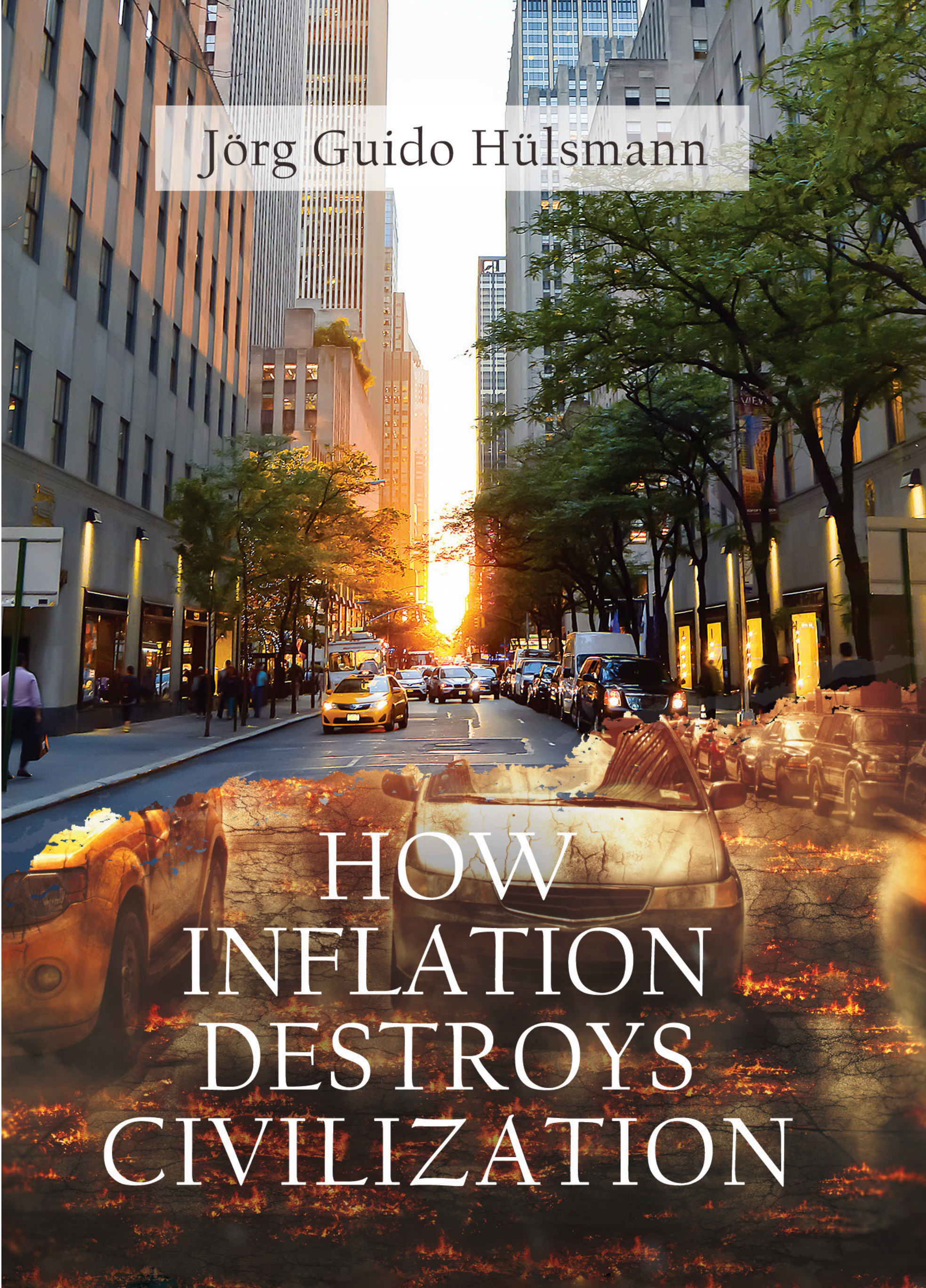
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HOW
INFLATION
DESTROYS
CIVILIZATION

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How Inflation Destroys Civilization

The notion that inflation is harmful is a staple of economic science. But most textbooks underrate the extent of the harm, because they define inflation much too narrowly as a lasting decrease of the purchasing power of money (PPM), and also because they pay scant attention to the concrete forms of inflation. To appreciate the disruptive nature of inflation in its full extent we must keep in mind that it springs from a violation of the fundamental rules of society.

