Chapter 19, Part A

_____1. Inflation is
a. rising prices
b. an undue increase in the quantity of money
c. an increase in the quantity of money more rapid than the increase in the supply of gold
d. all of the above
e. (b) and (c) but not (a)

_____2. "Demand-pull inflation"
a. refers to an increase in the quantity of money and volume of spending as pulling prices up in the face of limited supplies of goods or services
b. is alleged to be the only way in which increases in the quantity of money and volume of spending can succeed in raising prices
c. both (a) and (b)

_____3. "Cost-push inflation"
a. alleges that prices rise from the side of supply rather than from the side of demand
b. is presented as a mutually exclusive alternative to the quantity theory of money, whose operation is allegedly confined to "demand-pull inflation"
c. both (a) and (b)

_____4. The doctrine of "cost-push inflation" embraces rising prices allegedly caused by
a. rising wage rates, in which case it is known as "wage-push inflation"
b. the greed of businessmen for higher profits, which is described as "profit-push" or "sellers' inflation"
c. sudden substantial reductions in the supply of critical materials, such as oil, in which case it is described as "crisis-push inflation"
d. all of the above

_____5. The doctrine of the "wage-price spiral" rests on the doctrine of cost-push inflation.

_____6. Like "cost-push inflation," so-called demand-pull inflation is also supposed to take a variety of forms. In addition to being caused by an increase in the quantity of money, it is supposed to be capable of being caused by
a. inexplicable increases in the velocity of circulation of money
b. the unexplained existence of "inflation psychology"
c. the growing use of credit cards, installment credit, or other forms of credit
d. the increasing greed of consumers for more goods
e. all of the above

_____7. Since numerous possibile causes can be adduced to explain rising prices in this or that case, the definition of inflation as rising prices results in people having no ready idea of what causes inflation at any given time.

_____8. The definition of inflation as rising prices implies that
a. if businessmen did not raise their prices, inflation would not exist
b. the greed of businessmen is responsible for inflation
c. the imposition of price controls would stop inflation by prohibiting the rise in prices
d. all of the above

_____9. The definition of inflation as rising prices distinguishes between prices rising from the side of demand (i.e., from the side of money and spending) and prices rising from the side of production and supply.

_____10. The definition of inflation as rising prices can lead to the government's inflation of the money supply in misguided efforts to hold interest rates down or to pay subsidies to producers in order to enable them to sell at below-market prices.

_____11. The formula for the general consumer price level is $P = \frac{D_C}{S_C}$.

_____12. The formula for the general consumer price level limits the direct, immediate explanation of rising prices to either a rise in aggregate demand or fall in aggregate supply and implies that if an alleged cause of rising prices cannot be shown to cause one or the other of these two direct causes, then it is simply not a cause of rising prices.

_____13. As far as it goes, the effect of supply on prices in the United States and practically all other countries over the last seventy years has been
a. a continuing rise brought about by a progressive fall in supply
b. a continuing fall brought about by a progressive rise in supply

_____14. Where falling supply has contributed to rising prices, its role has been relatively minor, in the most extreme cases accounting for perhaps as much as a doubling of prices over a period years over which prices rose many times more altogether.

_____15. In order for falling supply to account for a sustained 2 percent compound annual rise in prices,
a. supply would have to halve approximately every 35 years
b. supply would have to fall to approximately one-eighth of its initial level in little more than a century
c. the rapid disappearance of material civilization would be implied
d. all of the above

_____16. Falling supply is itself often the by-product of rapid increases in the quantity of money and aggregate demand.

_____17. An inflationary rise in prices includes not only a rise in the strict weighted average of all prices but also the fact that all prices, or at least the far greater part of them, are able to rise at the same time.

_____18. In cases in which a fall in supply takes place in the production of a necessity or a vital material, i.e., in any case in which the demand for a product is inelastic, the outcome will be

a. a rise in the price of the item more than proportionate to the reduction in its supply
b. a rise in the amount of money spent to buy that item and a corresponding fall in the amount of money spent to buy other items
c. a tendency toward a fall in prices wherever spending has had to decline in order to make possible the concentration of funds on the purchase of the good in reduced supply.
d. all of the above

_____19. Because it would be accompanied by a fall in many prices, falling supply cannot explain the range of price increases that exists under inflation, which extends to all goods and services, or at least to the far greater part of them, at the same time.

_____20. In contrast to falling supply, the combination of an increase in the quantity of money and rising aggregate demand is capable of raising all prices at the same time and so satisfies the requirement of explaining the necessary range of price increases that exists under inflation.

_____21. An inflationary rise in prices includes not only a rise in the strict weighted average of all prices, and in at least the broad range of prices, but also a systematic tendency for stockholders to gain at the expense of bondholders and for debtors in general to gain at the expense of creditors.

_____22. Rising prices caused by falling supply do not enable stockholders and other debtors to gain at the expense of bondholders and other creditors, because falling supply does nothing to increase the monetary income or wealth of the average stockholder or creditor, who is in the position of having as many fewer physical units of goods and wealth as the price per unit of goods and wealth has risen.

_____23. Rising prices caused by falling supply are incompatible with the debtor/creditor effects associated with inflation.

_____24. Rising prices caused by falling supply, such as would result from massive enemy bombing of factories in a war, would result in stockholders actually being worse off than bondholders as the result of rising prices, because they would lose their capitals to a greater extent than the bondholders, as well as having to pay the same higher prices as the bondholders.

_____25. Unlike rising prices caused by falling supply, rising prices caused by rising aggregate demand

a. are accompanied by rising monetary incomes and wealth on the part of stockholders and debtors, which enables these groups to gain as prices rise, to the extent that their monetary incomes and wealth rise more rapidly than prices
b. are fully compatible with the debtor/creditor effects associated with inflation
c. both (a) and (b)

_____26. The belief that falling supply is a cause of inflation implies

a. the belief that rising supply is a cause of deflation and thus of depression
b. the overproduction doctrine
c. both (a) and (b)

_____27. Falling aggregate supply must be eliminated as the cause of an inflationary rise in prices, leaving only rising aggregate demand because

a. with few exceptions supply has increased over the period in which prices have been rising, making its actual contribution a reduction in prices compared with what they otherwise would have been
b. where supply did fall, its fall could not begin to explain the extent of the rise in prices
c. reductions in supply are frequently the result of rapid increases in aggregate demand
d. reductions in supply as a sustained cause even of moderately rising prices would imply the disappearance of material civilization at a rate rivaling or surpassing that of the collapse of the Roman Empire
e. all of the above

_____28. Falling aggregate supply must be eliminated as the cause of an inflationary rise in prices, leaving only rising aggregate demand because it

a. cannot explain the range of price increases associated with inflation
b. cannot explain the effects on the relations between stockholders and bondholders, and debtors and creditors in general, associated with inflation
c. implies the overproduction doctrine
d. all of the above

_____29. People are led to believe that the rising prices of the last two generations could not have been caused by rising aggregate demand, but only by rising costs of production or the greed for higher profits, because they mistakenly believe that more demand raises prices only at the point of full employment, which we have not had during this time, and short of that point serves merely to increase employment.

_____30. The cost-push doctrine is mathematically equivalent to blaming rising prices on falling supply, since it claims that no increase in demand is necessary, which leaves only falling supply as the explanation of rising prices.

The following is a four-part question.

Starting from a position of full employment and given unchanged aggregate demands for consumers' goods and labor, an unchanged productivity of labor, and an unchanged size of the labor force, calculate the unemployment rate that would result from

_____31. A cumulative rise in wage rates of 10 percent.

_____32. A cumulative rise in wage rates of 25 percent.

_____33. A cumulative rise in wage rates of 33 1/3 percent.

_____34. The effect of wage increases imposed by labor unions is to create mounting unemployment if there is no increase in the quantity of money and thus in aggregate demand.

_____35. Starting from a position of full employment, and recalling that in the depths of the Great Depression the unemployment rate did not exceed 25 percent, calculate to what extent labor unions could succeed in raising wage rates before bringing about an unemployment rate comparable to that of the great depression, if there were no increase in the quantity of money and thus in aggregate demand.

_____36. Given the fact that a mounting unemployment rate would finally lead to an end to further union wage demands as more and more of the unions' membership came to be added to the unemployment roles, and even assuming that the unemployment rate that would be necessary for this would be as high as that of the Great Depression, the maximum, cumulative effect of labor unions driving up wage rates would be an increase in priceson the order of one-third.

_____37. In the early 1980s, an unemployment rate briefly in excess of 11 percent was sufficient to eliminate most of "wage push."

_____38. Starting from a position of full employment and given unchanged aggregate demands for consumers' goods and labor and an unchanged size of the labor force, but now assuming a doubling of the productivity of labor over the same period of time that the labor unions succeed in driving up wage rates sufficiently to cause a Great-Depression level of unemployment, calculate the change in the general consumer price level.

_____39. If, over the same period of time that the unions were driving up wage rates, the productivity of labor were to rise, prices could actually fall substantially, despite the rise in wage rates.

_____40. Over time, labor unions are not a significant cause of rising prices, but of unemployment.

_____41. "In order for "wage-push" to have a sustained significant effect on the general consumer price level, and avoid burning out in mounting unemployment, it must be sustained by an increasing quantity of money and rising aggregate demand."

