present supply of wheat but on the expected future supply and on the quality of the wheat, so the value of a dollar depends on a similar variety of considerations. The value of money...is not determined by merely mechanical or physical relationships, but primarily by psychological factors....the increase in commodity prices often occurs *before* the increase in the money supply...."

Hazlitt makes the important point that "If it had not been for the increase in production [as a result of increases in technology and efficiency], the rise in prices would have been much greater than it actually was." That's because even though more goods were produced more efficiently, inflation still caused prices to rise. So the problem of inflation is even worse than you thought.

Hazlitt says that the worst of all the false remedies for inflation is wage and price controls. "...price fixing quickly brings about a shortage of the very things whose production the government is most eager to encourage." Such controls "only discourages, distorts, and disrupts production, *without* curing the inflation....Thus one government intervention begets a further government intervention. Because government has failed in its primary task—that of preventing private coercion—politicians ask, in effect, for price and wage fixing; and we are driven toward totalitarian controls."

"But the price level and the infinitely complex price and wage interrelationships of [each] day [are] the result of the state of supply and demand *on that day*. And supply and demand seldom remain the same...." With an estimated nine million different prices in the U.S. (far more today), there are "more than 40 trillion interrelationships of these prices; and a change in one price always has repercussions on a whole network of other prices....No single mind, and no bureaucracy, has wisdom and knowledge enough to correct these. Every time a bureaucrat tries to correct one price or wage maladjustment or 'inequity,' he creates a score of new ones."

"But [price-fixing bureaucrats] are subjected...to tremendous pressure by the organized pressure groups. Those in power soon find that price and wage control is a tremendous weapon with which to curry political favor or to punish opposition." Even though price control "is always put into effect in the name of an alleged 'emergency,' it creates powerful vested interests and habits of mind which prolong it or tend to make it permanent....Price control is the major step toward a fully regimented or 'planned' economy. It causes people to regard it as a matter of course that the government should intervene in every economic transaction....and worst of all...price control diverts attention away from the only real cause of inflation...."

Hazlitt explains how currency printing and low interest rates go together: "When interest rates are held [by the Federal Reserve] artificially low, they encourage an increase in borrowing. The process works both ways—for it is necessary to increase the money and credit supply in order to keep interest rates artificially low." Of course, both of these fuel asset bubbles (and crashes).

But it's not just the government that benefits from inflation: "...one of the effects of inflation is to bring about a redistribution of wealth and income. In its early stages (until it reaches the point where it grossly distorts and undermines production itself) it benefits some groups at the expense of others. The first groups acquire a vested interest in maintaining inflation....inflation must always end in a crisis and a slump...." Inflation also "wipes out the value of past savings, discourages future savings, redistributes wealth and income wantonly, encourages and rewards speculation and gambling at the expense of thrift and work, undermines confidence in the justice of a free enterprise system, and corrupts public and private morals."

Inflation requires government deception: "When the Chancellor of the Exchequer announced the devaluation of the British pound in 1949, Winston Churchill pointed out that [he] had previously denied any such possibility no fewer than [12] times....this is what 'devaluation' means. It is a confession of bankruptcy....The political technique for [devaluation]...consists of strenuous, even vicious repudiation beforehand of any notion of revaluation....This is what 'monetary management' really means. In practice it is merely a high-sounding euphemism for continuous currency debasement. It consists of constant lying in order to support constant swindling....Instead of precious metals, [people must] hold paper promises whose value falls with every bureaucratic whim."

Hazlitt explains how gold prevents these problems: "[Gold puts] a check-rein on the politician....Just as 'managed' paper money goes with a statist and collectivist philosophy, with government 'planning,' with a coercive economy in which the citizen is always at the mercy of bureaucratic caprice, so the gold standard is an integral part of a free-enterprise economy under which governments respect private property, economize in spending, balance their budgets, keep their promises, and refuse to connive in overexpansion of money or credit....The gold standard provided a practically automatic check on credit expansion. That is why the bureaucrats abandoned it....[Gold] reflects and measures the extent of the lack of confidence in the domestic currency [and] can be kept longer than a politician's pledge."

Laws that prohibit buying or owning gold are "a left-handed confession by our monetary authorities that the people do prefer gold to paper and would make the exchange if they could....They are left...with the practice of buying real estate, common stocks, mink coats and motor cars, TV sets and oriental rugs, jewelry—any equity or luxury that is not dollars or a fixed obligation payable in dollars. They are forced...into extravagance and speculation."

Hazlitt refutes the notion that the genie of inflation can be controlled once let loose: "None of these countries [with high inflation] found it at all difficult to get its inflation going, but most of them were finding it politically almost impossible to stop...the more evident the evil consequences of inflation became [during the French Revolution], the more rabid became the demands for still more inflation to cure them....no nation has yet succeeded in keeping an inflation, once started, under control....you can't afford to tell people in advance that you are *planning* to cheat them [as the Fed does]....if people know that prices will be 3% higher, say, next year, they will bid prices up nearly that much right away."

