

Why Bread Will Soon Cost \$10 Per Loaf

Imagine that your old car is nearing the end of its life and you are considering the purchase of a new vehicle. You visit the dealer and find a car you like, but its price is a bit more than you can afford—so you decide to delay the purchase until next year. Now imagine that the government has decided to give every family in the United States a “new car voucher” valued at \$5,000. The voucher can be used only to purchase a new car, and only by the family in whose name the voucher was issued. There is no expiration date on the voucher. When you buy a new car, you give the voucher to the dealer. He applies the voucher amount to the purchase price, and when he redeems it he will be given \$5,000 by the government.

What would happen in that scenario? More than likely you will decide to buy that new car now, rather than next year. So you head down to the dealer to buy the car—and discover that the dealer has boosted its price by several thousand dollars. Are you surprised? You should not be, because you are not the only person who received a new car voucher in the mail. In fact, five other people are looking at the same car you want to buy. Why *wouldn't* the dealer increase his prices? Yesterday he had 100 cars on the lot and only three or four prospective buyers in the showroom. Today he still has about 100 cars on the lot—but now he has 20 far more serious buyers in the showroom. The number of cars has not gone up, but there are many more people—with many more dollars—eager to buy those same cars. Not surprisingly, the prices are increased.

If the government did not have the funds to pay for the \$5,000-per-household car vouchers, it might issue the vouchers anyway and then simply send \$5,000 checks to the car dealers when they redeem the vouchers. By printing new currency to cover those checks, the government “inflates” the money supply. The additional dollars in the economy cause an increase in prices. The term “inflation” actually refers to the process of “inflating the money supply,” *not* the price increases themselves. Technically, rising prices are not inflation; they are the *result* of inflation. (That is how we *should* think, but that is not how the government *wants* us to think. The government wants us to blame the middleman—the car dealer—not the person turning on the printing press that churns out the money.)

Now let's look at a few individual Americans. John and his wife Mary go to work and together earn \$1,500 per week. In exchange for that \$1,500, John and Mary provide their employers with productive work that creates goods or services for the economy. John, Mary, and the economy are in equilibrium. They earn \$1,500 through productive work, and they spend or save \$1,500. It evens out. John and Mary may spend all of their \$1,500 every week, or they may spend some of it and save some of it. In any event, the \$1,500 that existed before they received their paychecks still exists; it has simply been moved around. The economy still has that \$1,500 *somewhere*.

But Mike, a neighbor of John and Mary, is on welfare. Let's assume Mike collects \$1,200 per month in welfare benefits. (The exact amount is not important for this argument.) But keep in mind that, unlike John and Mary, Mike is *not* creating any goods or services—

because Mike is on welfare. Mike did not earn that \$1,200. He was simply given the money by the government.

In the space of one month, John and Mary earn \$6,000 (\$1,500 per week times four weeks), and Mike is given \$1,200 in welfare payments. Between the three of them they have \$7,200 to spend or save in the economy each month. But only \$6,000 in goods or services was created between the three of them each month. Mike received \$1,200, but produced nothing. John and Mary produced \$6,000 in goods or services and received \$6,000 in return.

Let's consider where Mike's \$1,200 comes from. If the federal budget is in balance, Mike's \$1,200 in welfare benefits is fully funded by taxes. John and Mary might earn \$6,000 per month, but pay \$1,200 in taxes, which ends up being given to Mike. John and Mary create \$6,000 worth of goods or services but, after taxes, have only \$4,800 to spend. Mike has \$1,200 to spend. Together the three of them spend \$6,000, which balances the \$6,000 of wealth that two of them, John and Mary, created. Prices do not increase because the supply of goods and services created matches the cash demand. There is no inflation; the money supply has not been inflated. That \$6,000 existed at the beginning of the month, and it still existed at the end of the month. It did, however, change hands—going from the two employers, directly to John and Mary, and indirectly to Mike.

Problems arise, however, when the federal budget is *not* in balance. If the government is not collecting enough in taxes to cover expenditures and has to print money to cover the difference, rising prices are the result—because the supply of money has been inflated. Here is what happens:

John and Mary still have their jobs, and Mike is still on welfare. But now Erica loses her job and goes on welfare. Let's assume Erica, like Mike, is also given \$1,200 per month in welfare benefits. What is the situation now? John and Mary earn \$6,000 per month and pay \$1,200 per month in taxes. The government now needs an additional \$1,200 per month to pay Erica's welfare benefits. But it does not dare increase John's and Mary's taxes to \$2,400 per month. What, then, does the government do? It prints money. It creates an additional \$1,200 per month out of thin air.