_____42. The increase in the quantity of money and rising aggregate demand

a. allows "wage push" to continue because it removes the brake of mounting unemployment
b. calls wage push into being when it otherwise would not exist, by virtue of reducing or removing the threat of its causing additional unemployment
c. positively encourages wage push by virtue of raising nominal profits, which constitutes a veritable red flag to the unions and their demands for wage increases
d. causes prices of goods available only in limited quantity to rise, which, together with rising prices caused by the unions' previous wage demands, leads the unions to demand wage increases to keep pace with price increases
e. all of the above

_____43. Given that wage push could not be very significant in the absence of increases in the quantity of money and volume of spending, it follows that the intellectual zone of explanation of rising prices previously regarded as belonging to the wage-push doctrine should henceforth be regarded as having been annexed by the quantity theory of money.

_____44. The "profit-push" doctrine claims that the greed of businessmen for profits is what drives up prices.

_____45. In the absence of increases in demand even a protected legal monopolist, while almost certainly charging high prices, would not charge continually *rising* prices.

_____46. Even if a protected legal monopolist were faced with a rising demand for his particular product, no rise in the general consumer price level would be present in the absence of a rise in *aggregate* demand, because in that case the rise in demand for the monopolist's product would presuppose or cause an equivalent fall in the demand for other products and thus operate to reduce the prices of other products.

_____47. Apart from the case of protected legal monopolists, the normal operation of the profit motive is steadily to reduce prices, not increase them, because a major way to earn premium profits is to reduce the costs of production, which cost reductions competition passes on to consumers.

_____48. What explains the association between rising prices and higher nominal profits is an increasing quantity of money and rising aggregate demand, which raises both prices and sales revenues, which latter serves to increase profit margins and thus the rate of profit.

_____49. The "crisis-push" doctrine refers to the price-raising effects of sudden substantial reductions in the supply of critical materials, such as oil.

_____50. In the absence of increases in the quantity of money and aggregate demand, supply crises while causing dramatic increases in the prices of some goods, would result in numerous price reductions, including reductions in prices that constitute costs of production, because the concentration of spending on the goods whose supply had been reduced would come from spending on numerous other goods, whose prices would thus be driven down.

_____51. The effect of a decrease in the supply of oil is to

a. increase
b. decrease

the demand for automobiles, iron and steel, and the services of auto workers and steel workers

_____52. A decrease in the supply of oil is what explains the rising prices of all other materials and in the prices based on the prices of those other materials.

_____53. Any given supply crisis is unable to explain more than a one-time delimited rise in the general consumer price level corresponding to the extent to which it serves to reduce aggregate supply.

_____54. In the absence of increases in the quantity of money and aggregate demand, the resolution of any given supply crisis should usually be expected to be followed by a reduction in the general consumer price level, probably all the way to the point of where the price level was before the crisis.

_____55. In judging the effects of supply crises, the public and the media confuse

a. the dramatic rise in the price of the good whose supply is in crisis and in the prices of its products, with a general rise in prices, failing to realize that the steep rise in the price of the good whose supply is in crisis implies a reduction in many other prices
b. an essentially one-time, delimited rise in prices with a continuing rise in prices
c. both (a) and (b)

_____56. The public's views about the effects of supply crises on prices are misled by the fact that news of the crisis appears on page one of the newspapers, while news of its resolution is more likely to appear on page fifty-one.

_____57. In order to explain a rising price level on the basis of supply crises, one would have to find not only replacement crises for the ones that have been solved, but additional crises as well. And in the next year, one would have to find replacements for this larger number of crises, along with still more additional crises; and this would have to go on from year to year at a compound rate.

_____58. According to the wage-price spiral doctrine, prices rise because wages rise, and wages rise because prices rise. Wages and prices, it is believed, simply chase each other upward in a spiral, and that is why prices go on rising.

_____59. In the absence of increases in the quantity of money and aggregate demand, any wage-price spiral would quickly burn itself out in mounting unemployment. This proposition is illustrated by the phenomenon of "givebacks" in the early 1980s, when it was common for labor unions to give up their contractual right to such things as cost of living increases.

_____60. The "velocity" doctrine

a. admits the essential role of rising aggregate demand in raising prices
b. denies the essential role of increases in the quantity of money in raising aggregate demand
c. implies that spending rises because of decreases, often unexplained, in the demand for money for holding
d. all of the above

_____61. Increases in velocity caused by factors such as growing security of property and the development of financial markets and financial institutions are accompanied by an increase in the number of stages in production and a corresponding need for more stages of spending in the ultimate production of consumers' goods, and also by increases in the production and supply of consumers' goods. Therefore, it is unlikely that they would be a cause of rising prices of consumers' goods.

_____62. Increases in the quantity of money operate to raise velocity by means of reducing the demand for money for holding.

_____63. Increases in the quantity of money reduce the demand for money for holding by means of

a. causing rising prices, which can lead to people prefering to buy sooner rather than hold cash to buy later
b. creating the belief that cash can readily be obtained by borrowing it, thus reducing the need to hold it, which belief is the result of inflation in the form of credit expansion
c. causing rising demand for products and thus a greater ability to liquidate inventories easily and profitably, thereby encouraging the holding of more inventory and less cash
d. raising short-term interest rates and making it worthwhile to lend out sums that otherwise would have been held in cash
e. all of the above

_____64. All that is required to reduce velocity is to cut back on the rate of increase in the quantity of money, the effect of which will be to raise the demand for money for holding by going in reverse along the lines indicated in the choices in the previous question.

_____65. Velocity is lower in countries with less rapidly increasing quantities of money and higher in countries with more rapidly increasing quantities of

money—for example, it is much higher in Brazil than in the United States.

_____66. Velocity is higher in the United States today than it was when the country was on the gold standard and its money supply increased less rapidly.

_____67. Since the early ’80s, velocity has declined, along with slowing of the increase in the quantity of money.

_____68. The intellectual zone of explanation previously claimed by the velocity doctrine should henceforth be regarded as annexed by the quantity theory of money. For it is the growth in the quantity of money that explains the inflationary rise in the velocity of circulation of money.

_____69. Properly understood, the term “inflation psychology” refers to the various ways in which a rapidly expanding quantity of money reduces the desire of people to hold money.

_____70. Inflation psychology is

a. caused by prolonged experience of the fact of inflation

b. an uncaused primary that explains inflation

_____71. Inflation psychology operates from the side of supply as well as from the side of demand. It does so by influencing the expectations of sellers.

_____72. Inflation psychology operates from the side of supply when

a. businessmen come to anticipate that in the years ahead inflation will raise the replacement costs of their plant and equipment, and that they must begin to raise prices today, in order to be in a position to accumulate sufficient replacement funds

b. workers demand wage increases in order to cover the rise in prices they expect to occur over the life of their employment contracts

c. landlords demand rent increases to cover the rise in prices and costs they expect to occur over the life of their rental contracts

d. lenders demand interest rates high enough to cover the increase in prices they expect to occur over the life of their loan contracts

e. all of the above

_____73. In operating in the ways described in the previous question and thus leading to a rise in prices in advance of the actual increase in spending, inflation psychology makes inflation into a cause of unemployment.

_____74. What is required to eliminate inflation psychology is

a. speeches by public officials ridiculing it and urging people to abandon it

b. the government’s stopping its policy of inflation

_____75. Once its policy of inflation has created inflation psychology, stopping inflation may not immediately appear to work, because, in the belief that the government will soon resume its policy of inflation, people may have placed themselves in even more overextended positions, in which they are operating with even lower money balances, have further increased their borrowings, and are asking still higher wages and prices. In such conditions, the elimination of inflation psychology is likely to be accompanied by a major recession.

_____76. Inflation psychology would not be a problem under a gold standard because it would have little or no factual basis. To the extent such a psychology began to develop, it would quickly run up against the fact that the money supply did not keep up with it, because it simply could not. At that point, the consequence would be that inflation psychology would disappear.

_____77. The “credit-card doctrine” holds that credit cards make possible a rise in spending without any expansion in the quantity of money and thus serve to raise prices.

_____78. The use of credit cards, such as the American Express card, in which the whole balance due is payable at once, requires the existence of two cash balances instead of one to finance the same purchase: the checking-account balance of the credit-card customer to pay his credit-card bill, and a cash balance by the credit-card company to pay the merchant. Thus, it is arguable that the use of this credit card serves actually to reduce the velocity of money rather than increase it, despite the fact that people no longer need to hold as much currency as they otherwise would.

_____79. Insofar as the possession of credit cards may actually contribute to a rise in velocity, by representing guaranteed lines of credit and thereby sparing people the need to hold cash balances as large as before, the rise in velocity is to be attributed to the ability of the banking system to increase the quantity of money, because this is what makes possible the granting of lines of credit not based on savings. Where savings are the foundation of the lines of credit, the process originates in a decline in spending elsewhere in the economic system and thus will not serve to increase overall spending in the economic system.

_____80. According to the consumer-installment-credit doctrine, prices rise because the granting of consumer-installment credit enables consumers to make an additional demand for goods.

_____81. To the extent that consumer-installment credit or any other form of credit is granted out of savings, it does not serve to increase aggregate demand, but merely to divert the ability to spend from the saver ot the borrower.

_____82. The granting of credit is inflationary when the funds lent are newly created, not when they are the result of saving.

_____83. Debts incurred through the borrowing of

savings are not inflationary, while debts incurred through the borrowing of newly created money are inflationary.

_____84. The "consumer-greed" doctrine is the claim that inflation is the result of the consumers' "greed," including their desire for a higher standard of living.