Inflation is what happens when people increase the money supply by fraud, imposition, and breach of contract. Invariably it produces three characteristic consequences: (1) it benefits the perpetrators at the expense of all other money users; (2) it allows the accumulation of debt beyond the level debts could reach on the free market; and (3) it reduces the PPM below the level it would have reached on the free market.

While these three consequences are bad enough, things get much worse once inflation is encouraged and promoted by the state (fiat inflation). The government's fiat makes inflation perennial, and as a result we observe the formation of inflation-specific institutions and habits. Thus fiat inflation leaves a characteristic cultural and spiritual stain on human society. In what follows, we will take a closer look at some aspects of this legacy.

1. Hyper-centralized Government

Inflation benefits the government that controls it, not only at the expense of the population at large, but also at the expense of all secondary and tertiary governments. It is a well-known fact that the European kings, during the rise of their nation states in the seventeenth and eighteenth centuries, crushed the major vestiges of intermediate power. The democratic nation states of the nineteenth and twentieth centuries completed the centralization of power that had been begun under the kings. The economic driving force of this process was inflation, which at that point was entirely in the hands of the central state apparatus. More than any other economic reason, it made the nation state irresistible. And thus it contributed, indirectly at least, to the popularity of nationalistic ideologies, which in the twentieth century ushered in a frenetic worshipping of the nation state.

Inflation spurs the growth of central governments. It allows these governments to grow larger than they could become in a free society. And it allows them to monopolize governmental functions to an extent that would not occur under a natural production of money. This comes at the expense of all forms of intermediate government, and of course at the expense of civil society at large. The inflation-sponsored centralization of power turns the average citizen more and more into an isolated social atom. All of his social bonds are controlled by the central state, which also provides most of the services that formerly were provided by other social entities such as family and local government. At the same time, the central direction of the state apparatus is removed from the daily life of its protégés.

2. Fiat Inflation and War

Among the most gruesome consequences of fiat money, and of paper money in particular, is its ability to extend the length of wars. The destructions of war have the healthy effect of cooling down initial war frenzies. The more protracted and destructive a war becomes, therefore, the less is the population inclined to support it financially through taxes and the purchase of public bonds. Fiat inflation allows the government to ignore the fiscal resistance of its citizens and to maintain the war effort on its present level, or even to increase that level. The government just prints the notes it needs to buy cannons and boots.

This is exactly what happened in the two world wars of the twentieth century, at least in the case of the European states. The governments of France, Germany, Italy, Russia, and the United Kingdom covered a large part of their expenses through inflation. It is of course difficult to evaluate any precise quantitative impact, but it is not unreasonable to assume that fiat inflation prolonged both wars by many months or even one or two years. If we consider that the killings have reached their climax toward the end of the war, we must assume that many millions of lives could have been saved.

Many people believe that, in war, all means are just. In their eyes, fiat inflation is legitimate as a means to fend off lethal threats from a nation. But this argument is rather defective. It is not the case that all means are just in a war. There is in Catholic theology a theory of just war, which stresses exactly this point. Fiat inflation would certainly be illegitimate if less offensive means were available to attain the same end. And fact is that such means exist and have always been at the disposition of governments, for example, credit money and additional taxation.

Another typical line of defense of fiat money in wartime is that the government might know better than the citizens just how close victory is at hand. The ignorant population grows weary of the war and tends to resist additional taxation. But the government is perfectly acquainted with the situation. Without fiat money, its hands would be tied, with potentially disastrous consequences. The inflation just gives it the little extra something needed to win.

It is of course conceivable that the government is better informed than its citizens. But it is difficult to see why this should be an obstacle in war finance. The most essential task of political leadership is to rally the masses behind its cause. Why should it be impossible for a government to spread its better information, thus convincing the populace of the need for additional taxes? This brings us to the following consideration.

3. Inflation and Tyranny

War is just the most extreme case in which fiat inflation allows governments to pursue their goals without genuine support from their citizens. The printing press allows the government to tap the property of its people without having obtained their consent, and in fact against their consent. What kind of government is it that arbitrarily takes the property of its citizens? Aristotle and many other political philosophers have called it tyranny. And monetary theorists from Oresme to Mises have pointed out that fiat inflation, considered as a tool of government finance, is the characteristic financial technique of tyranny.

4. Race to the Bottom in Monetary Organization

As Austrian economists have argued in some detail, fiat inflation is an inherently unstable way of producing money because it turns moral hazard and irresponsibility into an institution. The result is frequently recurring economic crises. Past efforts to repair these unwelcome effects, yet without questioning the principle of fiat inflation per se, have entailed a peculiar evolution of monetary institutions—some sort of an institutional "race to the bottom."

