Mis·Inflation

THE TRUTH ABOUT INFLATION, PRICING, AND THE CREATION OF WEALTH

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Preface

—WILSON

Part way through his life, Dante Alighieri found himself in a dark wood, and badly in need of a guide.

> Midway upon the journey of our life
> I found myself within a forest dark
> For the straightforward pathway had been lost.[1]

While not Dante's equal in anything aside from the lost-in-the-woods part, I have to say I have been fully his equal in having some questions that needed to be answered. Economics has been called a dark and dismal science for centuries, and resembled a dark

1. *The Divine Comedy*, trans. Henry Longfellow (London: George Routledge, 1867), *Inferno*, 1 [Canto 1, lines 1-3].

thicket closely enough to provoke me into asking some of my questions.

This was particularly the case when it came to those aspects of economics that I had thought I understood—like inflation, for instance. But I kept finding the actual events not seeming to confirm what I had been bracing for. In short, many of the predictions I had trusted somehow failed to materialize. And so a number of years ago I began to wonder, whatever happened to inflation? Specifically, it seemed to me that the government had been printing enough funny money to have us well into Weimar-levels of inflation by now, and so there I was, trying to figure out why it didn't seem to be happening. Now when you are in a dark and tangled wood like this, one naturally hopes to run into a Virgil of monetary policy, say, someone like David Bahnsen. And as much as I would love to extend this metaphor a bit more, I sense that our editors are getting restless and are thinking about staging an intervention.

I had been aware of David's work in the financial world for some years, and was really appreciative of his contributions to our public life together, particularly his book *Crisis of Responsibility*. One day it occurred to me that I could take this niggling question of mine about inflation, and just write to David and ask it. He was kind enough to reply, and that gave me the idea of writing a series of letters, thus getting a whole slew of questions answered, and for more folks than just myself. I then broached the idea of such a project with David, he was kind enough to agree, and you hold the results of that correspondence in your hands.

I thought it would be good to do this via written correspondence because the mistakes we conservatives make in economics really are tenacious mistakes. Because conservatives really do have a good grasp of most economic realities, it can be really hard for us to get our minds around the idea that we might not have everything dialed in. And so a written conversation enables us to go back and check the arguments when the old questions arise in our minds again—as they inevitably will. Let's say a couple years from now you go out and buy a gallon of milk for ten dollars. You might want to go back home again and pull this book down from the shelf for a little review and reassurance.

Please note. The question is not whether real inflation has happened in history, because we know that it has. The issue is whether that is the best explanation for what we see happening around us now. We are not arguing that the glass is half full when most conservatives say it is half empty. We are saying that everybody is looking at the wrong glass, and the one we are looking at is even emptier.

Not surprisingly, our discussion of inflation will touch on a number of other related issues. If you read these exchanges, you will come to understand the true definitions of inflation and deflation. You will come to learn why the apocalyptic-hyperinflation predictions have been wrong over and over again. You will see why commodity pricing (gas pump, groceries, etc.) is a bad benchmark for measuring inflation, and what a more reliable benchmark actually is. In these pages, we discuss how balanced budgets can be a good thing without them being the Holy Grail. We get into the sociological ramifications of gold-bug investing, and why your Uncle Wyatt really needs to think outside his safe box. We talk about how reckless government spending really is a catastrophic thing, but how the looming catastrophe might not be what everyone was anticipating—more like carbon monoxide poisoning than a giant fireball. You will learn why deflation is a lot less fun to think about, and why it is a much more likely scenario. And how do the government and the banks use and manipulate debt anyway? That's a good question too.

We conclude with a discussion of where true wealth resides, which is in the hearts, and minds, and families of entrepreneurs who are not risk-averse—because being risk-averse is tantamount to being love-averse. The government is guilty of regulatory suffocation when it comes to entrepreneurs, but it has to be said that some quarters of the conservative world are making their own contributions to that same kind of suffocation. We really need to find our way out of this dark wood.

In short, we have sought in these pages to provide an on-ramp for free-market conservatives who love the spirit of enterprise, and who want to put behind them a spirit of timidity and fearfulness.