_____85. The consumer-greed doctrine mistakenly assumes that
a. "greed" implies a reduction in the demand for money for holding
b. the effect "greed"—i.e., of the desire for a higher standard of living—is to raise prices rather than lower them by virtue of people's efforts to produce more, as the means of earning higher incomes
c. both (a) and (b)

_____86. What is required to make "consumer greed" translate into a lower demand for money for holding rather than a higher demand for money for holding is the government's policy of inflation, which penalizes the ownership of cash holdings through rising prices.

_____87. As far as the explanations of rising prices other than the quantity theory of money contain any kernel of validity at all, it is only as an extension of the quantity theory of money.

_____88. The undue increase in the quantity of money that underlies the rise in prices must be laid at the door of the government, because
a. the moneys chosen by the market were, and would be again, in the absence of government intervention, gold and silver, which are moneys that do not increase at a rate sufficient to cause a sustained, significant rise in prices
b. in the last seventy years, the government of the United States, like that of virtually every other country, has had unlimited power to expand the quantity of fiat paper money and has made ample use of that power
c. both (a) and (b)

_____89. All of the knowledge concerning the cause of rising prices can be summarized in a definition of inflation as an increase in the quantity of money more rapid than the increase in the supply of gold and silver, which is to say, an increase in the quantity of money caused by the government.

_____90. In contrast to the definition of inflation as rising prices, the definition of inflation in the preceding question provides
a. essential comprehensive knowledge concerning the cause of rising prices
b. the ability to understand the causation of the full range of symptoms associated with inflation
c. the ability to distinguish between rising prices caused by more demand and rising prices caused by less supply
d. knowledge concerning how to stop inflation
e. the ability to raise further questions about the causes and effects of inflation properly understood
f. all of the above

Chapter 19, Part B

_____91. A government budget deficit
a. means an excess of government spending over its tax revenues
b. requires that the government borrow equivalent funds
c. both (a) and (b)

_____92. Government borrowing can be from
a. the citizens (other than the fractional-reserve banking system)
b. the central bank (in the US, the Federal Reserve System)
c. from the private, fractional-reserve banking system
d. all of the above

_____93. Government borrowing from the central bank entails the creation of new and additional standard money, which the central bank creates and then lends to the government.

_____94. Government borrowing from the private, fractional-reserve banking system typically entails the creation of new and additional checking deposits, which is what the banks lend.

_____95. Government borrowing from the central bank or from the fractional-reserve banking system entails the creation of new and additional money, while government borrowing from the citizens does not.

_____96. Government budget deficits financed by the creation of new and additional money
a. enable the government to increase its spending without the citizens having to decrease their spending
b. result in an elevation of the level of total spending as the new and additional money passes from hand to hand
c. is inflationary
d. all of the above

_____97. Government budget deficits
a. when financed by the savings of the citizens, are accompanied by a reduction in spending on the part of the citizens or on the part of those to whom the citizens would otherwise have lent the money
b. in and of themselves are not inflationary
c. both (a) and (b)

_____98. Government budget deficits are
a. inflationary insofar as they are financed by the creation of new and additional money
b. not inflationary insofar as they are financed by the lending of previously accumulated savings
c. both (a) and (b)

_____99. If the monetary unit were gold, whose supply the government and the banking system cannot increase, budget deficits could not be financed by the creation of new and additional money.

_____100. Inflation can take place while the government operates with a budget surplus, if the central bank or the fractional-reserve banking system buys up previously issued government securities and thereby creates new and additional money.

_____101. Only the budget deficit of the federal government can be inflationary, not those of state or local governments, because only the federal government has the power to create new and additional money and to place the fractional-reserve banking system in a position to create such money. Lacking that power, the states and localities are essentially forced to borrow only from the citizens.

_____102. No matter how large its debt becomes, the ability of the federal government to create new and additional money prevents it from going bankrupt in the technical sense of not having the money available to meet its debt, so long as its debt is payable in the kind of money that it can create.

_____103. Because creating money to pay its debt reduces the purchasing power of money and thus cannot serve to repay debt defined in terms of a given purchasing power, the federal government has probably long been bankrupt in the sense of an inability to repay its debt in terms of the same purchasing power in which the debt was contracted.

_____104. So long as the federal government has the power to create money, no lack of money compels it to reduce its spending or its indebtedness.

_____105. Compelling the government to limit its spending and indebtedness requires depriving it of the ability to create new and additional money.

_____106. If the monetary unit were defined as a fixed weight of gold, of a definite finess, as it was in the United States from 1788 to 1933, the government, not being able to create gold, could not enlarge the basic money supply and thus could not finance its deficits by means of inflation.

_____107. In the absence of the ability to inflate the money supply, government budget deficits
a. would not be inflationary
b. would ultimately lead to government bankruptcy if pursued as a policy
c. both (a) and (b)

_____108. The specter of government bankruptcy under a gold standard, and the accompanying uncertain political and economic climate, would lead to
a. an increased demand for gold for holding
b. an increased demand for gold for export
c. a threat to the solvency of the banking system, insofar as its assets included government securities
d. a threat to the quantity of money, insofar as gold was exported and insofar as government securities provided backing for fractional-reserve checking deposits or bank notes
e. all of the above

_____109. Answers to the previous question imply that under a gold standard, government budget deficits would ultimately be deflationary rather than inflationary.

_____110. Government budget deficits have the potential to be deflationary even in the short-run, to the extent that their financing deprived business firms of working capital—a highly unlikely result in today's conditions, but very possible under a gold standard.

_____111. The motives and rationale for budget deficits and inflation can be described under the following headings:
a. the welfare state
b. inflation and war finance
c. inflation and the "easy money" doctrine
d. inflation as the alleged cure for unemployment
e. all of the above

_____112. Deficits, and the inflation to finance them, are the cornerstone of the welfare state. They are indispensable in order to lend the appearance of reality to the belief that the government is the source of free benefits, which belief is the fundamental delusion underlying the welfare state.

_____113. The ability to inflate is valued in part because it makes it possible for the government to finance wars which it would not be politically possible to finance through taxation.

_____114. Inflation in the form of a policy of "easy money" is supported by the belief that credit expansion is a means of creating capital and lowering interest rates.

_____115. Probably the most important single root of the policy of inflation in the present day is the belief that inflation is necessary in order to prevent or combat mass unemployment.

_____116. An underlying influence of the socialist ideology is present in the use of inflation to finance the welfare state, in that
a. the expansion in government functions and powers entailed in the growth of the welfare state is a major step toward the establishment of socialism
b. both the welfare state and socialism itself are advocated in the name of the alleged helplessness

of the average individual and the alleged omniscience and omnipotence of the State
c. inflation creates the appearance of the kind of relationship between the individual and the State described in (b): on the one side stands the individual with his unmet needs, and on the other side, the State, ready to help with funds not derived from individuals, but miraculously created outside the economic system, out of thin air
d. all of the above

_____117. The socialist ideology and support for the "easy money" doctrine overlap insofar as
a. both share a belief in the existence of free benefits, in this case the alleged benefit of capital costlessly created out of thin air by the manufacture of new and additional money
b. credit expansion and its accompanying reduction in the rate of interest is perceived to be the means of achieving the "euthenasia of the rentier"—Keynes's effort to achieve the goals of Marxism without the necessity of a revolution
c. both (a) and (b)

_____118. The belief that inflation is necessary to prevent or combat unemployment is largely an indirect result of the influence of the socialist ideology. This is because the labor legislation and other government interference that creates the problem of mass unemployment in the first place is the result of the influence of the Marxian exploitation theory, which holds that in the absence of government interference on behalf of higher wages, wage rates will go to the level of minimum subsistence.

_____119. A policy of government budget deficits is incompatible with the principle of representative government, since it obligates future generations to pay taxes for the payment of principal and interest on a debt neither they nor their representatives have any role in incurring and which their representatives cannot be present to oppose.

_____120. The government's ability to inflate the money supply has contributed to the growth in the size of the government relative to the economic system by making new and additional government programs appear costless, because the government is no longer under the compulsion of financing them by raising taxes. This enables supporters of the programs merely to describe their prospective benefits, while opponents are depicted as maliciously opposing the benefits.

_____121. The government's ability to inflate the money supply destroys peoples' understanding of the fact that the government is supported by them and leads them to believe instead that they are supported by the government.

_____122. The government's ability to inflate the money supply underlies the belief that Washington, D. C., a city that is economically insignificant in terms of what it produces or contributes to production, is nevertheless capable of bailing out the economies of such major cities as Detroit, Newark, and New York, indeed, the economies of entire states and multistate regions.

_____123. When the gold standard is overthrown and the government gains the power to spend funds it does not have to obtain from the people,
a. the government can no longer easily be viewed as deriving its powers and rights from the people
b. the government is enabled to throw off its status as the servant of the people, deriving its just powers from the consent of the governed, and to appear instead in the guise of the Provider and Father of the people, with the people deriving their existence, powers, and rights from the government
c. a veritable revolution occurs in the relationship between the government and the people
d. all of the above

_____124. Inflation operates to redistribute wealth and income from creditors to debtors, as the result of
a. the rising prices it causes
b. its increasing the incomes and monetary wealth of the debtors, while the incomes and monetary wealth of the creditors are contractually fixed
c. (a) and (b) in combination

_____125. To the extent that their corporations are debtors, stockholders receive the benefits of debtors during inflation.

_____126. A government's power to inflate is potentially capable of achieving a redistribution of wealth and income among its citizens on a scale rivaling that of the French and Russian revolutions.

_____127. Inflation does not raise all prices at the same time and to the same extent, but rather raises some prices sooner than other prices.