Each month John and Mary continue to create \$6,000 per month in goods and services, for which they are paid \$6,000. They pay \$1,200 in taxes. Mike receives a \$1,200 welfare payment. Erica also receives a \$1,200 welfare payment. Together, they have earned \$6,000 per month. But they are now spending \$7,200 per month: John and Mary have \$4,800 to spend; Mike has \$1,200 to spend; and Erica has \$1,200 to spend. *There is no longer an equilibrium.* Collectively, the four of them have earned \$6,000. But, collectively, they are spending \$7,200. Because that \$1,200 difference is newly-printed cash not backed up by productive work (or gold), the result will be rising prices.

Why? For the same reason that free “car vouchers” would cause car prices to rise: *there is more cash available to spend on the same amount of goods and services.* John, Mary,

Mike, and Erica may not be buying new cars, but they are buying *something*. They are spending \$7,200 on *something*. But they have only *created* \$6,000 worth of that *something*. As a result, the price of \$6,000 worth of goods and services increases to \$7,200. What used to cost \$6,000 now costs \$7,200.

There are tens of millions of Johns and Marys in the nation. But there are also tens of millions of Mikes and Ericas. If there is a limited number of Mikes and Ericas, the taxes paid by all the Johns and Marys are sufficient to subsidize those Mikes and the Ericas. The problem in today's economy is that there are far too few Johns and Marys, far too many Mikes and Ericas, and far too much money being printed to pay the bills of the Mikes and Ericas.

In each of the last three years the federal government has spent between \$1.2 and \$1.4 trillion *more* than it collected in tax revenue. The fourth consecutive year will be no different. Operating at a deficit is certainly not new to the government. It has not had a legitimate surplus in more than 40 years. But the massive deficits of the last three years are the straws that will break the camel's back. Or, perhaps more accurately, they are the tsunami of red ink that will overwhelm the United States—and that tsunami won't just affect people living near the beach. It will cause monumental misery for most of the nation's 310 million inhabitants.

When the government spends more than it collects in taxes, it tries to borrow the difference. China and Japan have been the primary lenders over the last few years. (Anyone who purchases a U.S. Savings Bond is also one of the lenders.) But in 2011 the Treasury Department had a great deal of trouble finding enough lenders to cover the government's debt. In fact, it could not find anywhere near enough lenders. As a result, more than 60 percent of all the money the federal government borrowed in 2011 came from the Federal Reserve. In other words, Treasury Secretary Timothy Geithner could not find enough suckers to lend him the \$1.3 trillion he needed to cover the Democrat/Republican/Obama deficit, so he had to turn to Federal Reserve Board chairman Ben Bernanke to bail him out.

The "Fed" bought about \$800 billion in Treasury bills, bonds, and notes. What most people never bother to ask is, "Where did the Federal Reserve get that money? Is Ben Bernanke, like Uncle Scrooge, sitting on trillions of dollars of cash and gold?" No, he is not. (Many argue that when Bernanke speaks he is about as incomprehensible as Scrooge's nephew, Donald Duck. In Bernanke's case it is intentional.) No, the Fed did not have \$800 billion lying around doing nothing. So where did that money come from? The answer is that Bernanke simply created \$800 billion via bookkeeping entries, and... *presto! The new money appeared!* Geithner issued \$800 billion in Treasury bonds, which Bernanke placed in a file cabinet somewhere. Geithner then updated the federal government's books to show that it had an additional \$800 billion—*money that did not even exist the day before*.

With that sneaky process out of the way, the Treasury Department had \$800 billion in new money with which to pay the federal government's bills. That new \$800 billion

helped cover checks to Social Security recipients, Medicare and Medicaid payments to doctors and hospitals, payments to military contractors, salaries of federal employees and soldiers, loans to Solyndra, food stamps, GSA conventions in Las Vegas, millions of hollow-point bullets for Homeland Security, interest on the national debt, and so on. As those checks are cashed and the funds are spent, that new money filters its way through the private economy.

