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Inflation

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Article abstract

Nous avons cru qu'il intéresserait nos lecteurs de lire cette étude que M. Arthur Pedoe présentait récemment au congrès des agents de la Prudential de Londres. Si l'auteur n'apporte rien de neuf à ceux qui se sont déjà préoccupés du sujet, il donne aux autres un aperçu court, simple et assez caractéristique de l'état actuel des esprits dans les milieux officiels. A.

Inflation

by

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Nous avons cru qu'il intéresserait nos lecteurs de lire cette étude que M. Arthur Pedoe présentait récemment au congrès des agents de la Prudential de Londres. Si l'auteur n'apporte rien de neuf à ceux qui se sont déjà préoccupés du sujet, il donne aux autres un aperçu court, simple et assez caractéristique de l'état actuel des esprits dans les milieux officiels. A.

In opening the subject of Inflation one feels like the darkie preacher who began his sermon by telling his congregation that he would attempt to "explain" the unexplainable, to "fathom" the unfathomable and to "unscrew" the inscrutable.

Inflation seems to be the "bogey", the "big bad wolf", about which one hears so much these days. Insurance agents know how to meet the usual alibis of, — "My wife won't let me" or "I can't afford it", but the latest alibi is, — "Why should I buy insurance when Inflation will destroy the value of the policy ?" Should you go further into the matter and ask your prospect exactly what he means by the statement, you will find he is entirely ignorant of what Inflation is or means. He has only made the statement as something he has heard and which sounds like a very good alibi.

It will help you to know something of Inflation in order to run this "bogey" to earth. The Canadian Government is now borrowing at the lowest rate in its history, 3%. It is remarkable that it should be able to borrow at this low rate while engaging in war and at a time when the war does not seem to be going as well as we would wish. Economists have written treatises pointing out that 3% is the minimum rate which can be offered to people on their savings for any lower rate would appear to make savings "not worthwhile".

The "minimum" rate of interest reminds one of the story about the pawnbrokers's boy in school. When his teacher asked him, "What is 3% interest for one year on one thousand dollars ?" the boy remained silent. "Surely you know the answer to that simple question ?" said the teacher. "Make it 5%, teacher," answered the boy, "and I'll be interested".

That the Government of Canada can borrow during wartime at the low rate of 3% illustrates the tremendous faith which the people of Canada have in their Government.

This is the situation in Canada. Let us imagine what would happen if the people began to lose faith in the Government. Firstly, the Government would have to offer more interest and instead of 3% would increase it to 3½%, 4%, 5% and perhaps higher. As the rate became higher, so the value of the bonds which the public had already bought would begin to fall. When your bond for which you paid $1,000 becomes worth $800 or less, you feel it is time to get out of it and save what you can. The result is selling and further depreciation of Government Bonds resulting in even greater lack of confidence in the Government. Just as any other business men, the Government borrows its current needs from the banks repaying the banks with the proceeds of its loans from the public. As the banks see the confidence of the public weakening they begin to cut down on their loans to the Government. The way out for the Government would be increased taxation but a Government which lacks the confidence of the people is generally afraid to stir up more opposition by increasing taxes. In a democracy, lack of confidence in the Government generally means a change of Government and so things get put right. However, it sometimes happens that the Government is determined to retain power however great the lack of confidence by the people. Such a Government has the resort open to it of using the printing press to obtain funds and when this starts, we have "Printing Press Inflation".

It costs just as little to print a thousand-dollar bill as a one-dollar bill. By working a little overtime, the Government printing press can turn out billions of dollars. As soon as the printing press gets busy a chain of consequences is set into motion which is calamitous to a country. Those at the head of industry and finance are the first to awaken to the danger. The banks know that the money they loan to-day will be worth far less when it is paid back and so loans are restricted or offered at prohibitive rates of interest only. The printing press means that the Government need not restrict any of its expenditures and generally vast projects are opened up irrespective of cost or tender for, after all, payment is to be made just by bits of paper. A fur coat has a tangible value irrespective of the cash you pay for it; so has a house, farm, land and food. As a result, the people who know what is going on begin to spend all their money and savings on getting things of tangible value. Merchants are aware that prices are going up and the longer they hold goods from the market, the greater will be the profits. Farmers, etc. who see prices going up, week by week, hold their food from the markets for the same reason. Thus, although the money to spend increases by leaps and bounds, the things to be bought become more and more scarce. Workmen agitate for increases in wages but by the end of the week they find the increased wages purchase less than their former wages did at the beginning of the week.