Important milestones of this process were fractional-reserve banking, national central banking, international central banking, and finally paper money. The devolution of monetary institutions has been on its way for centuries, and it has still not quite reached the absolute bottom, even though the process has accelerated very considerably in our age of paper money.

5. Business under Fiat Inflation

Fiat inflation has a profound impact on corporate finance. It makes liabilities (credits) cheaper than they would be on a free market. This prompts entrepreneurs to finance their ventures to a greater extent than otherwise through credits, rather than through equity (the capital brought into the firm by its owners).

In a natural system of money production, banks would grant credit only as financial intermediaries. That is, they could lend out only those sums of money that they had either saved themselves or which other people had saved and then lent to the banks. The bankers would of course be free to grant credits under any terms (interest, securities, duration) they like; but it would be suicidal for them to offer better terms than those that their own creditors had granted them. For example, if a bank receives a credit at 5 percent, it would be suicidal for it to lend this money at 4 percent. It follows that on a free market, profitable banking is constrained within fairly narrow limits, which in turn is determined by the savers. It is not possible for a bank to stay in business and to offer better terms than the savers who are most ready to part with their money for some time.

But fractional-reserve banks can do precisely that. Since they can produce additional banknotes at virtually zero cost, they can grant credit at rates that are lower than the rates that would otherwise have prevailed. And the beneficiaries will therefore finance some ventures through debts that they would otherwise have financed with their own money, or which they would not have started at all. Paper money has very much the same effect, but in a far greater dimension. A paper-money producer can grant credits to virtually any extent and at virtually any terms. In the past few years, the Bank of Japan has offered credits at 0 percent interest, and it right now proceeds in some cases to actually pay people for taking its credits.

It is obvious that few firms can afford to resist such offers. Competition is fierce in most industries, and the firms must seek to use the best terms available, lest they lose that "competitive edge" that can be decisive for profits and also for mere survival. It follows that fiat inflation makes business more dependent on banks than they otherwise would be. It creates greater hierarchy and central decision-making power than would exist on the free market. The entrepreneur who operates with 10 percent equity and 90 percent debts is not really an entrepreneur anymore. His creditors (usually bankers) are the true entrepreneurs who make all essential decisions. He is just a more or less well-paid executive—a manager.

Thus fiat inflation reduces the number of true entrepreneurs—independent men who operate with their own money. Such men still exist in astonishing numbers, but they can only survive because their superior talents match the inferior financial terms with which they have to cope. They must be more innovative and/or work harder than their competitors. They know the price of independence and they are ready to pay it. Usually they are more attached to the family business and care more for their employees than any anonymous banker.

Because credits springing from fiat inflation provide an easy financial edge, they have the tendency to encourage reckless behavior by the chief executives. This is especially the case with managers of large corporations who have easy access to the capital markets. Their recklessness is often confused with innovativeness.

The economist Josef Schumpeter has famously characterized fractional-reserve banking as some sort of a mainspring of innovative economic development, because it provides additional money for entrepreneurs with great ideas.

It is conceivable that in some cases it played this role, but the odds are overwhelmingly on the other side. As a general rule, any new product and any thoroughgoing innovation in business organization is a threat for banks, because they are already more or less heavily invested in established companies, which produce the old products and use the old forms of organization. They have therefore every incentive to either prevent the innovation by declining to finance it, or to communicate the new ideas to their partners in the business world.

Thus, fractional-reserve banking makes business more conservative than it otherwise would be. It benefits the established firms at the expense of innovative newcomers. Innovation is much more likely to come from independent businessmen, especially if income taxation is low.

6. The Debt Yoke

Some of the foregoing considerations also apply outside of the business world. Fiat inflation provides easy credits not only to governments and firms, but also to private persons. The mere fact that such credits are offered at all incites some people to go into debt who would otherwise have chosen not to do so. But easy credits become nearly irresistible in connection with another typical consequence of inflation, namely, the constantly rising price level. Whereas in former times the increase of prices has been barely noticeable, in our day all citizens of the Western world are aware of the phenomenon. In countries such as Turkey or Brazil, where prices increase at annual rates of 80 to 100 percent, even younger people have personally experienced it.

Such conditions impose a heavy penalty on cash savings. In the old days, saving was typically done in the form of hoarding gold and silver coins. It is true that such hoards did not provide any revenue—the metal was "barren"—and that they therefore did not lend themselves to the lifestyle of rentiers. But in all other respects money hoards were a reliable and effective form of saving. Their purchasing power did not just evaporate in a few decades, and in times of economic growth they even gained some purchasing power.

