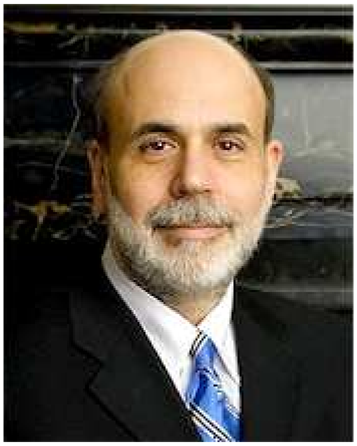
Matt Yglesias

Jul 27th, 2009 at 10:43 am

Bernanke Versus the Inflation People



Currently, the US unemployment rate stands at 9.5 percent. With the unemployment rate at 9.5 percent it's difficult for the majority of workers to argue for a raise. This is definitely true when we consider that millions of additional Americans are currently only working part-time even though they'd like full-time hours. What's more, Ben Bernanke is forecasting that the unemployment rate will eventually rise to over 10 percent and that by the end of 2011—18 months from now—it will still be over eight percent. Under those circumstances we're looking at a protracted period of flat or falling wages.

And yet somehow we still have people like Cato's Doug Bandow darkly warning about the threat of inflation. But where is this inflation going to come from? And if it does miraculously arise, why can't the Fed start reducing liquidity then? There's something very strange about the inflation people's outlook and their insistence that we should ignore the problem of actual mass unemployment right now in favor of the hypothetical problem that anti-unemployment policies might generate inflation at some future point. It's like they're standing outside a burning building worrying that the fire department's hoses are going to ruin the furniture.

I think it's pretty problematic that we have people arguing that with the Fed Chair job held by Republicans for 22 straight years, only extending the streak to 28 years can establish the Fed's "political independence." But that said I'm definitely glad that we got Bernanke rather than some of these other cranks who seem to be kicking around in right-of-center circles these days.

- Comments
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84 Responses to "Bernanke Versus the Inflation People"

1. *Francisco The Man* Says:
   July 27th, 2009 at 10:59 am

   Well, it’s easy. The Cato Clowns will always have a job if they want it, so they’re not concerned about unemployment. After all, it doesn’t affect them personally. So they’re worried about the (overhyped, largely non-existent) threat of inflation.

2. *ron* Says:
   July 27th, 2009 at 11:02 am

   But that said I’m definitely glad that we got Bernanke rather than some of these other cranks who seem to be kicking around in right-of-center circles these days.

   Bernanke was at the Fed or economic advisor to Bush when this financial mess was percolating. He encouraged it.
   When someone does as lousy a job as Bernanke thay should be fired. Not ranting and raving is not enough to qualify him.

3. *Noah* Says:
   July 27th, 2009 at 11:06 am

   “The inflation people”…I think we can come up with a more perjorative, catchy name than that! “Inflationheads”? “Inflationistas”? “Inflationtards”?

4. *ron* Says:
   July 27th, 2009 at 11:06 am

   Read this article by Robert Kuttner for a good take on where we realy stand:

   http://www.huffingtonpost.com/robert-kuttner/wall-street-on-speed_b_245121.html

5. *DTM* Says:
   July 27th, 2009 at 11:09 am

   Well, if you were a large net lender going into the recession, you may well be making a lot of money in real terms these days. So a cynic might suggest for some people it is less a matter of really worrying about the macroeconomic effects of inflation, and more a matter of wanting to see the party last as long as possible.

6. *JD* Says:
   July 27th, 2009 at 11:12 am

   It’s like they’re standing outside a burning building worrying that the fire department’s hoses are going to ruin the furniture.

   I would say that it is more like standing outside a burning building worrying that the fire deparment’s hoses will use to much water, increasing the threat of a drought. Which if there really are indications of a drought in the horizon, and the effects of a drought are worse than the effects of letting the house burn, is not a stupid worry.

   Basically, while it may be that the proper conclusion is that we should not worry about inflation right now (I am not sure what the correct conclusion is) I do not think being worried about it is at all as silly as you imply.

7. *Don Williams* Says:
   July 27th, 2009 at 11:16 am

   Is inflation caused by worker wage demands or by how much money is printed? Weimar Germany had 30 percent unemployment — I don't recall its workers having high wage demands in the 1920s.

