Books: Steve Forbes, Nathan Lewis, and Elizabeth Ames’s ‘Inflation’

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Inflation: What It Is, Why It’s Bad, and How to Fix It by Steve Forbes, Nathan Lewis, and Elizabeth Ames is a timely and accessible discussion of inflation and its perils. They explain the scourge, its causes, and the enormous havoc it wreaks on societies, and they have a silver bullet. Mindful inflation will be with us a while, they also counsel investors on how to protect their assets.

The authors define inflation as the devaluation of money and price increases as its symptom. They distinguish between nonmonetary and monetary inflation.

Nonmonetary inflation is caused by natural and government-induced changes in supply and demand. If war disrupts oil supplies, the price of oil will rise reducing demand and spurring increased production elsewhere. If consumers become fonder of Paso Robles wines, their price will rise, shifting demand perhaps to Australian and French substitutes, and incenting Paso winemakers to produce more.

Government tax, trade, and regulatory policies too change people’s incentives, and, can suppress or boost supply and demand. Increasing taxes, tariffs, and restrictive regulation suppresses supply, causing nonmonetary inflation. The remedy while politically fraught, isn't complicated. It's reducing and simplifying taxes, tariffs, and regulation.

Forbes, Lewis, and Ames, however, focus on and are more worried about monetary inflation, which is the corruption of money. Governments have debased money for thousands of years. They recount horrendous inflations in ancient Rome and China, the Spanish Empire, 17th-century France, colonial America, and Weimar Germany. While the US hasn't suffered the horrors of hyperinflation like Venezuela and Zimbabwe, the Fed has relentlessly devalued the dollar. Since the Fed's 1913 creation the dollar's value has declined 97%. From September, 2008 to December, 2022 the monetary base – money in circulation and bank reserves, increased a whopping 605%. Creating too many dollars devalues them. Waitresses' tips and retirees' savings deposits and pensions become worth less.

More money per se isn't a problem if there's demand for it. Notwithstanding having only one fourth the population Switzerland has eight times more money per capita than Canada. People trust and therefore want the franc because the Swiss National Bank protects its value better than other central banks defend their fiat currencies.

Money is a measure of value. A yard wouldn't be useful if it continually changed. By reducing the dollar's value inflation undermines trust and debases social behavior. It makes planning more difficult and sets people against each other. Inflation punishes creditors and savers, while benefiting debtors, the biggest of which is Uncle Sam. It causes resource misallocation. Inflation's also a stealth tax, which is why so many governments while professing to oppose it, in practice support it. John Maynard Keynes observed devaluing money enables government to "confiscate, secretly and unobserved, an important part of the wealth of their citizens."

Fed, political, and commentariat orthodoxy, perversely, holds a little inflation is good for the economy. To the contrary, even modest dollar debasement is destructive, and can mushroom, as we're discovering.

The authors observe that low inflation has been a condition of healthy economic growth.

The 19th century was a golden age of growth for America, with periods of gentle deflation. Under the gold standard from 1950-1970 real GDP per capita grew 2.77% annually. Economist Judy Shelton observed during the fifties and sixties "We had maximum shared growth. It wasn't just the wealthiest at the expense of the poorest. It was shared. Everybody was moving up." The working class are more vulnerable to inflation than affluent gentry who, generally, can better insulate their assets.

In 1971 President Nixon severed the dollar's final link to gold. "The Nixon Shock" abandoning the Bretton Woods gold standard, wage and price controls, and tariffs, ushered in an era of inflation lasting until titanium-spined Fed Chair Paul Volcker broke the scourge's back in the early eighties.

Over the last half century real per capita GDP growth averaged 1.71%. The authors posit with no inflation, real GDP growth of the fifties and sixties would have continued and Americans' real per capita income would be 72% higher. Stable money is a sine quo non of prosperity. While multiple factors, influence growth, with zero inflation over the last fifty years, they're right, Americans' real per capita wealth and income would today be much higher.

After WW2 Germany and Japan were economic basket cases suffering hyperinflation. Both countries banned government deficit spending and adopted Lewis's "Magic Formula" of sound money and low taxes, tying their currencies to the gold-backed dollar and cutting taxes. Consequently, Germany's and Japan's economies boomed.

Forbes, Lewis, and Ames' silver bullet to monetary inflation is simple, to tie the dollar's value to gold. It wouldn't be a classic gold standard. Rather the Fed would have a target gold price. When gold's price rose above the target, the Fed would reduce the supply of dollars. When it fell below it, the central bank would increase the money supply. The authors note early on in his tenure Fed Chairman Alan Greenspan loosely and unofficially hewed to this approach.

Tying the dollar to the price of gold would put paid to Fed's "dual-mandate," under which it's pushed easy money on the theory it maximized employment. And the central bank would no long need a legion of economists to implement monetary policy.

Is monetary reform possible?

Paraphrasing Milton Friedman, it's important to establish a political climate of opinion that will make it politically profitable for the wrong people – congressmen who like easy money, to support a hard dollar. And, unless it's politically profitable for the wrong people to do the right thing, the right people won't do the right thing either. Politicians must be made to pay a steep political price for supporting continually debasing dollar.

Every American worried about inflation should read Inflation. Engaged and better-informed voters can make Congress feel the heat and increase the political cost of not fixing the Fed's monetary mandate to protect the dollar's value.

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