It is easy to see how such a trend unless stopped must end in cessation of all business and economic life. I want to emphasize that at anytime the Government, by taking things in hand, could stop the avalanche. Many times in history this "Printing Press Inflation" has been attempted with disastrous effects and the immediate results are so overwhelming that it does not take long before the people get a Government who get things stabilized.

However, from 1920-1924 one country allowed "Printing Press Inflation" to go to the full limit until its currency was rendered absolutely worthless; the country was Germany. During the War 1914-1918, the German Government had inflated its currency partly because it was afraid to disturb the people with high taxation. By the end of the War, the German currency had been inflated to four times its pre-war level. At the end of the War, the new Government seemed to lose control entirely and the printing press was used to turn out hundreds of billions of paper Marks. Municipalities and even private firms were allowed to print their own currency and everybody went on a wild, crazy orgy of spending until the purchasing value of the currency became the mathematical zero. An idea of the decrease in value is given in the following table showing the purchasing value of 100 Marks, say $50,00, in normal days.

By the 1st July,	1919, the purchasing value had fallen to	$7.00
" " " "	1920 " " " " " "	3.00
" " " "	1921 " " " " " "	1.50
" " " "	1922 " " " " " "	0.25
" " " Jan.	1923 " " " " " "	0.01 (one cent)

After that, until a new currency was established, the purchasing value of the old currency fell to such an extent that the Mark bills were worth more as paper than they were as money.

I want to emphasize that this destruction of the German currency was deliberately done by the German Government. It could have been stopped at any time during the downward run as it had to be stopped eventually. It was deliberately done partly to make the collection of reparations impossible. As you know, the Germans were required to pay for the rebuilding of Belgium and Northern France which they had destroyed. However, the greatest sufferers by this "Printing Press Inflation" were the Germans themselves. Wealthy people who had large incomes from bonds and mortgages found themselves penniless. Old men and women, retired on pensions, found the annuities would not buy a crumb of bread and had to go back to work or starve or freeze to death which many of them did. The economic life of the country was destroyed and even those who wanted to work could not find anything to do. In spite of the suffering caused by the War, I believe the German people suffered more in 1920-1924 during the period of "Printing Press Inflation" than they did throughout the years of the War. Such a thing has never happened in any civilized country before and should never happen again. It is inconceivable that such a thing could happen in Canada unless we all went crazy.

As you can imagine this inflation destroyed the insurance business in Germany. In spite of heavy War losses and the inflation which took place during the War, the German life insurance companies were sound and active at the end of the War. But the "Printing Press Inflation" destroyed the value of their policies as well as the greater part of their assets. To picture what happened, imagine that at one time the cost of the postage to a policyholder of his premium notice was worth more than the sum assured under his policy.

The Other Kind of Inflation

We also speak of Inflation when we describe the fluctuations of prices from month to month and year to year. Combined indexes are published each month showing the cost of a household budget involving certain quantities of food of various kinds, clothing, rent, etc. These vary from month to month. As you know the prices of most raw materials and food vary from day to day. When prices go up steadily, people say Inflation is taking place. However, over a period of years prices tend to move in a cycle. Sometimes we have a definite trend covering a period of 20 or 25 years. Thus, taking the purchasing power of the dollar in 1913 as a standard, we find that in 1895, during the great slump which preceded the discovery of gold in Klondike, such a dollar had a purchasing power of $1.43 and its purchasing power fell steadily from $1.43 in 1895 to $1.00 in 1913 and to 44c in the post-war boom of 1920. However, for the next 10 years the purchasing power of the dollar rose from 44c to 89c and in 1935 it was 76c.

Some people are concerned with this fluctuation of the purchasing power of money and would like to "insure the insurance". In my opinion this cannot be done. No one can guard himself absolutely against the future which is why we buy life insurance. The problem is to have $100 a month at age 65 or to insure that your family will have $100 a month if anything happened to you. We must have faith that our Government will make every effort to keep price levels on an even basis. We have no surety what the purchasing power will be of the $100 a month provided under our insurance policies. It may be $150 a month; it may be only $50 but even $50 a month is so much better than nothing !