   The Dollar Index fell to a low of around 72 last year. It subsequently recovered to around 80 or so but has been sliding from that recovery point in the last month or so. It's around 75? now, i believe. Gold has also been rising recently — or conversely,the dollar has been declining.

8. *Alien-radio* Says:
   July 27th, 2009 at 11:16 am

   Inflation reduces the value of money for those that have lots, and reduces the value of debt.

   concern trolling about inflation is nothing but the rich exposing their fundamental disgust and fear that proportionately they aren't going to score as highly as they used to.

9. *TacoPahn* Says:
   July 27th, 2009 at 11:18 am

   Does inflation need rising wages? I can see rising inflation with zero wage increase,i.e. if the dollar tanks and the cost of every imported item (everything) then shoots towards the moon. And how can anyone see the politics of the Fed draining liquidity with employment over 10%, sending the economy back into a now W shaped recession? Not saying we shouldn't be taking these actions, but the issue is far from clear IMO.

10. *Benny Lava* Says:
    July 27th, 2009 at 11:18 am

    Inflation helps debtors, deflation helps creditors. Therefore conservative thinktanks like Cato (can I start calling them "the Cato"?) will champion deflation because they favor banks. Pretty simple. This isn't about reality, it never was.

11. *Poptarts* Says:
    July 27th, 2009 at 11:19 am

    We were extremely, extremely lucky George W. Bush nominated Bernanke. Ron has no clue, although I agree with the Kuttner piece's sentiments.

    Different people have different hobbie horses. For example, Hector's are abortion, Jesus and Calvin-Klein clad hipsters.

    For the CATO people it's inflation.

12. *kid bitzer* Says:
    July 27th, 2009 at 11:23 am

    i'm sorry, but i don't think that giving the fed chairmanship to the republican party in perpetuity does enough to prove its independence.

    in order to prove that the fed is *really* above all partisan meddling, we have to make sure that the fed chairman is always a republican, and that the president who appoints him is always a republican.

if there are any democrats involved, that would raise clear issues of partisanship.

13. *Jasper* Says:
July 27th, 2009 at 11:28 am

And if it does miraculously arise, why can't the Fed start reducing liquidity then?

Well, the tools available to the Fed take time to work; by the time inflation is rising to undesirable levels, it's usually too late to smoothly nudge it downwards via monetary policy. What's necessary is to make correct guesses about what the economy will be doing six or twelve or eighteen months in the future. That said, Mat's broader point is well taken. And anyway, *some* inflation is *needed* now and in the near future, as insurance against a renewal of deflationary pressures, and as a balm to debtors.

A lot of the right wing critique of current fed policy is disingenuous, of course: they'd like nothing better than a deflationary, unemployment rate-increasing policy of tightening by the Fed.

14. *Jeffrey Davis* Says:
July 27th, 2009 at 11:36 am

Where's the evidence that inflation is even nascent?

The argument regarding inflation is just neo-Hooverism in other clothes.

15. *Anandakos* Says:
July 27th, 2009 at 11:43 am

Matt,

There are two kinds of inflation — demand pull or "the wage-price spiral" and monetary dilution — think Zimbabwe where there is 70% unemployment. The Cato people are worried about the monetary dilution kind, and it is far more dangerous.

The demand pull kind can usually be choked off by a vigilant central bank: they crank up short term interest rates until the economy squeaks.

Monetary dilution inflation is harder to control when it gets going, but the question is "are we really laying the groundwork for it"? I'm not completely convinced, though some of the arguments are strong.

Remember that about six to eight trillion in notional value was removed from stock market valuations during the crash; about three trillion has now been restored. That is "notional" or "market" value, not underlying asset value. Most of the companies whose stocks have plummeted, except for the propped-up financial firms, have really not had an equivalent reduction in potential earnings.

Added to that reduction has been the loss in notional housing wealth, another three to five trillion dollars. So US wealth at the stock market low was down nearly 10 trillion dollars. Even the darkest estimates of Fed and Treasury stimulus comes to about $2.7 trillion. So only a portion of the missing "wealth" has been replaced.

