23 Things We're Telling You About Capitalism VI [1]

Written by Tim Worstall [2] | Tuesday 14 May 2013

The sixth thing about capitalism we're told is that inflation just isn't so bad. Further, that the attempts to reduce inflation have led to greater economic instability elsewhere. We should thus chillax about inflation and concentrate on other things.

Chang is indeed correct about low rates of inflation. The 1-3% sort of levels that central banks currently aim for aren't so bad: indeed they often aid other changes in the economy. Take, for example, Keynes' point about the rigidity of nominal wages. If inflation is 3% and wage rises 1% then real wages will be falling (as, sadly, they sometimes need to do, see Germany early this century) and this will cause a great deal less fuss and social unrest than if inflation is zero and nominal wages fall 2%.

It's also true that the aim is for low inflation because, in a debt financed society, we really don't want to get into a deflationary period. If nominal incomes and production values fall while nominal debt levels stay static it's entirely possible to enter a sort of death spiral. So erring on the side of caution, a couple of percent, is sensible enough.

Chang goes on to make the leap to the idea that moderate (which, apparently, means 20-40% a year) is also not so bad. He agress that hyperinflation is bad for:

" Hyperinflation undermines the very basis of capitalism, by turning market prices into meaningless noise".

This is an example of how Chang continually conflates capitalism and markets. They're really just not the same thing. They might work well together but capitalism is a description of who gets to own the productive asserts: the capitalists. Markets describe a method of exchange. These simply are not the same thing at all. Indeed, we can have capitalism without markets (the Soviet system was state capitalism without markets) and we can have various forms of socialism with markets (Tito's Yugoslavia was an attempt at this and we can certainly have socialist entities within markets: Mondragon, the Co Op and John Lewis come to mind), but it is vital to keep in mind that the two are descriptions of different things, not just interchangeable names for the same socio-economic system.

But Chang's real complaint isn't about inflation: it's about the economic instability of the other parts of the "neoliberal" package. By concentrating on killing inflation we've raised such things as job instability and other forms of non-price instability. Chang thinks this is a bad idea: I think it's entirely excellent. No, not because I'm a rabid neoliberal (although I am) nor because I want to grind the faces of the workers into the dust as they cower in fear of losing their jobs.

No, the entire point and aim of this game of an economic system is that we want to move productive assets from lower value uses to higher value ones. That's what we're trying to do for this movement is the very definition of wealth creation. And, given that we've still got near a billion people living on \$1 a day and the like, more wealth creation is still an urgent task.

If we have this need to be continually moving productive assets to higher valued uses then yes, labour will

be more insecure in its current employment. As will capital and land of course: and most especally so will human capital. Very few indeed expect to leave university these days and not have to learn new skills by the time they retire. Price insecurity, that inflation, does aid us in these reallocations: but not once we've got past that 1-3% level. Byt the time we get to 20% and up, the price insecurity is raising that signal to noise ratio in that information that prices are giving us. Thus we find that the allocations of assets that we're making is becoming less efficient as a result of the rise in that noise.

Even what Chang calls "moderate" inflation will, in an economy anywhere near the technological boundary, lead to us simply not having accurate enough information to know what we should be doing next: and that hampers wealth creation. It's worth noting that the economies he uses to show that inflation isn't so bad are those which were, at the time, decidedly not at that technological boundary.

As an analogy let us compare inflation to oil or grease. Chang and I are agreeing that drowning in a vat of hyperinflation is a bad idea, most unpleasant. We're also both agreeing that a little bit of oil greases the operation of the economy. The difference is that he sees the lake of oil on a skidpan as being an exciting experience, one that doesn't limit our speed, I as one where the feedback from the system leaves us all entirely out of control and with no idea where we're going or how to change where we are.

As to increasing economic instability in this neoliberal age: yes, quite. We've got the instability we need and require: the flexibility to deploy productive assets from lower to higher value uses. You know, to aid in making the poor rich.

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