Most importantly, they were extremely suitable for ordinary people. Carpenters, masons, tailors, and farmers are usually not very astute observers of the international capital markets. Putting some gold coins under their pillow or into a safe deposit box saved them lots of sleepless nights, and it made them independent of financial intermediaries.

Now compare this old-time scenario with our present situation. The contrast could not be starker. It would be completely pointless in our day to hoard dollar or euro notes to prepare for retirement. A man in his thirties who plans to retire thirty years from today (2004) must calculate with a depreciation factor in the order of 3. That is, he needs to save three dollars today to have the purchasing power of one of these present-day dollars when he retires. And the estimated depreciation factor of 3 is rather on the low side!

It follows that the rational saving strategy for him is to go into debt in order to buy assets the price of which will increase with the inflation. This is exactly what happens today in most western countries. As soon as young people have a job and thus a halfway stable source of revenue, they take on credit to buy a house—whereas their great-grandfather might still have first accumulated savings for some thirty years and then bought his house in cash. Needless to say that the latter has always been the Christian way. In Saint Paul's letter to the Romans (13:8) we read: "Owe nothing to anyone, except to love one another; for the one who loves another has fulfilled the law."

Things are not much better for those who have already accumulated some wealth. It is true that inflation does not force them into debt, but in any case it deprives them of the possibility of holding their savings in cash. Old people with a pension fund, widows, and the wardens of orphans must invest their money into the financial markets, lest its purchasing power evaporate under their noses. Thus they become dependent on intermediaries and on the vagaries of stock and bond pricing.

It is clear that this state of affairs is very beneficial for those who derive their living from the financial markets. Stockbrokers, bond dealers, banks, mortgage corporations, and other "players" have reason to be thankful for the constant decline of money's purchasing power under fiat inflation. But is this state of affairs also beneficial for the average citizen? In a certain sense, his debts and increased investment in the financial markets are beneficial for him, given our present inflationary regime.

When the increase of the price level is perennial, private debt is for him the best available strategy. But this means of course that without government interventionism into the monetary system other strategies would be superior. The presence of central banks and paper money make debt-based financial strategies more attractive than strategies based on prior savings.

It is not an exaggeration to say that, through their monetary policy, Western governments have pushed their citizens into a state of financial dependency unknown to any previous generation. Already in 1931, Pius XI stated:

> . . . it is obvious that not only is wealth concentrated in our times but an immense power and despotic economic dictatorship is consolidated in the hands of a few, who often are not owners but only the trustees and managing directors of invested funds which they administer according to their own arbitrary will and pleasure.
>
> This dictatorship is being most forcibly exercised by those who, since they hold the money and completely control it, control credit also and rule the lending of money. Hence they regulate the flow, so to speak, of the life-blood whereby the entire economic system lives, and have so firmly in their grasp the soul, as it were, of economic life that no one can breathe against their will.[1]

One wonders what vocabulary Pius XI would have used to describe our present situation. The usual justification for this state of affairs is that it allegedly stimulates industrial development. The money hoards of former times were not only sterile; they were actually harmful from an economic point of view, because they deprived business of the means of payments they needed for investments. The role of inflation is to provide these means.

However, money hoarding does not have any negative macroeconomic implications. It does definitely not stifle industrial investments. Hoarding increases the purchasing power of money and thus gives greater "weight" to the money units that remain in circulation. All goods and services can be bought, and all feasible investments can be made with these remaining units. The fundamental fact is that inflation does not bring into existence

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[1]Pius XI, *Quadragesimo Anno* (1931), §§ 105, 106. See also Deuteronomy 28: 12, 43–44.

any additional resource. It merely changes the allocation of the existing resources. They no longer go to companies that are run by entrepreneurs who operate with their own money, but to business executives who run companies financed with bank credits.

The net effect of the recent surge in household debt is therefore to throw entire populations into financial dependency. The moral implications are clear. Towering debts are incompatible with financial self-reliance and thus they tend to weaken self-reliance also in all other spheres. The debt-ridden individual eventually adopts the habit of turning to others for help, rather than maturing into an economic and moral anchor of his family, and of his wider community. Wishful thinking and submissiveness replace soberness and independent judgment. And what about the many cases in which families can no longer shoulder the debt load? Then the result is either despair or, on the contrary, scorn for all standards of financial sanity.