The danger is that the replacement is highly liquid near-money while what was lost was non-monetary asset value. The velocity of money has slowed so at this time the actual near-money supply really hasn't increased compared to the pre-crash economy. In fact, I believe it is somewhat smaller than it was in early September, but significantly larger than in late November at the depths of the panic.

So at this time we don't have money dilution, and hence no inflation. The question is, "can the Fed and Treasury remove the nearly $3 trillion of near-money without tipping the economy into another recession and thereby avoid inflation?" Obviously, we won't know for another couple of years.

16. *Ed Smithe* Says:
July 27th, 2009 at 11:51 am

Matt,

You really need a bit of discipline to avoid economic analysis in your posts. It is most certainly not your strong point by any sense of the imagination.

The inflation is coming from the government spending more and more money, bankrolled by Bernake's Fed. For Fed watchers, what Bernake has done is completely sell out the Fed to this idea that we're going to spend ourselves out of this recession. With respect to his support for easy money in the 90's/21st century, he was wrong. He's also wrong about this. At some point in time, they're going to have to put a stop to this by raising rates. For every day that they don't do that, the price that will have to be paid is going to grow larger and larger. It's not helping to create jobs, and I'd imagine that when they have to start raising rates (assuming they do), that isn't going to help jobs either.

What you guys can't seem to wrap your heads around is that there's no such thing as a free lunch. When the government continues to borrow this amount of money, there's eventually going to be a price to be paid.

You've been wrong about the stimulus, wrong about the economy, wrong about unemployment…and now you're going to be wrong about inflation. Either the Fed is going to raise rates or we're going to have inflation. That's reality.

17. *ron* Says:
July 27th, 2009 at 11:53 am

More grist for the mill. Exactly why are Bernanke and Geithner in favor of allowing CDS to exist?

http://www.cfo.com/article.cfm/14113089/?f=rsspage

18. *Joe Strummer* Says:
July 27th, 2009 at 11:58 am

It's no mystery where the inflation is going to come from. It comes from monetizing the debt, and "printing" currency in the form of outright money to banks in the form of TARP and credit guarantees.

This is not a mystery. It's not magical. Inflation rates are low because banks have, until this point, and probably for another 6 months, horded the money rather than used it to advance credit. You notice that credit has remained remarkably tight even though interest rates have remained relatively low owing to government monetary policy.

Second, China and others own a ton of dollars, and they have as you know been making many noises about the value of those dollars given American fiscal and monetary policy. Unless you think the Chinese have no where else to put their savings, then at some point China will probably decide to own fewer of those dollars. The strength of the dollar depends on others' willingness to buy dollars.

But of course gold, the Euro, commodities, and an IMF special drawing rights currency, if created, are all perfectly good alternatives to the dollar, if you're Chinese.

Most Americans, unfortunately, don't have the ability to easily convert their money into non-Dollar denominated assets. Too bad for them.

19. *Rob* Says:
July 27th, 2009 at 11:59 am

Ed needs to shut up talking about monetary economics because he knows crap about it.

Yes they are going to have to raise rates when inflation actually you know looks to be occurring as such a level that it maybe problematic, but if Greenspan showed us anything its that his inflation targets were much too close to the zero bound and so we need up the targets. In addition there is no reason to pay these cost when they are the highest, ie now when they should be paid when after the economy moves above long run growth.

20. *DTM* Says:
July 27th, 2009 at 12:04 pm

What you guys can't seem to wrap your heads around is that there's no such thing as a free lunch. When the government continues to borrow this amount of money, there's eventually going to be a price to be paid.

What you can't seem to wrap your head around is that sometimes borrowing to make a timely investment is a good idea. In this case, we are borrowing to help put people who would otherwise be involuntarily idle to work. Once that is no longer necessary, we will stop borrowing for this purpose and pay the money back. That is no more a mystery than a firm borrowing to invest in a new project and then paying the money back once the project is working.

Generally, the fact that there is no such thing as a free lunch doesn't mean you can't realize a net gain from more efficient allocations of economic resources. In this case, lot of involuntarily idle workers is an inefficient allocation of economic resources, so the gain we get from addressing that problem isn't a free lunch, just sound economic policy.

21. *Joe Strummer* Says:
July 27th, 2009 at 12:05 pm

Yes they are going to have to raise rates when inflation actually you know looks to be occurring as such a level that it maybe problematic, but if Greenspan showed us anything its that his inflation targets were much too close to the zero bound and so we need up the targets. In addition there is no reason to pay these cost when they are the highest, ie now when they should be paid when after the economy moves above long run growth.