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As we have seen the purchasing power of money moves in cycles. It is not as if a man paid for his insurance in a lump sum and then his beneficiaries received depreciated dollars. We, as a rule, pay for our insurance over a long period of time and our beneficiaries, by taking advantage of the instalment settlements in our policies (and also we ourselves), can spread the proceeds over a long period of time. There is every chance that the purchasing power of the dollars that we or our beneficiaries will enjoy will be, on the average, equal in purchasing power to the dollars we have paid in premiums.

As a rule, people are worried about the immediate future. Assuming an insured pays $30.00 per thousand for his insurance and dies after two premiums are paid. He has paid $60.00 and we pay his beneficiaries $1,000. Even if the purchasing power of the dollar has fallen by one-half, his beneficiaries still get 833% of the money paid in and if, by spreading the proceeds over 10 years the average purchasing power became normal, the beneficiaries would have received 166% of the money paid in. This fluctuation in purchasing power is not a serious criticism of life insurance.

Attempts to Stabilize Purchasing Power

You hear many arguments as to the things better than life insurance into which you should put your money so as to avoid possible inflation. As you know, your average policyholder puts $60.00 to $100.00 a year into life insurance. What investment can he do with such a small amount outside life insurance ? However, let us follow the argument and consider the various alternatives to life insurance which are available.

Real Estate. — A corner lot near Peel and St. Catherine Streets in Montreal will always have a value irrespective of currency so long as there is a Canada and a Montreal. But unless you have tens of thousands of dollars that is out of question. As for other real estate there is always the problem of taxation, depreciation and vacancies. You must always be prepared to carry real estate and many a beneficiary who has inherited an empty building has been faced with the problem of selling it for what it will fetch or using his other income to pay taxes and up-keep for an indefinite period. Speaking of empty lots, as you know, thousands of them are abandoned every year and are repossessed for taxes. Although we can visualize how a very wealthy man could do well by buying real estate which in the future will be worth a great deal irrespective of the purchasing power of the dollar, yet it is obvious that it is not an investment for 99% of the public. These wealthy men who do buy real estate also know the value of life insurance.

Stocks. — There is the alternative of buying common stocks which are supposed to represent the earning power of a business or an industry. Common stocks may be a hedge against inflation but their highly fluctuating character both as to income and market value make them undesirable except as a small proportion of one's assets. Choosing common stocks and changing them as industry changes requires far more knowledge than the great majority of people possess. It is interesting to see the details of the estates left by wealthy men, often investment experts themselves, and how many "dud" investments they had made during their lifetime. There is hardly an estate detailed for probate but has items marked as value "One Dollar" or "No Value". For the great majority of your prospects the results of their investments in common stocks show that they would have been better off to-day if they had put their money away in a safety box in dollar bills without any interest earned at all.

Canada and the War

There may be fears among you as to how Canada can stand the war expenditure. There are a few figures which I will give which will illustrate the tremendous financial resources of Canada. In 1929, the boom year, the interest on Canada's National Debt amounted to 125 million dollars whereas in that year the total receipts from Dominion Income Tax were 60 million dollars. In 1939, although the Debt had increased by approximately a billion dollars, the interest on the National Debt was only 128 million dollars due to the lower rates of interest in effect. However, the receipts from Income Tax were 141 million dollars. Remember, the 1939 Income Tax did not include any war taxation. As you know, huge increases in Income Tax have been levied this year which should at least double the amount received from Income Tax.

Let us assume that the war will cost Canada three billion dollars. The interest on this increase in debt at present rates will be 90 million dollars a year, yet the increase in Income Tax is estimated at over 141 million dollars. There is nothing to worry about here.

As you know, Canada came out of the last war with an increased stature. The huge development of industry in Canada during the last war developed the economic life of the country and this is being duplicated in the present war. All signs point to Canada becoming one of the greatest countries in the world after the war. In the last war the amount of life insurance sold in Canada increased by two and one-half times from $200,000,000 in 1914 to over $500,000,000 in 1919.

In 1939 the amount sold was only $624,000,000. There is no reason why a similar increase should not take place in this war which should react to your advantage and the advantage of our Company.