Douglas Wilson
March 2022

LETTER 1

Where Did the Inflation Go?

—WILSON

Dear David,

Knowing that fiscal policy is a passion of yours, and keeping in mind that it is an ongoing confusion of mine, I was wondering if I might trespass upon our friendship for a little bit. As I survey the decisions being made at the national and international level, I am having trouble fitting everything into a coherent picture.

I said that it was a confusion of mine, but it is a very particular kind of confusion. It is not the confusion of a cocker spaniel trying to understand quantum mechanics, which might be described as confusion across the board, on every level. This confusion of mine has to do with a body of knowledge that I have that I believe to be true, and trying to reconcile that with what is actually happening out there in the economy. All of it could be summed up in the question, "Where did the inflation go?"

If you decide to answer me, keep in mind that I am a layman in the realm of economics. But I am a layman who is generally well-read when it comes to economics "at the level of politics," you might say. This, to be distinguished from economics at the level of finance bankers, or hedge fund managers, or bitcoin junkies. My economic outlook would be an amalgam of Thomas Sowell, Friedrich Hayek, Milton Friedman, George Gilder, Frédéric Bastiat, Henry Hazlitt, Gary North, and so on. So put me down as a member of the old-timey inflation-is-theft/hard money school of thought.

My basic question (to start off with) is why the rapture hasn't happened yet. For my entire adult life, hard-headed fiscally responsible conservatives have been catching the last train out, and yet there always seems to be another train after the last train out. I believe that Gary North even wrote a book called *The Last Train Out.* And back in the eighties, Larry Burkett wrote *The Coming Economic Earthquake*, scaring the living daylights out of a lot of evangelicals.

LETTER 2

Fiscal vs Monetary Policy

—BAHNSEN

Dear Douglas,

Interestingly, there is a word choice in the very first sentence of your letter that I believe is going to prove important in my reply. You start off saying, "Knowing that *fiscal* policy is a passion of yours . . . ," while I am quite confident that you meant, "Knowing that *monetary* policy is a passion of yours." It would be pretty petty (and beneath me) if I were merely trying to nitpick or make hay of a minor vocabulary error, but in fact, I think that error will prove to be the very essence of where I believe our country stands as it pertains to the economic [in/de]flation debate.

Fiscal policy refers to that which impacts the economy from the "fiscal" side of the aisle—meaning, government policy. The low-hanging fruit here is usually tax policy (us supply-siders love fiscal policy when it means lowering the tax on growth and productivity), or else government spending (the Keynesian focus in fiscal policy for roughly seventy-five years).

But monetary policy refers to the actions of the central bank to effect their dual mandate—essentially, sound money and full employment. They are different tools, commanding differing schools of thought around each of them, and yet, many believe they are one and the same, *and these days, they are so dangerously entangled with one another,* people can be forgiven for conflating the two.

The question of, "Where did the inflation go?" is one that many are asking, and have been asking, for a long time. I hope that my answers here will help explain my point of view clearly and cogently, but more importantly, provoke a deeper understanding of the truly insidious decisions that have led us to the current state of affairs, one that I believe is quite concerning.

"Economics at the level of politics" is probably preferable to "economics at the level of a bitcoin junkie," but I digress. I assure you, most of the economic influences you cite were and are tremendous influences on me as well (Friedman, Gilder, Bastiat, Hazlitt). And I believe

LETTER 3

When Isn't a Stimulus Inflationary?

—WILSON

Dear David,

So I went and confused an Irishman for a Scot, didn't I? Got it—fiscal policy and monetary policy are two different animals. One barks and the other purrs. I understand everything now, and promise to try to be better.

In the past I have compared hard money economic analysts to men who have fallen off a skyscraper. Let's say that they have done so alongside some other people, and these others are somehow in denial. So on the way down, the hard money analysts have been seeking to persuade the ones in denial that we all, in fact, have fallen off that skyscraper. Their arguments are cogent, sound, and irrefutable. The fall has in fact happened. And then they ruin their ethos by saying something like, "and we are all going to hit the sidewalk in . . . *now*!" And then nothing happens because we are all still at the eighty-eighth floor. It seems to me that our team is really good at explaining the fact of having fallen off the skyscraper, and really bad at judging the distance to the sidewalk.