Anyway, that's what Ed was saying. Yes, the "prosperity" of the last 15 years was mostly illusory, driven by absurdly low credit costs, created by Greenspan, and encouraged by Clinton, Bush, and now also Obama. That's why we had a real estate bubble.

The answer was to restore some sanity in monetary policy. But of course Obama and Bernanke haven't done that. They've simply tried to re-inflated the bubble.

We need a Volcker to come in and raise interest rates. The problem of course is that raising interest rates to 10 percent will not do it. Most of you don't recall that in the early 1980s, interest rates were 14, 15 percent in order to squeeze out inflation. And that was after the much more mild recessions of the 1970s where inflation was a problem, but not like it's going to be now. Look for interest rates to go north of 15 percent in the next 2 or three years.

Then ask yourself "what's that going to do to any real estate recovery."

As much as I like Yglesias on a whole host of issues, he really knows shit about monetary economics.

Out here in America there are a lot of 35 year olds with houses that are under water. Look for them to be under water on those mortgages for the next 10-15 years.

22. *DTM* Says:
    [July 27th, 2009 at 12:10 pm]

    You notice that credit has remained remarkably tight even though interest rates have remained relatively low owing to government monetary policy.

    Actually, the relevant spreads have come way down, although collectively not quite to normal.

    Unless you think the Chinese have no where else to put their savings, then at some point China will probably decide to own fewer of those dollars.

    Any such process would necessarily be very gradual and designed to minimize the impact on inflation rates, because otherwise the Chinese would just be devaluing their own holdings.

23. *DTM* Says:
    [July 27th, 2009 at 12:11 pm]

    Look for interest rates to go north of 15 percent in the next 2 or three years.

    I'll take some of that action.

24. *Joe Strummer* Says:
    [July 27th, 2009 at 12:14 pm]

    You can all bitch about people who are "obsessed" about inflation etc., but the point is that INFLATION IS A REGRESSIVE TAX.

    Since wealthy people have the ability to move money into higher yield securities to help them mitigate the effects of inflation, people with wealth are not as badly affected as people without it.

    For those of us who earn money by working, wages ALWAYS LAG INFLATION. So yes, having a job is great. Having a job that pays a living wage is also great. But making sure that wages beat inflation means making sure we have low inflation.

    Why is inflation a regressive tax? Because inflation is the result of government printing money (instead of raising taxes) to pay for stuff. When government does that, it simply increases the amount of dollars in the world for the same amount of shit. An increase of dollars per amount of shit IS inflation. But we don't NEED dollars. We need SHIT. The kind of shit that feeds us, clothes us, gives us shelter, and makes life fun and interesting.

    Those of us who don't have the luxury of investing money or living off trust funds, want to be able to earn money that has the SAME purchasing power or MORE over time. If we don't we're getting POORER.

    My parents bought a tract home in 1971 for about $18,000. Today that home probably goes for $180,000. But the people living in it today are not 10 times better off than my parents. It's just that the value of money has declined to the extent that it requires 10 times more DOLLARS to buy the same house.

Those people, who are middle class today, as my parents were in 1971, are in substantially the same boat. The primary life improvements that the people today enjoy are technological advances which are incredibly important. But that's a different issue.

25. *ron* Says:
July 27th, 2009 at 12:16 pm

Inflation could indeed be a problem at some point in the future - but right now DEFLATION is the much greater danger.

The money that has been pumped into bank reserves is basically irrelevant because it is not being lent to real businesses and it can disappear whenever the Fed wants.

The bailout money is being used to leverage stock and commodity trades. That does nothing for jobs or recovery of the real economy. What it does do is allow Goldman-Sachs and others to play poker with your money.

26. *Benny Lava* Says:
July 27th, 2009 at 12:25 pm

Most of you don't recall that in the early 1980s, interest rates were 14, 15 percent in order to squeeze out inflation. And that was after the much more mild recessions of the 1970s where inflation was a problem, but not like it's going to be now. Look for interest rates to go north of 15 percent in the next 2 or three years.

