

more than 4 million workers. Long ago Irving Fisher suggested that bonds be issued with an escalator clause to protect against inflation. In fact, he headed a corporation which used this form of financing. I also earlier suggested the wisdom of using an escalator clause in payments of benefits to the old.

Indeed, a general use of escalator clauses would be dangerous. The result would be that instead of a lag of some prices behind the general inflation inclusive of income payments, these would immediately react to an inflation and therefore tend to aggravate the inflation. But a judicious use of escalator clauses in limited markets, where the cost of inflation is the greatest, might well be justified.

It should also be noted that any attempt to escape the effects of inflation through the purchase of equities is also subject to some reservations. The more people buy common stock in order to protect against rising prices, the higher common stock prices will rise and, therefore, the return will tend to be reduced. This was clearly evident by 1959 when the yield on common stock declined substantially below that on bonds. In fact, when the Government issues a 5-year note paying 5 percent, as it did in 1959, the investor who wants to protect himself against inflation achieves substantial security. It can be argued, for example, that the investor seeking the maximum return would expect to get a 2-percent additional return on fixed income yielding assets to match the annual 2 percent inflation, say, anticipated. A bondholder should receive 2 percent additional return to offset the anticipated inflation and in addition be compensated for the greater gains accruing to holders of equities because corporations are run on their behalf. In corporate finance the stockholder is the one who profits most from corporate management, not the bondholder. With rising prices and profits, the latter in part associated with rising prices, the gains would probably go largely to those who hold equities. Hence if stocks yield, say, 2 percent at present high values, then the bondholder might well expect a return of at least 5 percent in order to make up for the advantages of those who are especially protected by the directors and management of corporations and to offset the effects of inflation.

In an interesting study the First National City Bank tries to show what the effects of different kinds of investments would be upon the value in current dollars, and purchasing power of varying kinds of investment ¹² in 1948 dollars.

¹² First National City Bank Monthly Letter, "Business and Economic Conditions," April 1959, p. 46.