7. Some Spiritual Casualties of Fiat Inflation

Fiat inflation constantly reduces the purchasing power of money. To some extent, it is possible for people to protect their savings against this trend, but this requires thorough financial knowledge, the time to constantly supervise one's investments, and a good dose of luck. People who lack one of these ingredients are likely to lose a substantial part of their assets. The savings of a lifetime often vanish in thin air during the last few years spent in retirement. The consequence is despair and the eradication of moral and social standards. But it would be wrong to infer that inflation produces this effect mainly among the elderly. As one writer observed:

> These effects are "especially strong among the youth. They learn to live in the present and scorn those who try to teach them 'old-fashioned morality and thrift.' Inflation thereby encourages a

> mentality of immediate gratification that is plainly at variance with the discipline and eternal perspective required to exercise principles of biblical stewardship—such as long-term investment for the benefit of future generations."[2]

Even those citizens who are blessed with knowledge, time, and luck to protect the substance of their savings cannot evade inflation's harmful impact, because they have to adopt habits that are at odds with moral and spiritual health. Inflation forces them to spend much more time thinking about their money than they otherwise would. We have noticed already that the old way for ordinary citizens to make savings was the accumulation of cash. Under fiat inflation this strategy is suicidal. They must invest into assets the value of which grows during the inflation; the most practical way to do this is to buy stocks and bonds. But this entails many hours spent on comparing and selecting appropriate titles. And it compels them to be ever watchful and concerned about their money for the rest of their lives. They need to follow the financial news and monitor the price quotations on the financial markets.

Similarly, people will tend to prolong the phase of their life in which they strive to earn money. And they will place relatively greater emphasis on monetary returns than on any other criterion for choosing their profession. For example, some of those who would rather be inclined to gardening will nevertheless seek an industrial employment because the latter offers greater long-run monetary returns. And more people will accept employment far from home, because it allows them to earn just some little extra money, than under a natural monetary system.

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[2]Thomas Woods, "Money and Morality: The Christian Moral Tradition and the Best Monetary Regime," *Religion & Liberty* 13, no. 5 (Sept./Oct. 2003). The author quotes Ludwig von Mises.

The spiritual dimension of these inflation-induced habits seems to be obvious. Money and financial questions come to play an exaggerated role in the life of man. Inflation makes society materialistic. More and more people strive for money income at the expense of personal happiness. Inflation-induced geographical mobility artificially weakens family bonds and patriotic loyalty. Many of those who tend to be greedy, envious, and niggardly anyway fall prey to sin. Even those who are not so inclined by their natures will be exposed to temptations they would not otherwise have felt. And because the vagaries of the financial markets also provide a ready excuse for an excessively parsimonious use of one's money, donations for charitable institutions will decline.

Then there is the fact that perennial inflation tends to deteriorate product quality. Every seller knows that it is difficult to sell the same physical product at higher prices than in previous years. But increasing money prices are unavoidable when the money supply is subject to relentless growth. So what do sellers do? In many cases the rescue comes through technological innovation, which allows for a cheaper production of the product, thus neutralizing or even overcompensating the countervailing influence of inflation. This is, for example, the case with personal computers and other equipment built with a large input of information technology.

But in other industries, technological progress plays a much smaller role. Here the sellers confront the above-mentioned problem. They then fabricate an inferior product and sell it under the same name, along with the euphemisms that have become customary in commercial marketing. For example, they might offer their customers "light" coffee and "non-spicy" vegetables—which translates into thin coffee and vegetables that have lost any trace of flavor. Similar product deterioration can be observed in the construction business. Countries plagued by perennial inflation seem to have a greater share of houses and streets that are in constant need of repair than other countries.

In such an environment, people develop a more than sloppy attitude toward their language. If everything is what it is called, then it is difficult to explain the difference between truth and lie. Inflation tempts people to lie about their products, and perennial inflation encourages the habit of routine lies. The present writer has argued in other works that routine lies play a great role in fractional-reserve banking, the basic institution of the fiat money system. Fiat inflation seems to spread this habit like a cancer over the rest of the economy.

8. Suffocating the Flame

In most countries, the growth of the welfare state has been financed through the accumulation of public debt on a scale that would have been unthinkable without fiat inflation. A cursory glance at the historical record shows that the exponential growth of the welfare state, which in Europe started in the early 1970s, went in hand with the explosion of public debt. It is widely known that this development has been a major factor in the decline of the family. But it is commonly overlooked that the ultimate cause of this decline is fiat inflation. Perennial inflation slowly but assuredly destroys the family, thus suffocating the earthly flame of Christian morals.

