

Preface

I am very pleased to see my Ph.D. thesis finally published as a book. There are only small changes, actualizations, and adaptations from the version that I defended in December 2007 to obtain my Ph.D. degree from the Universidad Rey Juan Carlos in Madrid.

I had decided to write on deflation because I regarded the fear of deflation as a decisive barrier towards the installment of a better monetary system. The fear of falling prices has again and again been misused to justify monetary inflation with all its detrimental consequences. Especially, in times of crises the specter of deflation is invoked to inflate the money supply with the aim to prop up failed elites. Indeed, in December 2007 a storm was in the making that a few months later brought the international financial system to the verge of collapse. In autumn 2008 after the default of Lehman Brothers, a deflationary spiral was on its way to wipe away the international banking system and with it highly indebted governments, companies, and individuals. It was a unique opportunity to have a system liquidated that through institutional inflation continually redistributes wealth, generates business cycles, hampers savings and growth, and protects the political and economic elites from competition.

However, this option was not chosen. For 6 years now, the system has been stabilized thanks to an enormous inflation of the money supply via unprecedented instruments. The consequences have been a delay of the necessary restructuring of the economy, redistributions in favor of failed investors, a deterioration of central banks' balance sheets, and a surge in government debts among others. The recovery has been severely disturbed. A sustainable improvement of the situation and a solution to the general overindebtedness is not insight. Furthermore, the inflation meant to stop the deflationary spiral may well finally require some sort of monetary reform, if it does not cause an outright breakdown of the monetary system.

It cannot be a surprise that political and economic elites did anything in their power to prevent a deflationary meltdown. What is surprising is that they got away with it so easily. It is astonishing that even most of the people that were losing due to the inflation accepted the measures, because they thought something worse

would be prevented, namely a deflationary meltdown. It is understandable that economic and political elites fear deflation, but it is not so clear why almost all economists have developed a deflation phobia. It was this fear of deflation that has ensured that we are still stuck in the monetary system which was about to melt down in 2008. Unfortunately, at the time *In Defense of Deflation* was not out there to help combat the myths about price deflation.

There are all kinds of myths about price deflation that inhibit the surge of free market institutions, because these myths are used to justify interventions. The fear of a deflationary spiral is only one, albeit probably the most important of them. An almost equally harmful myth is that the rate of the growth of the money supply must be at least as high as the rate of economic growth, because otherwise there would be a harmful price deflation. This is an argument that even well-trained economists bring forward against the introduction of a gold standard or against the chances of bitcoins to become money.

Another myth that has become very relevant recently is that policies aiming at lowering costs, especially wages, and reducing public budget deficits would drive an economy into recession. Indeed, in the European sovereign debt crisis, austerity is branded as a harmful deflationary policy. Commentators recall the supposedly fateful deflationary policies of German Chancellor Heinrich Brüning in the early 1930s as a deterrent example of austerity. Moreover, the “rolling deflation” of 1931 is even used to argue in favor of an international lender of last resort, a step close to the introduction of a world currency.¹ In this book all these myths are rebutted. There is even an historical analysis of Brüning’s policies, showing that they helped to speed up recovery.

For the future of liberty and capitalism, it will be essential to eradicate the myths about deflation. Otherwise, no thorough changes in our monetary setup will be possible. Indeed, the fear of deflation feeds the advocates of inflation with powerful arguments. And inflation in turn feeds governments. Governments would have never reached the size they hold today without the financing of an inflationary monetary system. And as the government grows, liberty dies. Thus, it is essential for the future of liberty that the myths on deflation are rebutted. This book is an attempt to contribute to this endeavor.

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¹ See Kindleberger and Aliber (2005, p. 258).



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