Price increases are the inevitable result of that new money. Why? Because the nation suddenly has \$800 billion more in cash floating around, yet the nation is still creating the same amount of goods and services it was the day before Bernanke “created” that \$800 billion. In other words, there is more money chasing after the same amount of goods and services. That \$800 billion in new money is like the \$5,000 car vouchers. But while the car vouchers would only cause the price of cars to rise, that \$800 billion causes the price of almost everything to rise.

There are about 130 million working people in the United States, like John and Mary. But there are about 310 million Americans. That means there are 180 million people whose lives depend on the other 130 million. That 180 million includes, of course, people who cannot work and who are not expected to work, such as children, senior citizens, and disabled persons. *But there are an estimated 88 million Americans of working age who can work but who are not working.* Some want to work but cannot find jobs (and are counted as unemployed); some have stopped looking for work (and, to Obama’s advantage, are not counted in the “official” unemployment rate); some can work but choose not to; some are collecting welfare benefits; some are faking injuries or illnesses in order to collect disability benefits; and many have moved back in with their parents or in-laws. Mike and Erica are among those 88 million.

Of course, no one expects John and Mary’s children to work; they are the responsibility of John and Mary, who use some of their \$4,800 of monthly after-tax income to provide them with food, shelter, and clothing. That is not inflationary, because the family’s expenses are in equilibrium. (Two people directly provide for four, but the four consume no more than what the two earn.)

However, there are now tens of millions of millions of Americans who are not children dependent on their parents, but adults *dependent on the U.S. government*. The recipients of welfare, Medicaid, etc. are producing nothing yet are being given hundreds of billions of dollars per year to spend. (A portion of the nation’s Social Security recipients can also be counted in that group, because the system is operating at a deficit: each year it pays out more than it collects in FICA taxes. One can reasonably argue that the retirees are merely being paid back what they paid into the system, so they should not be blamed for the federal deficits. But the problem is that the money they paid into the system was spent long ago. It was not “set aside” and invested for their old age. Collectively, therefore, Social Security recipients now increase the federal deficit. That statement is *not* intended to assign any blame to them—the blame is the government’s for having spent their retirement assets. It is merely a recognition of reality. To the extent that the Social

Security system is in the red—paying out in benefits more than it collects in taxes each year—it is inflationary, because money must be printed to cover the shortfall.)

The problem we now face is that the federal government cannot possibly raise taxes high enough to cover the \$1.3 trillion annual deficit. That shortage amounts to \$10,000 for each and every one of those 130 million working Americans. Who believes that those 130 million workers could afford—let alone be willing—to pay \$10,000 more per year in taxes? Can John and Mary afford an additional \$20,000 per year in taxes based on their annual income of \$72,000? Obama and others argue, “Well, let’s just raise taxes on the top one percent!” But that means only 1.3 million of those 130 million working people would have to cover the \$1.3 trillion shortage, or \$1 million per person per year. Most of the people in the top one percent do not even earn \$1 million per year. How, then, can they be taxed an additional \$1 million each? Even Warren Buffet, Bill Gates, and Donald Trump could not cover the \$1.3 trillion annual deficit. If the government were to forcefully confiscate *all* of their wealth to help cover the 2012 deficit, what would it do in 2013, when they would no longer have anything left to confiscate? Or 2014? Or 2015?

The government is therefore in a bind. It cannot raise taxes enough to cover the deficit. Even Obama’s proposed “Buffet tax” of a minimum 30 percent on all millionaires would raise no more than \$5 billion per year. That would reduce the \$1.3 trillion deficit to a “mere” \$1.295 trillion. *That* certainly would not solve the problem.

Because it needs an extra \$1.3 trillion per year, the government tries to borrow that amount. But, as noted, the Treasury Department cannot find enough buyers of U.S. debt. Thus, Ben Bernanke inflates the money supply, enabling the Treasury to pay its bills with newly-printed dollars. That expansion of the money supply causes prices increases.

Federal spending certainly needs to be slashed, but even if almost all federal programs were eliminated there would still be a revenue shortage. The “entitlement programs” alone (Social Security, Medicare, Medicaid) plus interest on the national debt eat up *all* the tax revenue. Not half. Not most. *All* the tax revenue. After paying for entitlement spending and interest, *there is no money left for anything else*. There is no money to pay the salaries of our Armed Forces, let alone the costs of operating the Departments of Homeland Security, Interior, Energy, Education, Commerce, Housing and Urban Development, Veterans Affairs, State, Justice, FBI, CIA, NPR... or Senator Harry Reid’s cowboy poetry festivals.

