Some economic relationships to keep in mind…

Inflation vs Deflation

When there is <u>fewer</u> of something available, its value increases.

When there is <u>more</u> of something available, its value decreases.

So…when there are <u>fewer</u> dollars around, each dollar is worth more.

Because the dollar is worth more, you can buy more stuff with it. (The dollar's value has increased.)

When you can buy more stuff with the same dollar, that means prices have **decreased**.

This is called "deflation."

But, when there are <u>more</u> dollars around, each dollar is worth less.

Because the dollar isn't worth as much, you can't buy as much stuff with it.

When you can buy less stuff with the same dollar, prices have **increased**.

This is called "inflation."

Another way of thinking about this…

As the number of dollars in circulation increases, each dollar has less value (since whenever there is more of something, its value goes down).

As each dollar's value goes down, you need more of them to buy the same amount of stuff. This means prices are going up (inflation).

As the number of dollars in circulation decreases, each dollar has more value (since whenever there is less of something, its value goes up).

As each dollar's value goes up, you need fewer of them to buy the same amount of stuff. This means prices are going down (deflation).

The "Gold Standard"

Under the gold standard, the number of dollars that can be in circulation is tied to the amount of gold in the treasury. Under the Gold Standard, you can trade in each one of your dollar bills for a fixed amount of gold.

Since the government promises that each and every dollar can be redeemed for gold, the number of dollars printed cannot exceed the amount of gold in the treasury.

If each ounce of gold is worth 100 dollars and the government has 10,000 ounces of gold in the treasury, how many dollars can it circulate?

Answer: 1 million dollars

Why? 100 dollars per ounce **x** 10,000 ounces = 1,000,000 dollars

When there is more gold in the treasury, the government can print more dollars.

When there is less gold in the treasury, the government can print fewer dollars.

The dollar's value is fixed – it is worth so much in gold. The dollar is "good as gold."

Debtors vs. Creditors as related to Inflation vs. Deflation

If you owe a fixed amount of dollars, say $100, you are a debtor.

If you lend someone a fixed amount of dollars, say $100, you are a creditor.

If you are a debtor, you want inflation.

WHY?

Because when inflation occurs, there will be more dollars in circulation. As the number of dollars in circulation increases, each dollar will decrease in value (the more of something → the less valuable that something becomes).

If you owe $100 dollars, and the value of each dollar you owe decreases, the real value of your debt is decreasing.

So, in reality, when you pay back that $100 to the person who lent it to you, you are paying back less than you borrowed because, after inflation, that same $100 can buy less stuff. That $100 is ***less*** valuable.

You pay back something that is ***less valuable*** than what you borrowed. It's like you borrowed $100, paid back $90 but got credit for paying back the whole $100. This makes you, the debtor, happy.

If you are a creditor, you want deflation.

WHY?

Because when deflation occurs, there will be fewer dollars in circulation. As the number of dollars in circulation decreases, each dollar will increase in value (the less of something → the more valuable that something becomes).

If you lend $100 dollars, and the value of each dollar you lend increases, the real value of what you have lent is increasing.

So, in reality, when the person to whom you've lent the $100 pays you back, they are actually paying you back more than what you lent them because, after deflation, that same $100 can buy more stuff. That $100 is ***more*** valuable.

You get paid back something that is ***more valuable*** than what you lent. It's like you lent $100, but got paid back $110 (this is on top of whatever interest you might collect from the loan). This makes you, the creditor, happy.

So…

If you lend someone $100, you want deflation because when deflation occurs, there will be fewer dollars in circulation, so each dollar that you lent will be worth more and so the value of what you are owed will increase.

If you borrow $100, you want inflation because when inflation occurs, there will be more dollars in circulation, so each dollar that you borrowed will be worth less and the value of what you borrowed will decrease.

How does all this relate to farmers during the late 19th Century?

Gold Standard vs Coinage of Silver

Farmers understood that sometimes they had to go into debt if they were going to make any money because the expenses had to be paid at the front end – buying seeds, farm equipment, paying workers, etc. They couldn't plant their crops without first incurring these expenses.

Their income would come at the back end – selling their crops once they had harvested them. Once the harvest came, they expected to be able to pay their debt AND make a profit.

Because of deflation, however, the real value of their debt was growing over time. This cut into their profits. More and more of that profit went to paying down their debt.

On top of that, since, under deflation, prices were going down, they were selling their crops for less and less.

Moreover, the more they produced (in hopes of selling more so as to get out of debt), the more they flooded the market with corn or wheat or whatever. This drove down the price of their crops even more. In some cases, the more they produced, the less profit they made.

To farmers, this seemed unfair. The system seemed stacked against them – designed to insure they suffered economically no matter how good they were at doing their job (producing crops.)

One solution was to do something to stop deflation, so at least the value of their debt would stop going up. Accordingly, farmers sought a way to produce inflation.

Under the Gold Standard, the government could not simply print more dollars (printing more dollars, that is "inflating" the currency, was the most obvious way to lower the value of each dollar). Only if more gold was discovered and found its way into the treasury could the government print more dollars.

During this period, however, there was a shortage of gold. The amount of gold in the treasury was decreasing, and so, rather than printing more dollars (as the farmers wanted), the government, lacking gold to back the dollars, ended up printing fewer dollars. This meant deflation got worse (when there were fewer dollars, each dollar's value went up – and the value of each dollar that a farmer owed went up, so the value of the farmer's debt also increased).

Farmers who struggled to pay debts that were increasing in value due to the deflation caused by the adherence to the Gold Standard came to see the Gold Standard as the villain – the Gold Standard system was what allowed their creditors to prey on them.

To gain some relief from their increasing debts, some farmers want more dollars printed, and, since the Gold Standard system is keeping this from happening, they demand that something other than gold should "back" each dollar.

The answer is to have a "bi-metallic" currency. If another metal, in addition to gold, could "back" each dollar, the government could print more dollars. This would end the deflation and give the farmers relief from their mounting debts.

The "other metal" was silver. If the government allowed gold AND silver to "back" the dollar, the number of dollars the government could print would increase (inflation).

The farmers would benefit since the value of their debt would decrease as the number of dollars in circulation increased.

Obviously, the farmers' creditors opposed a "bi-metallic" currency since this would produce inflation (more dollars circulating) and, under inflation, they would take the loss – the dollars they were paid back would not be as valuable as the dollars they had lent out.

Not only bankers and financiers who lent money opposed a "bi-metallic" currency, however. If the number of dollars increased and each dollar became worth less (inflation), prices would rise. This would hurt consumers. As a result many urban workers (consumers) opposed the "coinage of silver."

In this case, the issue of gold vs silver divided the "have nots" (farmers and workers) while the "haves" (wealthy financiers) were more unified.