_____128. In addition to its effects on the redistribution of wealth and income between debtors and creditors, inflation also redistributes real income in favor of those who receive the new and additional money relatively early, and who are thus in a position to buy at prices that have not yet rise for the most part, and those who receive it only later on and who have had to buy at rising prices before their selling prices and incomes rose.

_____129. Those who introduce the new and additional money gain at the expense of others, inasmuch as they are enabled to consume without having had to produce, and thereby drain away part of the production of others without providing goods and services in exchange.

_____130. The poor and the elderly have traditionally been among the worst victims of inflation, because they frequently must live on fixed incomes while inflation proceeds to drive up the prices of practically everything they must buy.

The following is a three-part question.

_____131. Inflation makes the traditionally safest types of investments, such as high grade bonds, life insurance policies, and savings accounts, the least safe in terms of its potential damage to the purchasing power of such investments.

_____132. Under a fiat, paper money system, the safety of all such contractually fixed investments comes to depend on

a. the rate at which prices rise
b. the rate at which the quantity of money and volume of spending increases
c. knowledge of the quantity theory of money on the part of the government officials in charge of the increase in the money supply
d. the courage and integrity of government officials who may know and understand the quantity theory of money, to be quided by their knowledge in the face of political pressures urging more rapid increases in the quantity of money
e. all of the above

_____133. In making the traditionally safest types of investments the least safe, inflation undermines capital formation by placing the large number of people who require such investments, in the position either of having to turn to alternative vehicles, such as gold hoarding, which do not provide funds for business investment, or ceasing to save altogether, or doing so only on a smaller scale.

The following is an eleven-part question.

An imaginary tiny business firm buys a supply of merchandise for $100 and exactly one year later sells its merchandise for $110. The tax rate on profits is 50 percent and does not change. After some years the quantity of money and volume of spending in the economic system come to increase at a 10 percent compound annual rate, as do both the selling price and the replacement cost of the firm's merchandise.

_____134. State the firm's profit before the onset of inflation.

_____135. State the amount of tax the firm must pay before the onset of inflation.

_____136. State the amount of the firm's profit that it needs to use for the replacement of its merchandise, before the onset of inflation.

_____137. State the amount of after-tax profit remaining to the firm, before the onset of inflation, after it has made full allowance for replacement.

_____138. State the firm's sales revenues in the first year in which the inflation begins.

_____139. State the firm's profit in the first year of the inflation.

_____140. State the amount of tax the firm must pay in the first year of the inflation.

_____141. State the amount of the firm's profit that it needs to use for the replacement of its merchandise, in the first year of the inflation.

_____142. State the amount of after-tax profit remaining to the firm, in the first year of the inflation, after it has made full allowance for replacement.

_____143. Recalculate the firm's pretax profit to serve as a measure of its gain from operations only after full allowance for replacement of its merchandise has been made.

_____144. Calculate the percentage of the firm's restated profit in your answer to the preceding question that is constituted by the amount of taxes you previously calculated that the firm owed in the first year of the inflation.

The following is a fifteen-part question.

An imaginary business firm buys a machine that will last for 10 years for $1 million. It depreciates the machine on a straight-line basis over 10 years. In a period in which there is no inflation, the firm's annual sales revenues in connection with this machine are also $1 million, while its annual operating costs in connection with the machine are $850,000. Sometime during the course of the machine's depreciable life, inflation succeeds in doubling the quantity of money and volume of spending in the economic system and also in doubling the annual sales revenues and operating costs of this firm in connection with the use of this machine. It also succeeds in doubling the replacement price of the firm's machine to $2 million. Throughout, the rate of tax on profits remains unchanged at 50 percent.

_____145. Calculate the firm's annual gross profit (i.e., its profit pre-deduction of depreciation cost) in the year(s) before the start of the inflation.

_____146. Calculate the firm's annual depreciation charge in the year(s) before the start of the inflation.

_____147. Calculate the firm's annual net profit before tax in the year(s) before the start of the inflation.

_____148. Calculate the amount of tax the firm must pay on its profit in the year(s) before the start of the inflation.

_____149. Calculate the amount of the firm's profit that it needs to set aside for the replacement of its machine, in the year(s) before the start of the inflation.

_____150. Calculate the amount of after-tax profit remaining to the firm, in the year(s) before the start of the inflation, after it has made full allowance for replacement.

_____151. Calculate the firm's annual gross profit (i.e., its profit pre-deduction of depreciation cost) when sales revenues and operating costs have doubled.

_____152. Calculate the firm's annual depreciation charge when sales revenues and operating costs have doubled.

_____153. Calculate the firm's annual net profit before tax when sales revenues and operating costs have doubled.

_____154. Calculate the amount of tax the firm must pay on its profit when sales revenues and operating costs have doubled.

_____155. Calculate the amount of the firm's annual profit that it would need to set aside for the replacement of its machine at a price of $2 million, if somehow it had a full 10 years over which to accumulate an additional million dollars in repalcement funds.

_____156. Calculate the amount of after-tax profit remaining to the firm after making such additional allowance for replacement.

_____157. Recalculate the firm's pretax profit to serve as a measure of its gain from operations only after this necessary additional allowance for replacement of its machine has been made.

_____158. Calculate the percentage of the firm's restated profit in your answer to the preceding question that is constituted by the amount of taxes you previously calculated that the firm owed when its sales revenues and operating costs had doubled.

_____159. Inflation operates to increase the effective rate of taxation on business profits with unchanged rates of taxation. It does so by increasing the amount of profit that is subject to the unchanged tax rate at the same time that most of that additional profit is required for the repacement of assets whose prices inflation raises, and which thus does not represent any sort of genuine economic gain. The rise in the effective rate of tax is seen when recalculates pre-tax profit to allow for the additional funds required for replacement at higher prices and takes the tax the firm is required to pay as a percentage of that much smaller recalculated profit.

_____160. The preceding sets of questions show that the high nominal profits that accompany inflation are also accompanied by sharply reduced after-tax real profits.

_____161. The preceding sets of questions show that the public and the media know very well what they are talking about when they complain of high profits as the cause of inflation or as a source of benefit from inflation.

_____162. To offset the effects of inflation on profits, tax rates on profits need to be

a. raised to capture the unconscionable gains being reaped by large corporations

b. reduced in order to prevent the rise in the effective rate of taxation of real profits resulting from the enlargement of nominal profits and rise in replacement prices

_____163. In impoverishing people through rising prices and at the same time bloating nominal profits while reducing real profits, inflation both foments anti-capitalistic hostility and undermines economic activity.

The following is a thirteen-part question.

In a period of no inflation and no annual rise in prices, an individual has a capital of $1 million, which he lends out at a 4 percent annual interest rate. At the same time, there is a flat-rate proportional income tax of 25 percent, which remains unchanged all throughout. Subsequently, inflation ensues and succeeds in raising prices at an annual rate of 6 percent and in raising interest rates to 10 percent.

_____164. Calculate this individual's annual income from this $1 million of capital when there is no inflation.

_____165. Calculate the amount of this individual's income tax on the interest income from this $1 million of capital.

_____166. Calculate this individual's after-tax income derived from his ownership of this $1 million of capital.

_____167. State the amount of this individual's after-tax income derived from his ownership of this $1 million of capital that needs to be set aside and added to his capital in order to maintain the buying power of his capital at an unchanged amount, i.e., equal to that of $1 million the year before.

_____168. Calculate the rate of interest this individual earns on his million dollars of capital after deducting his payment of taxes on the interest income.

_____169. Calculate the rate of interest this individual earns on his million dollars of capital after deducting both his payment of taxes on the interest income and any necessary set aside of income to maintain the buying power of his capital.

_____170. Calculate an individual's annual income derived from $1 million of capital when inflation has raised interest rates to 10 percent.

_____171. Calculate his income tax on the income you stated in your answer to the preceding question.

_____172. Calculate his after-tax income.

_____173. Calculate the amount of this individual's after-tax income derived from his ownership of this $1 million of capital that now needs to be set aside and added to his capital in order to maintain the buying power of his capital at an unchanged amount, i.e., equal to that of $1 million the year before.

_____174. Calculate the amount of this individual's after-tax income derived from his ownership of this $1 million of capital that remains after setting aside the sum shown in answer to the previous question as necessary to maintain the buying power of his capital, i.e., his "real" income or gain on his capital.

_____175. Calculate the rate of interest this individual earns on his million dollars of capital after deducting both his payment of taxes on the interest income and any necessary set aside of income to maintain the buying power of his capital.

_____176. The preceding questions show that while sharply increasing nominal rates of interest and nominal interest incomes, inflation serves to sharply reduce real rates of interest and real interest incomes.

_____177. In the absence of inflation, assets such as houses, land, and buildings would not show any general or systematic tendency to rise. As a result, anyone selling existing such assets would generally not be subject to the payment of a capital gains tax. In this environment, we can imagine a vast collection of assets all of which have a given price, that we will call 100. Anyone selling an asset at the price of 100 can buy other such assets also at a price of 100. Now we imagine inflation to ensue, with the result that over a period of years, assets that were previously 100 now sell for 200. If the capital gains tax is 25 percent, calculate the quantity of other assets that a seller of a given asset for 200 will be able to buy after paying the capital gains tax.

_____178. Inflation operates to raise the effective rate of taxation on capital gains by virtue of systematically raising the prices of previously purchased assets, thereby creating taxable capital gains on those assets as and when they are sold, with the taxes being the greater, the greater is the inflation and the consequent rise in the prices. At the same time, after having paid the capital gains tax, the funds remaining to the sellers are the less adequate to buy comparable assets the more that prices have risen and the capital gains tax has deprived them of the funds needed to keep up.