Again, it is *impossible* to raise taxes enough to balance the federal budget. Entitlement spending must be reduced along with everything else, or the government will simply collapse under its own weight. But few politicians have the courage to address the situation with honesty, and those who do are excoriated by the leftist media and called hard-hearted evildoers eager to throw grandmothers over cliffs and drown puppies and kittens. What will happen, therefore, is that the government will simply continue to print money to cover its annual deficits. That inflation of the money supply will lead to continued prices increases. *Those price increases cannot be avoided*. What cost \$2 will soon cost \$5. And that \$5 will soon be \$10. The standard of living of virtually all

Americans will decline. That outcome can be avoided only if the voters elect candidates who are willing to be honest about the nation's fiscal problems and who are ready to address them. Regrettably, there are not many candidates like that on the ballots. But Americans need to support the candidates who understand that the food stamps of the person in front of you in the supermarket check-out line are paid for not just with your taxes, but also with the higher food prices that are caused by the expansion of the money supply.

Gary North, author of *Mises on Money*, points out, "The monetary base in 2008 was \$900 billion. Today, it is \$2.9 trillion. This was the largest expansion of the monetary base in peacetime U.S. history." In other words, there is more than three times as much cash in the economy today as there was in 2008. When you have three times as much cash and essentially the same amount of goods and services, it is impossible *not* to eventually experience massive price increases. If the government passed out \$2.1 trillion in car vouchers, for example, would the price of cars not skyrocket? If all the Johns and Marys earn \$900 billion but all the Mikes and Ericas are given \$2 trillion to spend, would prices not go up?

The only reason that massive amount of newly-printed money has not yet caused equally massive price increases is that much of it has not yet circulated through the economy. It is not being spent. It is being held by banks that are afraid to lend it because they have no confidence that new borrowers have the ability to pay it back, and it is being held by businesses that are afraid to expand their operations and hire new workers because they fear the massive taxes and regulations coming in 2013 and 2014 as a result of ObamaCare and other legislation passed over the last few years. But when that money eventually "hits the streets," it will cause *monumental* price increases. It cannot be avoided.

Economist and *New York Times* columnist Paul Krugman writes, "Many pundits assert that the U.S. economy has big structural problems that will prevent any quick recovery. All the evidence, however, points to a simple lack of demand, which could and should be cured very quickly through a combination of fiscal and monetary stimulus." Krugman could not be more wrong. There certainly *are* "big structural problems"—notably, too many Mikes and Ericas and too few Johns and Marys. Krugman, like most Democrats and too many Republicans, supports discredited Keynesian economics. He wants more government stimulus spending—paid for by printing money, or "monetary stimulus"—even though it will further increase the deficit and did not work when it was tried in 2009. The nation does not need more demand (more Mikes and Ericas); it needs more supply (more Johns and Marys).

Krugman believes that if enough money is printed and passed around, the demand for goods and services will result in job creation. In other words, if you distribute enough car vouchers then Detroit will have to hire more workers to build more cars. On the surface that argument may have some appeal. But that manipulation works only in the short run. After the vouchers have been exhausted, car sales return to normal levels and the newer workers get laid off. (That was the case with Obama's failed "Cash for Clunkers")

program.) Even worse, the car prices remain at the higher levels—and any money borrowed from China to fund the stimulus must be repaid with interest. Krugman and Obama see a leaky bath tub and, rather than working to fix the leak, advocate opening the faucet as far as it can go—leaving others to pay the water bill. Or, to use another water analogy, Krugman and Obama promise “enough lifeboats for all!” when they should be working to steer clear of the icebergs.

We do not need more Mikes and Ericas spending newly-*printed* dollars. We need more Johns and Marys spending and saving newly-*earned* dollars. The solutions to the problems of the economy include giving the Mikes and Ericas an incentive to find a job, giving businesses reasons to believe things will get better rather than worse, and drastically slashing the federal budget so that the money-printing frenzy can come to an end. If the next president does not work with the next Congress to do those things, the problems will only get worse—and Americans will soon learn that the cost of “free” birth control will not just be higher taxes, it will be \$10 loaves of bread.

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May 9, 2012