Interest rates were high in the 80s. How does that correlate to 15% inflation in the next 2 or 3 years exactly?

Out here in America there are a lot of 35 year olds with houses that are under water. Look for them to be under water on those mortgages for the next 10-15 years.

Nonsense crazy talk. I don't think anyone would pay a mortgage that is underwater for the long term. That is irrational. You could default and have that foreclosure fall off your credit rating in less time.

27. *DTM* Says:
July 27th, 2009 at 12:40 pm

For those of us who earn money by working, wages ALWAYS LAG INFLATION.

But that is simply untrue: sometimes they do, sometimes they don't. And yet your whole argument depended on this untruth.

Here is the real situation: the long-term inflation rate is actually a second-order consideration at best for most people (meaning non-net-lenders), as long as it stays within a certain reasonably broad range and isn't too volatile. Much more important to most people are employment rates and the distribution of income, because if unemployment rates are reasonably low and the distribution of income is reasonably broad, for most people wages will more than keep up with inflation.

In our present situation, it is certainly possible that when the threat of inflation finally shows up, the Fed's subsequent actions will be a little too slow or a little too ineffective. Thus, it is possible that rather than exactly hitting their inflation mark exactly, it will go a bit high for a bit before settling back down again. But again as long as unemployment rates are down and the distribution of income is broadening at that point, a little overshooting on inflation will be a relatively minor event for most people.

28. *Doug* Says:
July 27th, 2009 at 12:51 pm

For those that question the ill effects of quantitative easing, ask yourselves why shouldn't the fed cure our national debt problem by buying up all the existing debt and new debt issuance to finance the entire budget. We could even eliminate all taxes and just finance everything through issuing debt and having the Fed buy it up with newly created money. Why don't we do that?

Wouldn't the Fed really be able to walk back such a policy by later reselling that debt and reabsorbing the excess liquidity?
While the full monetization scenario is an extreme, the inflation people are concerned that we are getting too close to it. Remember that a good deal of U.S. prosperity is derived from our having the singular ability to print and borrow in the world's reserve currency. Current policies also threaten that and are inflationary or debasing for that reason as well.

I think the better fire analogy would be a large fire in a town below a dam and the debate is whether to fight the fire conventionally losing large sections of the town and rebuild the town later or blow the dam and let the flood put it out.

The inflation folks are worried about the flood damage and the loss of the dam. Not to mention that the flood may preserve some old fire trap buildings that it may be have been better to rebuild from scratch anyway.

29. *Joe Strummer* Says:
July 27th, 2009 at 1:13 pm

What Doug said.

As for DTM's response about how wages do or do not lag inflation, please explain to me a period in the last 50 years when wages actually beat inflation. True cost of living, not CPI. Also, my "whole" argument that inflation is generally bad does not depend on wages always being undercut by inflation. Even where wage gains simply keep pace with inflation, there's been no actual increase in individual employees' welfare (excepting technological developments). And if you can find me a time when wages actually beat the increases in the true cost of living, then all you'd prove is that inflation, as a regressive tax, was did not beat out wage increases. That doesn't make it any less regressive, since the regressivity feature of it is simply a statement that inflation falls hardest on the poorest.

Inflation could indeed be a problem at some point in the future - but right now DEFLATION is the much greater danger.

The money that has been pumped into bank reserves is basically irrelevant because it is not being lent to real businesses and it can disappear whenever the Fed wants.

This is nonsense. If the money can simply "disappear" whenever the Fed wants, then it isn't money. I don't know what it would be, but if the Fed could simply press a button and make all TARP and credit guarantees disappear in a poof off of whose ever books held them, then NO ONE would take that "money" as real money.

As to how the Fed will make the money supply decrease over time, it won't do it by making it magically “disappear”. It will simply raise interest rates (aka, the cost of borrowing). Because the cost of borrowing is the cost of borrowing to everyone (not just to Goldman Sachs), that means that the interest rates for home loans will have to rise as well.

How much? Again, I’ll take bets on 15 percent or above as of September 2012. You can put my money in a commodity. I’ll take two barrels of light crude oil delivered in September 2012 if I win. If I lose, I’ll pay $130 to you in September 2012.