_____179. Inflation can play a major role in the decay of the highways and other so-called infrastructure of a country. This is because as it pours new and additional revenues into their hands, governments frequently proceed as though the revenues were available for the expansion of government activities, and neglect the need to devote an adequate portion of them to replacement and maintenance at progressively rising prices. The result is decaying water and sewage systems, subway and rail lines, and bridges and tunnels, as well as decaying roads and highways.

_____180. The prosperity delusion of inflation
a. refers to the rise in nominal incomes and asset values that it creates and which leads people to believe that they are more prosperous and can thus afford to consume more, when in fact, after allowing for higher replacement prices and the higher prices that must be paid to acquire other assets, they are not more prosperous and cannot afford to consume more
b. serves to undermine saving and capital accumulation
c. both (a) and (b)

_____181. Even after people stop regarding themselves as enriched by inflation, inflation continues to promote overconsumption insofar as it leads people to believe that they still have positive investment income when in reality their position is one of losses.

_____182. In a period of inflation, with prices steadily rising, everyone has an exaggerated idea of the purchasing power of money, based on his past experience of prices, which, necessarily, is now outmoded. For example, his notion of the purchasing power of money rests in part on his estimate of the price of a new car or washing machine. But that estimate is based on his last experience of the prices of such goods, which may have occurred several months or even several years in the past, at which time the prices were undoubtedly lower than they are today. Thus, people consume in the mistaken belief that their incomes will enable them to afford to buy more than is actually possible at the now higher level of prices.

_____183. Inflation in the form of credit expansion operates
a. to reduce the rate of interest relative to the rate of profit
b. to raise both the rate of profit and the rate of interest absolutely
c. to encourage the incurrence of debt
d. all of the above

_____184. Von Mises has shown that credit expansion, and the artificial reduction in the rate of interest that it causes, creates the appearance of a more abundant supply of capital than in fact exists. On the basis of this appearance, businessmen are led to undertake projects for whose execution the actual supply of capital is inadequate. Such use of capital, for purposes inappropriate to the actual supply of capital, constitutes malinvestment.

_____185. Malinvestment is
a. the wasteful investment of capital
b. brought about by credit expansion and the low rate of interest it causes relatively to the rate of profit and to the rise in prices
c. exists in cases in which the profitability of an investment rests on no other foundation than credit expansion itself
d. exemplified by cases of wasteful inventory accumulation and wasteful investment in owner occupied housing
e. all of the above

_____186. Inflation in the form of credit expansion makes investments that actually lose in real terms ap-

pear to be profitable nonetheless, and to be profitable in fact to some investors.

The following is a five-part question.

In normal conditions, it does not pay to hold inventories for the sake of holding inventories. In fact, storage costs would make such behavior downright loss making. But now assume the existence of inflation strong enough to raise prices in general 15 percent per year, and the price of a specific commodity, say, copper, also 15 percent per year. Assume annual storage costs equal to 3 percent of the initial value of the copper. Assume also that credit expansion serves to keep the rate of interest at 10 percent.

_____187. Calculate the real rate of return on investing in an inventory of copper, holding it for a year, and selling it at a 15 percent higher price.

_____188. Calculate the percentage of the value of copper next year, after allowing for storage costs, that would nevertheless constitute the profit of a borrower if he can finance his investment in copper entirely with borrowed money.

_____189. Calculate the loss in real terms suffered by the lender.

_____190. The lender's loss finances the gain of the borrower and the loss on the investment as a whole.

_____191. The borrower's profit is made possible by the combination of the rise in prices and the relative lowness of the rate of interest, both of which are caused by inflation in the form of credit expansion.

The following is an eight-part question.

In the absence of inflation, with no secular trend of rising new-home prices, the prices of houses would tend to gradually decline as they got older. In such circumstances, buying a home would not often be thought of as an investment. Nevertheless to the extent that inflation proceeds more rapidly than houses depreciate, it makes the price of houses increase as they grow older. In this context imagine that the price of a home that is now 25 years old is twice as high as it was when the home was brand new. Over the same interval of time, however, the general consumer price level, including the price of new homes, has tripled. Assume that the home was originally purchased for $100,000, of which $80,000 was borrowed, and that through various refinancings, $80,000 continues to be owed on the house.

_____192. Calculate the real rate of return (taken as a total, not annualized) on the $100,000 investment made to purchase the new home, which is sold 25 years later at twice the price, when prices have tripled.

_____193. Calculate the homeowner's equity in the house at the time of its sale.

_____194. Calculate the homeowner's monetary profit on his investment.

_____195. Calculate the homeowner's real profit in terms of the prices prevailing in the year in which he purchased his home.

_____196. Calculate the mortgage lenders' loss in terms of the buying power of $80,000 at the time of sale when prices are 3 times higher than they were when the $80,000 was originally lent.

_____197. State the amount of loss in buying power on the overall original $100,000 investment in the house in terms of the prices that prevailed in the year in which the house was originally purchased.

_____198. Calculate the difference in real terms between the mortgage lenders' loss and the sum of the homeowner's gain plus the overall loss on the investment.

_____199. The mortgage lenders' loss finances the loss on the investment as a whole plus the gain of the homeowner.

_____200. In making home ownership a profitable investment for homeowners, inflation in the form of credit expansion encourages the diversion of savings and capital into home ownership at the expense of other investments.

_____201. Malinvestment impairs capital formation in reducing the efficiency with which existing capital is used, in that this holds down the production of new capital goods as well as new consumers' goods.

_____202. The existence of malinvestment confirms the proposition that inflation does not raise all prices at the same time and to the same extent, in that the credit expansion that causes it tends to raise the prices of such things as storable commodities and houses relative to most other prices, by virtue of creating an artificial additional demand for them based on the desire to take advantage of the special profit that such inflation creates in those lines.

_____203. When credit expansion and the malinvestment that it fosters come to an end, the prices of the goods and services artifially elevated relative to other prices then fall disproportionately relative to other prices.

_____204. The withdrawal-of-wealth effect is the uncompensated withdrawal of wealth from producers by the spenders of newly created money. It is essentially similar to the gains of counterfeiters, who take wealth out of the economic system while putting none in, and the corresponding loss of others.

_____205. The withdrawal-of-wealth effect

a. represents a diversion of capital to consumption insofar as the spenders of the new and additional money are consumers

b. represents probable malinvestment insofar as the spenders of the new and additional money are business firms, inasmuch as the firms which depend on the creation of new and additional money have proved unable to compete for capital on the regular loan market and require the subsidy that credit expansion represents
c. contributes to the undermining of capital formation
d. all of the above

_____206. Inflation operates to reduce the real rate of return on capital at the same time that it impairs capital formation via
a. the reversal-of-safety effect, which threatens savers with losses in terms of buying power
b. the tax effect, which diminishes the real after-tax rate of return through the rise in effective tax rates on profit and interest
c. the malinvestment effect, which represents the investment of capital in ways that are less efficient and actually loss-making in real terms
d. the withdrawal-of-wealth effect, which represents the withdrawal of wealth that constitutes part or all of firms' real rate of return on capital
e. all of the above

_____207. The fact that inflation reduces the real rate of return on capital as such implies that the gains of debtors resulting from inflation are less than the losses of creditors, a proposition which is explicitly demonstrated in the examples drawn from malinvestment in inventories and housing.

_____208. In its undermining of capital accumulation, inflation operates to
a. reduce the demand for capital goods relative to the demand for consumers' goods and the degree of capital intensiveness in the economic system
b. reduce the efficiency with which existing capital goods are employed
c. reduce the demand for labor relative to the demand for consumers' goods
d. reduce the productivity of labor
e. all of the above

_____209. As a result of its undermining of capital accumulation and thus both the productivity of labor and the so-called distribution factor, inflation serves to reduce real wages.

The following is a five-part question.

Assume that as a result of inflation's undermining of the foundations of real wages, the point has been reached where the prices of consumers' goods are rising more rapidly than wage rates, and the labor unions are imposing wage increases equal to the rate of price increases.

_____210. More specifically, assume that while the demand for consumers' goods is rising at a rate of 10 percent per year, the demand for labor is rising at a rate of only 8 percent per year and that if nothing else were present, this would cause prices to rise by 10 percent while wage rates rose by only 8 percent. Assume that to prevent this outcome, the unions demand wage increases of 10 percent, to keep pace with the price increases. Calculate the proportion of the presently employed wage earners who must become unemployed each year as the result of the continuation of such union demands.

Now assume in addition that while the supply of labor is unchanged, the supply of consumers goods is falling at a rate of 2 percent per year.

_____211. Calculate the annual rise in prices when the 2 percent annual fall in the supply of consumers' goods is combined with a 10 percent annual increase in the demand for consumers' goods.

_____212. State the rise in wage rates now needed to keep pace with the rise in prices.

_____213. Recalculate the proportion of the presently employed wage earners who must become unemployed each year as the result of union demands for wage increases on a par with price increases.
The efforts of labor unions to resist the fall in real wages caused by

_____214. The efforts of labor unions to resist the fall in real wages entails an attempt to raise wage rates relative to the demand for labor and thus results in unemployment.

_____215. Since common stock prices depend on the degree of saving, which inflation undermines, in the long-run inflation prevents stock prices from keeping pace with the prices of consumers' goods.

