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The one factor we know that causes inflation is the very thing many experts prefer to ignore.



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The Price Of Cheap Money

Inflation

By Mark Blyth and Nicolò Fraccaroli *Norton*, 288 pages, \$31.99

BY EDWARD CHANCELLOR

INFLATION IS both a remarkably complex and extremely simple phenomenon. The complexity lies in the variety of circumstances that typically accompany its appearance. These may include an energy or some other kind of supply shock, acute social conflict, excessive government indebtedness, fiscal profligacy or a collapse in the value of the currency on the foreign exchanges. Yet none of these factors necessarily result in the loss of monetary stability.

Then there's the straightforward explanation for inflation, succinctly expressed by Milton Friedman: "too much money chasing too few goods." An extraordinary increase in the money supply is both a necessary and sufficient condition for inflation. The monetarist theory of inflation dates back at least 500 years and can be found in the 16th-century writings of Copernicus and the French jurist Jean Bodin. There has never been an inflationary period that wasn't accompanied by an above-average monetary expansion.

The most remarkable aspect of Mark Blyth and Nicolò Fraccaroli's "Inflation: A Guide for Users and Losers" is that the simple, theoretically robust and historically validated monetarist theory is nearly ignored, while the contingent circumstances that often but don't always accompany inflation are vested with causal power.

Thus, the recent bout of inflation is explained in terms of the supply shock induced by the Covid-19 pandemic and Russia's 2022 invasion of Ukraine, which led to a brief escalation of energy prices. Never mind that Friedman himself pointed out that the two oil shocks of the 1970s could not have resulted in a widespread inflation without central banks accommodating them with loose monetary policies. Had the money supply remained fixed, the Chicago economist reasoned, there would have been a shift in relative prices—higher for energy and lower for most other goods—but no rise in the general price level.

The monetarist view of inflation doesn't make an appearance until halfway through this book. The authors are also inclined to the view that corporate price gouging—sometimes referred to as “greedflation”—also played a key role in the latest inflation. It's true that corporate America has become more concentrated in recent years, and that

has given many firms greater pricing power. But the rise in U.S. corporate profits in 2021 is best viewed as the means through which inflation entered into the system, not the cause of it—a phenomenon known as the Cantillon effect after the 18th-century economist Richard Cantillon. An expanding supply of money inflated corporate profits first, but after a time inflation worked its way into labor incomes, too.

Besides, the pandemic was accompanied by extraordinarily large fiscal deficits and, everything else being equal, fiscal deficits boost corporate profits. But Messrs. Blyth and Fraccaroli are as little interested in the fiscal origins of inflation as they are in its monetary ones. In their cursory survey of past hyperinflations they blame Zimbabwe's monetary collapse on a bungled agricultural reform, Argentina's on too much U.S. dollardenominated debt and Germany's epic inflation on the Weimar government's reluctance to pay reparations to the victorious Allies after World War I. In all three cases, the authors point to currency weakness as a major cause of inflation.

“As foreign goods get more expensive,” they write, “a country needs to print more money to buy the same goods”—as if the alternative, buying fewer goods, isn't an option. Curiously, Rudolf Havenstein, president of the Reichsbank in the early 1920s, likewise claimed that Germany's monetary collapse was due to the decline of the mark on foreign exchanges rather than the fact that his printing presses were working around the clock to create money out of thin air.

Since Messrs. Blyth and Fraccaroli underplay the monetary origins of inflation, they are critical of central banks' attempts to arrest inflation by hiking interest rates. They suggest that Paul Volcker's tightening in 1979-80 was unnecessary since inflation was already passing, and that the Federal Reserve chairman raised interest rates “in order to cause a massive recession.” In fact, Volcker's intention was to arrest the runaway growth in the money supply rather than destroy jobs. He reluctantly hiked rates again in 1980 only after inflation picked up.

The book is also littered with careless errors. The authors state that in 1871 France demanded a large war indemnity from Germany, when in reality it was the other way around. They claim that foreign capital flows into Germany stopped in 1929, whereas they reversed a year earlier after the U.S. raised interest rates. Most egregiously, we are told that interest rates soared in 2021, even though Western central banks didn't start hiking until the following year. Where are the factcheckers when you need them?

Instead of what they call “monetary austerity,” the authors suggest a number of other remedies for inflation, including price controls, windfall taxes and government subsidies. Yet the history of price controls, dating back to the Roman emperor Diocletian's Edict on Maximum Prices, issued in A.D. 301, has been one of abject failure. This is hardly surprising since price controls address inflation's symptoms (rising prices) and not its cause (the increase in the money supply). In fact, whenever the authors describe past instances of price controls they admit, sotto voce, that they didn't work.

The title of one chapter—“Why Didn't We See This One Coming?”—refers to the fact that most mainstream economists failed to anticipate the recent inflationary cycle. In fact, leading monetarists, observing the strong growth in the money supply in 2020 and 2021 and the effective monetization of massive fiscal deficits, accurately predicted in these pages and elsewhere that inflation was around the corner, as sure as night follows day. Unfortunately, the authors of this deeply flawed book are none the wiser for the experience. Mr. Chancellor is the author of “The Price of Time: The Real Story of Interest.”