What's the purpose of the Federal Reserve? To make counterfeiting appear respectable: "The U.S. Employment Act of 1946 declares that 'it is the continuing policy and responsibility of the Federal government to use all practicable means...to promote maximum employment, production, and purchasing power.' Many interpret this as a standing order [to the Fed] for inflation....The monetary managers are fond of telling us that they have substituted 'responsible monetary management' for the gold standard [which they call 'the barbarous relic']. But there is no historic record of responsible paper-money management."

"...inflation is nothing but a great swindle...that is practiced in varying degrees, sometimes ignorantly and sometimes cynically, by nearly every government in the world....It is a concealed tax....Why does this swindle go on? It goes on because governments wish to spend...but lack the courage to tax as much as they spend.... governments wish to buy the votes of some of us while concealing from the rest of us that those votes are being bought with our own money." The world's paper currencies are "blown about by every political wind, and at the mercy of every bureaucratic caprice. And the very governments that are inflating profess solemnly to be 'fighting' inflation."

Hazlitt explains the remit of central banks: "Since the end of WWII, governments everywhere have been pursuing three mutually contradictory aims: (1) constantly rising wages, (2) stable prices, and (3) full employment....these goals cannot all be achieved at the same time....[thus] the de facto choice of Western governments in the last decade or two has been constantly rising wages and full employment financed by a so-called 'creeping' inflation." Today, full employment is achieved by putting most of the long-term unemployed on the federal disability program, so they aren't considered unemployed. Of course, this requires a lot of spending (and deficit financing).

"[A Harvard professor] seemed to think that a 'creeping' inflation of some 2% a year would be both necessary and acceptable." Sound familiar? "...even if we assume we could control an inflation to a rate of 2% a year, it would be equal to an erosion of the purchasing power of the dollar by about one-half in each generation. The legalized robbery that such a 'solution' would involve of millions of bank depositors, life insurance policyholders, bondholders, and of everyone dependent on a fixed or sluggishly responsive income, is itself sufficient ground for rejecting it."

"Even so, it would not work. The moment an inflation is planned, acknowledged, and *foreseen*, the game is up. Inflation is a swindle. You cannot tell your intended victim in advance that you intend to swindle him....A serious or long-continued inflation is always in danger of getting out of control....the very knowledge of the existence of such a planned inflation would undermine confidence in the value of the dollar. It would bring a racing inflation immediately that could quickly get out of hand."

"...in the early stage of an inflation, [prices] usually rise by *less* than the increase in the money supply, but in the later stage of an inflation always rise by *more* than the increase in the money supply....And the scramble to get out of money and into things only intensifies the inflation...."

Hazlitt explains why interest rates are now spiking: "Excessively low rates always encourage overborrowing....cheap money cannot be continued indefinitely. It sets in motion forces that eventually drive interest rates higher....demand for credit soon increases as fast as the supply....When both borrowers and lenders begin to fear that inflation is going to *continue*, prices and wages begin to go up *more* than the increase in the supply of money and credit. Borrowers want to borrow still more to take advantage of the expected further rise in prices, and lenders insist on higher interest rates as an insurance premium against expected depreciation in the purchasing power of the money they lend."

Whatever the problem is, the answer proposed in D.C. is always more spending: "Practically everyone in Washington seems to agree that we can easily float ourselves out of slumps through more inflation. We need merely give ourselves a sufficiently big dose—of increased spending, or tax reduction, or anything else that will produce a whopping deficit."

Why does no one ever talk about the $163 trillion elephant in the room? "Our politicians, and most of our commentators, seem to be engaged in an open conspiracy not to pay the national debt—certainly not in dollars of the same purchasing power that were borrowed, and apparently not even in dollars of the present purchasing power. There is of course no explicit avowal of this intention....Very few of us even mention the problem of substantially reducing the national debt....Today one never sees nor hears a serious discussion of this problem."

"There is nothing new about [debt monetization]....This trick has a long and inglorious history....It was old when Adam Smith denounced it in The Wealth of Nations in 1776: 'When national debts have once been accumulated to a certain degree, there is scarce, I believe, a single instance of their having been fairly and completely paid. The liberation of the public revenue, if it has ever been brought about at all, has always been brought about by a bankruptcy; sometimes by an avowed one, but always by a real one, though frequently by a pretended payment....almost all states...ancient as well as modern [have] played this very juggling trick.'...since the substitution of paper for metallic money, the trick has become much easier and therefore more frequent."

One of the real divisions in this country isn't Trump vs. Biden, Red State vs. Blue State, or even the Elite Coasts vs. Flyover Country; it's between those who have benefitted from inflation vs. those who have not (and cannot). Hazlitt writes, "The incomes of those who receive this [new] money [Washington, D.C.] go up first. Those who begin spending the money first buy at the old level of prices....inflation involves a redistribution of real incomes. Those who benefit by it...must do so at the expense of others....This creates class or group divisions, in which the victims resent the profiteers from inflation....There is general recognition that the [inflationary gains] is not the result of merit, effort, or productiveness, but of luck, speculation, or political favoritism. It was in the tremendous German inflation of 1923 that the seeds of Nazism were sown."