_____216. The negative effects of inflation on saving and the availability of real capital gives rise to the phenomenon of an inflationary depression—i.e., a rapidly increasing quantity of money and rapidly rising prices accompanied by widespread insolvencies and bankruptcies, as the money available for the purchase of capital goods and labor becomes inadequate by becoming unable to grow rapidly enough relative to the rise in the demand for consumers' goods and in prices.

The following is a five-part question.

_____217. On the basis of the various ways in which it reduces the demand for money for holding, inflation, expecially in the form of credit expansion,

brings about an increase in the volume of spending and in sales revenues and incomes in the economic system that is more than proportional to the increase in the quantity of money and thereby reduces the degree of liquidity in the economic system, i.e., the ratio of cash holdings to current liabilities.

_____218. In reducing interest rates relative to the rate of profit, inflation in the form of credit expansion encourages the incurrence of debt.

_____219. Inflation in the form of credit expansion causes malinvestments, i.e., investments whose profitability is based on the existence of credit expansion.

_____220. When inflation in the form of credit expansion stops or significantly slows,

a. the demand for money for holding rises
b. the growth in sales revenues in the economic system slows, stops, or is reversed
c. profit margins and the general rate of profit in the economic system are reduced, as is cash flow
d. the unprofitability of malinvestments is revealed
e. many debts become unpayable because of the combination of now inadequate sales reveunues and cash flow and the unduly large debts incurred in the process of credit expansion
f. some substantial business firms suddenly fail
g. banks that have made substantial loans to business firms that have failed also fail
h. the failure of banks and their inability to redeem their checking deposts (and or bank notes) on demand reduces the quantity of money and further reduces the volume of spending in the economic system with the potential result of further business failures and then further bank failures, in successive waves, until the quantity of fiduciary media in the economic system is greatly reduced or even completely wiped out
i. all of the above

_____221. Inflation, especially in the form of credit expansion, sets the stage for a financial contraction and deflation.

_____222. To the extent that credit expansion serves to raise wage rates and/or materials prices, it

a. reduces the adequacy of existing capital funds, with the result that firms requiring credit turn out to need more credit than they had planned on, while those firms normally supplying credit turn out to be able to supply less than had been counted on, and may even need credit themselves in order to meet the requirements of their own internal operations at these higher wage rates and prices
b. can result in a “credit crunch” and the precipitation of business failures and then bank failures
c. both (a) and (b)

_____223. The failure of inflation to accelerate sufficiently can also cause the demand for money for holding to increase, and thus velocity to decrease, insofar as the demand for money for holding has become unduly low based on the expectation of a more rapid acceleration of inflation than turns out to be the case.

The following is a three-part question.

_____224. A gold clause is a feature of contracts that calls for payment either in physical gold of a definite weight and fineness or in whatever amount of paper money may be required to purchase such quantity of gold at the prevailing market price of gold.

_____225. If a bond is payable in the amount of $1,000 gold dollars, in which a gold dollar is defined as one-twentieth of an ounce of gold of a definite fineness, calculate the amount of paper dollars required to redeem that bond if the price of gold rises to $35.

_____226. If a bond is payable in the amount of $1,000 gold dollars, in which a gold dollar is defined as one-twentieth of an ounce of gold of a definite fineness, calculate the amount of paper dollars required to redeem that bond if the price of gold rises to $350.

The following is a nine-part question.

Assume the existence of a money supply that contains 250 million physical ounces of gold, with each ounce of gold defined as $20. Assume also that along with the gold, the money supply consists of a further $20 billion of paper money, payable in gold on demand, and up to now treated as the equivalent of $20 billion gold dollars.

_____227. Calculate the number of dollars represented by the gold component of the money supply.

_____228. Calculate the total money supply, consisting of the sum of the gold dollars represented by gold and the equivalent of gold dollars represented by the paper money.

Now assume that the supply of paper money is expanded from $20 billion to $22 billion and that, as result, the market price of gold rises from $20 per ounce to $25 per ounce.

_____229. Calculate the total money supply in terms of paper dollars, using $25 per ounce to determine the number of paper dollars represented by the gold supply.

_____230. While the price of an ounce of gold is now $25, calculate the price of a paper dollar in terms of a gold dollar still defined as one-twentieth of an ounce of gold.

_____231. Calculate the size of the total money supply expressed as gold dollars defined as one-twentieth of an ounce of gold.

_____232. Under a fractional-reserve gold standard, such as described above, inflation of the supply of paper money that is redeemable on demand in gold can lead to

a. a reduction in the quantity of money insofar as it is considered as the equivalent of gold
b. a reduction in the ability to repay debts containing gold clauses
c. both (a) and (b)

_____233. In the context of a fractional-reserve gold standard with numerous gold-clause contracts in existence, inflation of the paper money can constitute deflation from the perspective of gold money.

_____234. At the time of the Great Depression in 1929, most long-term debt in the United States, both government and private, contained gold clauses. Based on this fact and on your answers to the preceding questions, it follows that the policy of the Hoover Administration of running what for the time were major budget deficits, and the policy of the Federal Reserve of attempting to increase the supply of dollars in order to reduce interest rates and to finance the deficits, may have served to intensify the deflation and depression of the early 1930s by threatening the future convertibility of the dollar at $20 to the ounce of gold.

_____235. With international trade carried on on a gold basis, the policy of inflation and consequent devaluation against gold may have served to reduce the world supply of money calculated in gold and thus have been responsible for much of the decline in the volume of international trade in the early 1930s.

_____236. In recent years, the effect of an increase in the supply of Mexican pesos that caused a more-than-proportionate devaluation of the peso against the dollar

a. reduced the ability of Mexican firms to pay their dollar debts
b. represented a deflationary inflation
c. both (a) and (b)

_____237. In setting the stage for it to happen, inflation and credit expansion must be blamed for the mass unemployment that results from financial contraction, deflation, and depression.

_____238. In the face of the existence of strong monopoly labor unions, inflation is ineffectual as a remedy for existing unemployment because the unions will take advantage of the inflation to drive up wage rates, with the result that the larger volume of spending is likely to result in little or no increase in the quantity of labor demanded and thus little or no reduction in unemployment.

_____239. Those who are reemployed on the various make-work projects that almost always accompany any attempt to eliminate unemployment by means of inflation, are employed at a loss to the rest of the population, in that additional goods must be provided for them, including the means of production that they use, and while goods go to them from the rest of society, they do not produce any comparable output that can make compensation possible.

The following is a four-part question.

_____240. Inflation, having caused mass unemployment by creating all the necessary conditions for a financial contraction, can

a. never bring about a restoration of employment
b. bring about a restoration of employment provided either that there are no substantial monopoly labor unions present or, if there are, they are weakened to the point that they will not use the occasion of a rising aggregate demand to force up wage rates significantly

_____241. In the case in which inflation can bring about a restoration of employment, the essential problem remains that the policy of inflation continues, and with it, all of its destructive consequences.

_____242. If inflation is ever to be eliminated, the government must lose the power to inflate even in conditions in which doing so can reduce unemployment. Unemployment must be eliminated through a fall in wage rates and prices.

The following is a four-part question.

_____243. The resumption and continuation of inflation is bound to be accompanied by substantial unemployment sooner or later, by virtue of

a. the tendency of real wage rates to fall as the result of inflation and because of efforts to prevent this fall by forcing wage rates to rise fully as rapidly as prices, without benefit of the necessary increase in the demand for labor
b. the fact that as inflation becomes more extreme, the potential for sudden mass unemployment is created by efforts merely to moderate the inflation, and even by the failure sufficiently to accelerate it
c. both (a) and (b)

_____244. Assume the existence of a country in which the quantity of money and volume of spending are increasing at a rate of 50 percent per year and are accompanied by comparable increases in wage rates and prices. (Many Latin American countries have provided real world examples of such conditions.) Now assume that the country's government, having become alarmed at the pace of the inflation, decides to cut the rate of increase in the quantity of money to 25 percent, and the volume of spending follows suit. Calculate the proportion of the labor force that is presently employed that will suddenly become unemployed if, while the aggregate demand for labor now increases by only 25 percent, wage rates continue, simply by a process of inertia as it were, to rise by 50 percent.

_____245. If aggregate demand has been growing at a 50 percent annual rate and wages and prices begin to rise at a 75 percent annual rate, in anticipation of aggregate demand growing at 75 percent, and then aggregate demand fails to grow more than 50 percent, calculate the proportion of the labor force that is presently employed that will suddenly become unemployed.

_____246. A similar outcome to that described in the previous two questions results in conditions in which the demand for money for holding has fallen in anticipation of a degree of inflation that does not materialize, which then leads to a rise in the demand for money for holding.

_____247. The potentially most devastating consequence of inflation is that, once begun, the process tends to accelerate, with no necessary stopping point short of the destruction of the monetary unit by virtue of its losing its acceptability.

_____248. The loss of acceptability of the monetary unit occurs when people realize that between the time they accept it and even the earliest possible time they can spend it and thus pass it on to someone else, they will have suffered a substantial loss in buying power, at which point they refuse any longer to accept it and revert to barter if necessary.