The Christian family is the most important "producer" of a certain type of morals. Family life is possible only if all members endorse norms such as the legitimacy of authority, the heterosexual union between man and woman, and the prohibition of incest. And Christian families are based on additional norms such as the love of the spouses for one another and for their offspring, the respect of children for their parents, the reality of the Triune God, the truth of the Christian faith, etc. Parents constantly repeat, emphasize, and live these norms. This daily experience "brain-washes" all family members into accepting them as the normal state of affairs. In the wider social sphere, then, these persons act as advocates of the same norms in business associations, clubs, and politics.

Friends and foes of the traditional Christian family agree on these facts. It is among other things because they recognize the family's effectiveness in establishing social norms that Christians seek to protect it. And it is precisely for the same reason that advocates of moral license seek to destroy it. The welfare state has been their preferred tool for the past thirty years. Today the welfare state provides a great number of services that in former times were provided by families (and which, we may assume, would still be provided to a large extent by families if the welfare state ceased to exist). Education of the young, care for the elderly and the sick, assistance in times of emergencies—all of these services are today effectively "outsourced" to the state. The families have been degraded into small production units that share utility bills, cars, refrigerators, and of course the tax bill. The tax-financed welfare state then provides them with education and care.[3]

From an economic point of view, this arrangement is a pure waste of money. The fact is that the welfare state is inefficient; it provides comparatively lousy services at comparatively high costs. We need not dwell on the inability of government welfare agencies to provide the emotional and spiritual assistance that only springs

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[3]In many countries it is today possible for families to deduct expenses for private care and private education from the annual tax bill. But ironically (or maybe not quite so ironically) this trend has reinforced the erosion of the family. For example, recent provisions of the U.S. tax code allow family budgets to increase through such deductions—but only if the deductible services are not provided at home, but bought from other people.

from charity. Compassion cannot be bought. But the welfare state is also inefficient in purely economic terms. It operates through large bureaucracies and is therefore liable to lack incentives and economic criteria that would prevent the wasting of money. In the words of Pope John Paul II:

> By intervening directly and depriving society of its responsibility, the Social Assistance State leads to a loss of human energies and an inordinate increase of public agencies, which are dominated more by bureaucratic ways of thinking than by concern for serving their clients, and which are accompanied by an enormous increase in spending. In fact, it would appear that needs are best understood and satisfied by people who are closest to them and who act as neighbours to those in need. It should be added that certain kinds of demands often call for a response which is not simply material but which is capable of perceiving the deeper human need.[4]

Everyone knows this from first-hand experience, and a great number of scientific studies drive home the same point. It is precisely because the welfare state is an inefficient economic arrangement that it must rely on taxes. If the welfare state had to compete with families on equal terms, it could not stay in business for any length of time. It has driven the family and private charities out of the "welfare market" because people are forced to pay for it anyway. They are forced to pay taxes, and they cannot prevent the government from floating ever-new loans, which absorb the capital that otherwise would be used for the production of different goods and services.

The excessive welfare state of our days is an all-out direct attack on the producers of Christian morals. But it weakens these morals also in indirect ways, most notably by subsidizing bad moral

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[4]John Paul II, *Centesimus Annus*, § 48.

examples. The fact is that some alternative "life styles" carry great economic risks and therefore tend to be more expensive than the traditional family arrangements. The welfare state socializes the costs of such behavior and therefore gives it far greater prominence than it would have in a free society.

Rather than carrying an economic penalty, public license might then actually go hand in hand with economic advantages, because it dispenses the protagonists from the costs of family life (for example, the costs associated with raising children). With the backing of the welfare state, these protagonists may mock conservative morals as some sort of superstition that has no real-life impact. The spiritual dimension seems to be clear: The welfare state systematically exposes people to the temptation of believing that there are no time-tested moral precepts at all.

Let us emphasize that the point of the preceding observations was not to attack welfare services, which are in fact an essential component of Christian societies. The point is, rather, that fiat inflation destroys the democratic control over the provision of these services; that this invariably leads to excessive growth of the aggregate welfare system and to excessive forms of welfare; and that this in turn is not without consequences for the moral and spiritual character of the population.

The foregoing considerations are by no means an exhaustive account of the cultural and spiritual legacy of fiat inflation. But they should suffice to substantiate the main point: that fiat inflation is a powerhouse of social, economic, cultural, and spiritual destruction.

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