During inflation, "The gainers become used to an 'unearned increment.' They want to keep their relative gains. Those who have made money from speculation prefer to continue this way of making money instead of working for it....The long-term trend in an inflation is toward less work and production, and more speculation and gambling. The profiteers from inflation tend to spend freely, frivolously, and ostentatiously. This increases the resentment of those who have been less favored. The incentive to ordinary saving, in the form of savings accounts, insurance, bonds or other fixed-income obligations, tends to disappear....[Inflation] thereby penalizes and discourages thrift and saving, discourages the 'safer' and more conservative investments, and forces everybody to be a speculator or gambler....The spectacle of quick and easy returns increases the temptations to corruption and crime....Inflation is itself an immoral act on the part of government."

Frédéric Bastiat wrote that "Government is the great fiction, through which everybody endeavors to live at the expense of everybody else." Inflation is just another government program. Hazlitt writes, "...every inflation affects different persons and different prices *unequally* and at *different* times....Inflation always benefits some groups...before it benefits other groups, and more than it benefits other groups. And in most cases it benefits these first groups *at the direct expense* of the other groups....The political appeal of inflation comes from fostering the illusion in the great majority of voters that they will somehow get the better of the swindle, and profit at the expense of a few unidentified victims.... everybody cannot get rich at the expense of everybody else....The early minority can only [protect themselves from inflation] at the expense of the majority."

Hazlitt explains the problem of "the money illusion," which is the assumption that a dollar today has the same value as a dollar in the past, probably because in a world of uncertainty, the human brain is desperate to latch onto anything that seems to provide certainty: "We are so accustomed to measuring our incomes and our economic welfare in purely monetary [dollar] terms that we cannot break ourselves of the habit....Yet so strong and persistent is the money illusion that millions of people who are worse off in terms of the real purchasing power of their incomes probably imagine themselves to be better off because their dollar income is so much higher."

"[This illusion] will often be found together with...the special-case illusion. This is the belief that the reason my own money-income has gone up [over time] is that I have been personally very lucky or very talented, whereas the reason the prices *I* have to pay have gone up is just 'inflation'."

Trying to determine the intrinsic value of a stock is hard enough as it is, but consider how much more difficult it becomes when the yardstick you're using keeps changing. Hazlitt writes, "Whenever any inflation gets beyond a critical point (which can never be known in advance), the social losses and evils it brings are certain to cancel and exceed any initial gains....The whole structure of production becomes distorted. Businessmen and corporations are deceived by the way inflation falsifies their books....It becomes impossible for business managers to know to what extent their paper profits are real. But these profits often *look* bigger and bigger on paper."

These profits "provoke charges of 'profiteering.' Demagogues use them to inflame class hatreds against business." Statists blame the resulting poverty, hunger and financial and economic chaos on greed, speculators, hoarders and capitalism.

Hazlitt summarizes the problem with inflation: "Inflation makes it possible for some people to get rich by speculation and windfall instead of by hard work. It rewards gambling and penalizes thrift. It conceals and encourages waste and inefficiency in production. It finally tends to demoralize the whole community. It promotes speculation, gambling, squandering, luxury, envy, resentment, discontent, corruption, crime, and increasing drift toward more intervention which may end in dictatorship....Inflation is a twisted magnifying lens through which everything is confused, distorted, and out of focus, so that few men are any longer able to see realities in their true proportions....One of the worst consequences of inflation is that most of its mischiefs and injustices are irreparable."

What's the cure for inflation? "Stop inflating." Stop printing. Abolish the Fed.

Finally, I leave you with this quote by John Maynard Keynes:

“Lenin is said to have declared that the best way to destroy the capitalist system was to debauch the currency. By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. By this method they not only confiscate, but they confiscate arbitrarily; and, while the process impoverishes many, it actually enriches some. The sight of this arbitrary rearrangement of riches strikes not only at security but [also] at confidence in the equity of the existing distribution of wealth.”

“Those to whom the system brings windfalls, beyond their deserts and even beyond their expectations or desires, become 'profiteers,' who are the object of the hatred of the bourgeoisie, whom the inflationism has impoverished, not less than of the proletariat. As the inflation proceeds and the real value of the currency fluctuates wildly from month to month, all permanent relations between debtors and creditors, which form the ultimate foundation of capitalism, become so utterly disordered as to be almost meaningless; and the process of wealth-getting degenerates into a gamble and a lottery.”

“Lenin was certainly right. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose.”

What You Should Be Doing Now

As of the end of March, the UK stock market was the 11th cheapest in the world. I track about the 14 cheapest such stock markets, and the UK scores first (or possibly second) overall when you consider the tax burden, corruption and ease of doing business. Additionally, the UK does not impose a withholding tax on dividends received from UK companies, so UK stocks work well in a tax-deferred account as well as a taxable account. In recent weeks and days, UK stocks (especially small caps) have been crashing, and I have started to slowly nibble at select dividend payers with sound fundamentals and attractive prices.

Keep an eye on silver, too, which will be a buy if it drops about 5% lower.

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Generally, I don't have time to answer questions about your specific situation, but if you have a general question that I think other readers also have, let me know and I will provide an answer in a future issue.

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Before starting a new diet or exercise regimen, you should consult with a doctor, nutritionist, dietician, or personal trainer.