_____249. According to von Mises, the three stages that inflation goes through before reaching its ultimate limit are

a. the belief that although prices are rising, they will come down, and so it is better to postpone purchases
b. the belief that prices will never come down but only go on rising, and so it is better to buy now instead of waiting
c. the belief that the loss in the buying power of money will be so rapid that it is better to buy *anything* than to continue to hold the money
d. all of the above

_____250. Inflation has a tendency to accelerate because

a. a major underlying premise which leads to the policy of inflation in the first place—namely, the premise of the welfare state that the government has the power to provide free benefits for people who need them, a premise given the appearance of reality when the benefits are financed by means of inflation, logically calls for more and more such free benefits, financed by more and more inflation
b. the stimulative effects of any given rate of inflation tend to wear off and to require a more rapid rate of inflation to maintain them
c. inflation itself creates problems whose solution is perceived as requiring still more inflation
d. all of the above

_____251. On the basis of the fact that a more rapid rate of increase in the quantity of money leads to a fall in the demand for money for holding and thus to a rise in the velocity of circulation of money, it follows that

a. any one-time rise in the rate of increase in the quantity of money will be followed by a more rapid rate of increase in spending and thus in business sales revenues so long as velocity as well as the money supply is rising
b. any one-time rise in the rate of increase in the quantity of money will later on be followed by a no more rapid rate of increase in spending and in sales revenues once the demand for money for holding and consequent rise in velocity stabilize at their respective lower and higher levels
c. the rate of increase in spending and in sales revenues corresponding to any given rate of increase in the quantity of money must fall at some point
d. to maintain the rate of increase in spending and in sales revenues corresponding to any given rate of increase in the money supply in the period when it is joined by the effects of a rising velocity of circulation, a more rapid rate of increase in the money supply becomes necessary
e. all of the above

_____252. Because the rate of increase in spending and in sales revenues adds a corresponding component to the average rate of profit in the economic system, it follows that

a. the fall in the rate of increase in spending and sales revenues resulting from velocity stabilizing, operates to reduce the average rate of profit in the economic system
b. the maintenance of the average rate of profit at the level achieved by the combination of any given rate of increase in the money supply coupled with a rising velocity of circulation requires an acceleration in the rate of increase in the money supply
c. both (a) and (b)

_____253. In raising sales revenues and profits, inflation operates to benefit stockholders at the expense of bondholders, whose interest returns are contractually fixed. Yet in the face of continuing inflation, interest rates tend to rise, to offset this imbalance. In order for the stockholders to continue to gain at the expense of bondholders, an acceleration of inflation is required.

_____254. In the absence of an acceleration of inflation, the gains experienced by debtors at the expense of creditors as the result of inflation wear off.

_____255. The factors making for an acceleration of inflation in connection with profits are

a. the acceleration needed to maintain the oveall rate of profit on capital
b. the acceleration needed to enable stockholders to go on benefitting at the expense of bondholders

c. both (a) and (b)

_____256. Examples of inflation coming to be demanded as the means of solving problems largely created by inflation are
a. inflation-financed government rescues and bailouts of businesses, which have been driven to failure by the effects of credit expansion or the taxation of replacment funds resulting from the overstatement of profits brought about by inflation
b. inflation-financed government aid to the elderly, who have been impoverished by the decline in the buying power of their incomes and assets caused by the government's previous inflation
c. inflation-financed government aid to the mortgage market brought to near extinction by the threat posed by inflation to all long-term contracts
d. inflation to offset the reduction in the buying power of the government's own revenues
e. inflation to paper over credit crunches and profit squeezes brought on by inflation
f. all of the above

_____257. The use of inflation to solve problems created by prior inflation turns recessions into inflationary fueling periods.

_____258. Price indexing
a. addresses the problem of lags between the rise in the prices one must pay and the prices or income that one receives
b. at most enables an individual to catch up with the rise in prices, but does not compensate him for the loss of purchasing power in the interval before catching up, nor compensate him for the effects of again falling behind, as the prices he must pay rise before the prices he receives

_____259. In response to inflation and the threat of inflation, price indexes have come into use in the United States in
a. employment contracts
b. social security payments
c. the determination of the boundaries of income tax brackets
d. the payment of interest on a small amount of government bonds
e. all of the above

_____260. Additional areas that are likely candidates for the use of price indexes in the future are
a. the calculation of depreciation allowances for income-tax purposes
b. the calculation of interest income for income-tax purposes
c. a larger proportion of government-bond interest payments
d. all of the above

_____261. The use of price indexes operates to make inflation accelerate insofar as it serves to make prices rise still higher, as in price increases causing wage increases which then cause further price increases.

_____262. The use of price indexes operates to make inflation accelerate insofar as
a. it brings about a more rapid increase in the quantity of money and volume of spending in government efforts to overcome or forestall the reduced quantities of goods and labor otherwise demanded at the higher prices, and the unemployment this would cause.
b. the reductions in government revenue and increases in government expenditures that it causes lead the government to rely more heavily on the creation of new and additional money as a source of funds.
c. both (a) and (b)

_____263. Apart from wage indexing, there is no tendency for inflation to accelerate in the government's efforts to avoid unemployment.

The following is a four-part question.

_____264. Assume that labor unions demand an increase in wage rates 2 percent above the prevailing increase, if any, in the general consumer price level, but that there is no rise in the productivity of labor or in the distribution factor. The outcome will be
a. the unemployment of about 2 percent of the workers presently employed plus a further rise in prices of 2 percent
b. a further rise in prices of 2 percent but possibly no additional unemployment, if at the same time the government increases the quantity of money and thus the volume of spending by a further 2 percent
c. both (a) and (b), considered as alternatives

_____265. Calculate the rise in prices in a future year when the unions not only continue to demand an increase in wages of 2 percent above the expected rise in prices but the expected rise in prices now also comes to incorporate the additional 2 percent annual rise brought about by the unions' policy itself, supported by the government's policy of accomodating it through increases in the money supply.

_____266. Calculate the rise in prices in a further future year when the unions not only continue to demand an increase in wages of 2 percent above the expected rise in prices but the expected rise in prices is now still further elevated by a second 2 percent.

_____267. Witnessing the repeated failure of wage demands 2 percent above the expected rise in prices to achieve any actual benefit, because prices turn out to rise 2 percent faster, a likely effect is an acceleration of union demands, perhaps to 4 percent above the now prevailing rise in the consumer price level, as a means of offsetting the effect of the recurring extra 2 percent rise in prices.

_____268. Union wage demands in combination with a government policy of accommodating them through increases in the quantity of money and volume of spending

a. operate as a kind of upward "ratcheting" in connection with the acceleration of inflation
b. have the potential to reach double and triple digit levels
c. both (a) and (b)

_____269. The losses that inflation inflicts on bondholders and other creditors

a. result in increases in the rate of interest, as a means of preventing such losses
b. the establishment of a rate of interest high enough both to offset the rise in prices and to yield a positive real rate of return, would not only eliminate the gains of stockholders and other debtors, but impose losses on them equal to the losses on investments as a whole that are caused by inflation
c. to avoid or eliminate losses and regain the advantage of inflation, stockholders and other creditors must demand more rapid inflation
d. all of the above taken together

_____270. After repeated rounds of interest rates rising to levels sufficient to protect creditors from prevailing levels of rising prices, only soon to be followed by prices that rise still more rapidly so that once again creditors suffer losses, creditors will ultimately conclude that no rate of interest is high enough to protect them from inflation. At that point the loan market either withers and dies or must be maintained by infusions of new and additional money on a scale sufficient to meet whatever credit needs will be met.

_____271. The United States began to approach the kind of conditions described in the preceding question in the late 1970s, when the long-term fixed rate mortgage market virtually disappeared.

_____272. When the limits of the upward ratcheting of interest rates is reached, the potential is created for a quantum leap in the rate of inflation in an effort to supply vast needs for credit by means of the creation of new and additional money.

_____273. The potential of inflation to destroy the existing monetary unit, by accelerating to the point of people refusing to accept it,

a. would be accelerated by the availability of an alternative monetary unit that retained its purchasing power better and whose competition would rapidly undermine the demand for the inflating monetary unit
b. can result in the destruction of the division of labor and the material civilization that depends on the division of labor, if the destruction of the existing monetary unit is turned into the destruction of money as such by a combination of the continued acceleration of inflation and the prohibition of the development of an alternative monetary unit
c. both (a) and (b)

_____274. The leading historical example of the destruction of money is the late Roman Empire, whose civilization and culture could not survive without it.

Chapter 19, Part C

_____275. The widespread ownership of gold and silver coins coupled with the freedom to use them as media of exchange at their bullion value and to write enforceable contracts payable in them

a. would provide powerful competition for a rapidly inflating paper money and result either in the public spontaneously abandoning the paper money or in the government halting its inflation and making the paper money once again redeemable in gold on demand
b. would serve as a guarantee against the destruction of money as the result of hyperinflation
c. both (a) and (b)

_____276. Assuming that its rapid or at least substantial inflation is virtually inevitable, fiat money can be maintained in existence only by the forcible suppression of the competition of gold.

_____277. Inflation at the rate experienced in the United States in the 1970s turns the real rate of return on capital negative, for the reasons explained in connection with its undermining of capital accumulation. In such conditions, ownership of gold becomes a better alternative than normal investments, by virtue of the fact that the rise in its price along with prices in general maintains its purchasing power, while its minimal cost of storage is less than the losses in buying power experienced on normal investments. In such conditions, the rising demand for gold makes its price rise faster than the general rise in prices.