So your response was just the sort of thing I was hoping for, but while it beat back some of my questions, you successfully generated others. But before I get to those follow-up questions, let me see if I can summarize what you believe the two great hazards are. If I am reading you right, the things that concern you the most would be debt and deflation. In addition, I am assuming that later on in our exchanges you will explain to me how those two things are related—but that is merely a hopeful guess.

And on that matter of a debt crisis, I want to stick a pin in that because I suspect we will be talking more about that down the road. I have some questions about what a debt crisis might actually look like.

I am using the word *crisis* because you do use words like "horrific" and "quite concerning" and "insidious," while at the same time you are not wanting to encourage any kind of "doomsdayism." On this last

LETTER 4

The Benchmark of Inflation

—BAHNSEN

Dear Douglas,

The second batch of questions are perfectly logical follow-ons to the first batch, and I hope the second batch of answers moves us in a good direction. All of these things are complicated but it seems to me we are making progress, both in laying out a few definitions and then trying to unpack how one thing (properly defined) leads to another.

I do think the skyscraper analogy you use helps with one aspect of the hard money analyst errors—their use of flawed timing to accompany their predictions. But I would add two things to the mix that may or may not be agreeable to you:

1. I do not believe *all* hard money (and certainly not all *sound* money) advocates work off of the "we have fallen off a skyscraper" mentality. Some are more extreme in their doom and gloom than others, to say the least. Upon further inquiry, one cannot help but notice that oftentimes the true "we have fallen off a skyscraper" folks have a business model that benefits from more wild rhetoric, one way or another. But of course benefiting from a prediction does not make the prediction inherently false, but it may help explain the desire to attach a timeline to the fall.

2. The other piece I would suggest is that it seems to me hard money advocates are not merely saying "we have fallen off a skyscraper, and here's when we crash." They have stated *why* we have fallen off the skyscraper, which way we will blow on the way down, and what the crash will be like. They have provided ample levels of specificity, and not merely been wrong about the timing, but multiple cause and effect periphery as well.

I believe it is entirely appropriate for a sound money advocate (of which I am one, but you will note I find

LETTER 5

What Makes Deflation Bad?

—WILSON

Dear David,

Thanks very much. This is actually getting at my basic questions, at least the ones that started all this. But, not to be tedious, it also leads (of necessity, I think) to a few additional questions.

Your modifications to my skyscraper analogy are entirely acceptable to me. It was my disquiet over so many predictions not coming to pass that led me to want to pursue this subject with you in the first place. Although, speaking of that, I do want to ask about something else in passing. In recent weeks, I have seen a number of people pointing at phenomena that they say are the harbinger of the coming Biden inflation tsunami—the price of gas, price of eggs, prices of lumber, etc. If I am understanding you properly, you would say that the indicator of *actual* inflation, were it to happen, would be the bond market, and that these other things would be localized fluctuations, driven by various factors, stupid government decisions among them (e.g. lockdowns). Is that it? And besides, I don't want to be guilty of a bait and switch discussion, beginning by asking why there isn't any inflation, listening carefully to your answer, and then asking how you account for all the inflation then.

So your response on what the stimulus money is doing (and/or not doing) made really good sense to me. People are being fairly responsible with the irresponsible handouts, thus making the handouts less irresponsible, at least with regard to possible inflationary impact. The stimulus does add to the debt load, and hence to the long term deflationary pressures, but it has not resulted in a short term inflationary burst. Do I understand you correctly? This is because they basically gave everybody a bottle of whiskey to go get liquored up in order that they might spend a lot of money, but then instead of that everybody put their whiskey in the cabinet to be brought out for toasts on anniversaries and other special occasions.

In addition, you and I are in complete agreement on the debt amounts v. debt ratios thing. It doesn't help us