_____278. If not prevented by government interference, growing ownership of gold as an inflation hedge would lay the foundation for its spontaneous reemergences as money

a. inasmuch as the sizable number of people seeking to add to their ownership of gold would be willing takers of gold in exchange for goods and services
b. the existence of the people described in (a) would further increase the number of people willing to take gold in exchange, because even people not seeking to hold gold as an inflation hedge would know that they could reexchange it with the extensive group of those who were seeking to do so
c. the addition of the further group described in (b) to the number of people willing to take gold in

exchanges would lead to still more people becoming willing to take it on the basis of the now still greater ability to rexechange it
d. the culmination of a self-reenforcing process of growing numbers of people willing to take gold, would be its universal acceptability, i.e., its reestablishment as money
e. all of the above

_____279. The spontaneous remonetization of the precious metals would be greatly fostered if
a. it were not illegal for merchants to practice discrimination between paper money and precious metal coins of the same face value. (The constant, day-to-day experience of people being able to use a twenty-dollar gold piece as the equivalent of 320 or more paper dollars—its recent bullion value—and four silver quarters or ten silver dimes as the equivalent of more than $3, reflecting the recent bullion value of silver, would teach people that the problem of inflation resided in the paper money and make them want their pensions and contracts payable in gold or silver.)
b. if contracts payable in precious metal were legally enforcable and not treated as usurious merely because the depreciation of paper money might entail the repayment of vastly more paper dollars than were equivalent to the gold when the contract was made
c. if the increase in the paper dollar value of gold contracts, resulting from nothing other than the depreciation of the paper, were not subject to taxation
d. all of the above

_____280. Among the positive measures the government might take that would foster the remonetization of the precious metals are
a. the phasing in, over a period of a few years perhaps, of the collection of certain taxes, such as the proceeds of the tariff and perhaps certain excise taxes, in gold or in transferable claims to gold payable on demand and 100 percent backed by gold
b. the sale of government assets, such as the land it owns in the Western states and in Alaska, for gold or transferable claims to gold payable on demand and 100 percent backed by gold
c. enactment of a creditors' protection bill requiring that some modest portion of existing contracts, such as 5 or 10 percent of the sums involved, be payable in gold, at the option of the creditor, at the price of gold prevailing at the time of the bill's enactment (in the case of new contracts, the price of gold could be that prevailing when the contracts are made)
d. all of the above

_____281. The government's establishing a gold revenue for itself would
a. immediately sharply increase the demand for gold and its value
b. immediately make payment in gold acceptable to whoever had to pay such taxes
c. be a clear indication to everyone of the course of things to come
d. provide the government with a secure source of revenue that would be sufficient to maintain its essential, non-welfare-state, peacetime functions on the scale on which they existed earlier in American history
e. promote the highly desirable objective of the monetary demand for gold increasing as far as possible *in advance* of major financial obligations coming to be expressed in gold, which would be necessary in order for borrowers of gold not to find that it is vastly more difficult to acquire it at the time of repayment than at the time they borrowed it
f. all of the above

_____282. The kind of creditors' protection legislation described above would serve to provide a significant measure of protection for creditors against the possibility of being wiped out by the depreciation of paper money, because the almost certain rise in the price of gold far in excess of the rise in the general run of prices in such circumstances would make the amount of gold that was originally equal to just 5 percent of the value of a contract equal to a substantially higher percentage in terms of buying power.

The following is a two-part question.

Assume that a contract is made calling for the payment of $1 million in 20 years. Assume that the price of gold at the time of the making of the contract is $500 per ounce.

_____283. Calculate the quantity of gold in which the contract would be payable if the contract guarantees the option of the creditor to collect 5 percent of the face value of the contract in gold at the present, $500 price of gold.

_____284. Assume that by the time the $1 million becomes payable, prices in general have increased by a factor of 10 and that the price of gold has increased by a factor of 50. Calculate the percentage of the buying power of $1 million at the time the contract was made, that the payee would be able to collect at the time of the contract's fulfillment.

The following is a four-part question.

_____285. Almost any gold standard that was adhered to would eliminate the problem of inflation.

_____286. A 100-percent-reserve gold standard would make both inflation and deflation/depression impossible.

_____287. The falling prices that would exist under the gold standard, as the result of the increase in the

production and supply of goods surpassing the increase in the supply of gold and consequently the volume of spending in terms of gold,

a. would not be deflationary with respect to the rate of profit, which not only would not fall as the result of the falling prices, but would be positively increased to the extent that the increase in the supply of gold was the source of a continuing rise in productive expenditure and sales revenues and thus of a corresponding addition to the average rate of profit in the economic system
b. would not be deflationary with respect to the ability of business firms to repay their debts, because the average business would be in the position of having a larger supply of goods to sell at prices that fell less than in proportion to the increase in its supply, because of the increase in the quantity of money and volume of spending that takes place
c. would not be deflationary with respect to the ability of wage earners to repay their debts because the increase in the quantity of money and volume of spending that takes place would almost certainly surpass the increase in the supply of labor, with the result that money wage rates would not tend to fall but to modestly rise (real wages would rise both to this extent and to whatever extent prices fell)
d. all of the above

_____288. The 100-percent-reserve gold standard, so far from being deflationary would actually serve as the strongest possible guarantee against deflation because

a. the slow rate of increase in the quantity of money that it made possible would not give rise to temporary, unsustainable decreases in the demand for money for holding that in turn would serve to temporarily raise the velocity of money, only to be followed by a rise in the demand for money for holding and accompanying fall in the velocity of money
b. it would make impossible any significant decline in the quantity of money and volume of spending, irrespective of the failure of any debtors
c. both (a) and (b)

_____289. A 100-percent-reserve gold standard, indeed, any real gold standard that was adhered to, would

a. eliminate the possibility of peacetime government budget deficits on the part of any even semi-responsible government, by making bankruptcy the price of such a policy
b. sharply limit growth in the size of government, since all new spending would have to be financed by tax increases in the very same year
c. reduce the frequency and duration of wars, which would be an occasion for major tax increases
d. eliminate the risk of arbitrary redistribution of wealth and income through inflation
e. reduce the taxation of profit and interest income by not artifically creating such income, which is then subjected to taxation, but instead making it possible for a significant portion of profit and interest income in real terms to take the form of falling prices and thereby escape taxation
f. greatly encourage saving and capital accumulation
g. eliminate the risk of currency depreciation on the part of countries that had it
h. create the potential for a single currency across the whole world, with enormous benefit to international trade and investment
i. all of the above

Answers to Questions 1-289 on Chapter 19

Question #	Correct Answer	Question #	Correct Answer	Question #	Correct Answer	Question #	Correct Answe	Question #	Correct Answer	Question #	Correct Answer	Question #	Correct Answer	Question #	Correct Answer	Question #	Correct Answer	Question #	Correct Answer
1	e	31	9.09%	61	T	91	c	121	T	151	$300,000	181	T	211	12%	241	T	271	T
2	c	32	20%	62	T	92	d	122	T	152	$100,000	182	T	212	12%	242	T	272	T
3	c	33	25%	63	e	93	T	123	d	153	$200,000	183	d	213	4%	243	c	273	c
4	d	34	T	64	T	94	T	124	c	154	$100,000	184	T	214	T	244	16.70%	274	T
5	T	35	33%	65	T	95	T	125	T	155	$100,000	185	e	215	T	245	14.28%	275	c
6	e	36	T	66	T	96	d	126	T	156	zero	186	T	216	T	246	T	276	T
7	T	37	T	67	T	97	c	127	T	157	$100,000	187	-3%	217	T	247	T	277	T
8	d	38	-33%	68	T	98	c	128	T	158	100%	188	2%	218	T	248	T	278	e
9	F	39	T	69	T	99	T	129	T	159	T	189	5%	219	T	249	d	279	d
10	T	40	T	70	a	100	T	130	T	160	T	190	T	220	I	250	d	280	d
11	T	41	T	71	T	101	T	131	T	161	F	191	T	221	T	251	e	281	f
12	T	42	e	72	e	102	T	132	e	162	b	192	-33%	222	c	252	c	282	T
13	b	43	T	73	T	103	T	133	T	163	T	193	$120,000	223	T	253	T	283	100 oz.
14	T	44	T	74	b	104	T	134	$10	164	$40,000	194	$100,000	224	T	254	T	284	25%
15	d	45	T	75	T	105	T	135	$5	165	$10,000	195	$20,000	225	$1,750	255	c	285	T
16	T	46	T	76	T	106	T	136	none	166	$30,000	196	$53,333	226	$17,500	256	f	286	T
17	T	47	T	77	T	107	c	137	$5	167	none	197	$33,333	227	$5 billion	257	T	287	d
18	d	48	T	78	T	108	e	138	$121	168	3%	198	zero	228	$25 bill.	258	b	288	c
19	T	49	T	79	T	109	T	139	$21	169	3%	199	T	229	$28.25 bill	259	e	289	I
20	T	50	T	80	T	110	T	140	$10.50	170	$100,000	200	T	230	$0.80	260	d		
21	T	51	b	81	T	111	e	141	$10	171	$25,000	201	T	231	$22.6 bill.	261	F		
22	T	52	F	82	T	112	T	142	$0.50	172	$75,000	202	T	232	c	262	c		
23	T	53	T	83	T	113	T	143	$11	173	$60,000	203	T	233	T	263	F		
24	T	54	T	84	T	114	T	144	95.50%	174	$15,000	204	T	234	T	264	c		
25	c	55	c	85	c	115	T	145	$150,000	175	1.50%	205	d	235	T	265	4%		
26	c	56	T	86	T	116	d	146	$100,000	176	T	206	e	236	c	266	6%		
27	e	57	T	87	T	117	c	147	$50,000	177	0.875	207	T	237	T	267	T		
28	d	58	T	88	c	118	T	148	$25,000	178	T	208	e	238	T	268	c		
29	T	59	T	89	T	119	T	149	none	179	T	209	T	239	T	269	d		
30	T	60	d	90	f	120	T	150	$25,000	180	c	210	2%	240	b	270	T		