30. *rapier* Says:
July 27th, 2009 at 1:37 pm

The dilemma isn’t summarized as inflation vs deflation. The dilemma is the continuous intervention in the credit markets to effect low rates distorts markets and investment. Cumulatively the mal investment makes the system less productive and ever more fragile.

Each crisis of the last 25 years was financial. While the 87 crash had no avenue to even effect the GDP except slightly each and ever subsequent crisis has promised to be more destabilizing to the general economy. That is because the economy became ever more dependent upon the inflation of assets that the low interest rates strongly tended to support. In turn each crisis was met by the Fed and it’s partners the financial industry with more policies and tools designed to prevent the ever more serious threat of financial deflation.

As late as 07 many including Bernanke believed the system had reached a sort of perfection. Instead the system was grossly unstable and that fact is in evidence all around us. While it seems that yet another round of low interest rates and money creation will set us right again the fact is that the huge response will result in only an even more unstable system.

It may seem that the Fed can withdraw their support of low rates when the time deems it necessary but in truth they will not be able to. They actually haven’t in 25 years. Oh sure rates went up as well as down but credit growth never faltered, until now. Now the government including the Fed is the entire source of systematic credit growth. They simple decline of credit growth for a few months is what fomented this current crisis. The fragility of the credit fueled financialized economy plain to see. The ‘market’ for credit will not and cannot support the system and is now fully dependent upon government and central banks intervention.

A line has been crossed and there is no going back. Admittedly this is a belief not a provable fact but it is no less a belief than the one that we will return somehow, in good order, to approximately where we were.

31. *Poptarts* Says:
July 27th, 2009 at 1:39 pm

Doug:

While the full monetization scenario is an extreme, the inflation people are concerned that we are getting too close to it.

Why do they think that? Because the unemployment rate is at 9.5% and predicted to go higher and all of those big-spending unemployed workers are inflationary?

32. *ron* Says:
July 27th, 2009 at 1:44 pm

please explain to me a period in the last 50 years when wages actually beat inflation

The period 1964 - 1974 saw the greatest sustained rise in REAL wages in US history.
http://www.econbrowser.com/archives/2005/12/declining_real.html

This is nonsense. If the money can simply "disappear" whenever the Fed wants, then it isn't money.

See "Monetary Policy". Here is Wikipedia:

http://en.wikipedia.org/wiki/Monetary_policy

33. *Bob Roddis* Says:
July 27th, 2009 at 1:46 pm

The problem with you Krug-tards is that you are too intellectually dull, incurious and conformist to even begin to understand the Austrian Business Cycle Theory and some history. We're going to have bad inflation. Get used to it.

This inordinate fear of deflation is baseless. Consider the 1920-1922 depression which Krug-tards always ignore and suppress. Between the second quarter of 1920 to the third quarter of 1921, wholesale prices fell 44%. Factory employment and industrial production fell 30%. The Fed raised the discount rate from 4% to 7% and then back to 4%. The Harding government did basically nothing in the way of so called Keynesian stimulus. Harding specifically and intentionally did nothing to interfere with falling wages and prices.

Further, Federal spending declined from $6.3 billion in 1920 to $5 billion in 1921 and $3.3 billion in 1922 and the budget immediately went into surplus. Tax rates, meanwhile, were slashed—for every income group. And over the course of the 1920s, the national debt was reduced by one third. The crisis was over quickly precisely because of the lack of Keynesian style stimulus.

All that a central bank like the Fed can do is dilute the money supply. This amounts to a true theft of purchasing power from those holding the existing money stock to those receiving the new money. There is no basis to believe monetary dilution reduces unemployment other than to trick workers into receiving lower real wages or to draw them into unsustainable lines of work created by the Fed's artificial bubble.

There is no evidentiary, historical or logical basis to either fear deflation or to expect Keynesian "stimulus" to produce anything other than misery, poverty and economic dislocation. In any event, while there is no reason to fear deflation generally, it's not in the cards across the board.

Presently, because you Krug-tards are so up front with your noodle-brained theories, the public might actually catch on to your fraud. However, the establishment has the back of the financial elite which you Krug-tards insist upon protecting.

34. *Tim B* Says:
July 27th, 2009 at 1:46 pm

What you guys can't seem to wrap your heads around is that there's no such thing as a free lunch. When the government continues to borrow this amount of money, there's eventually going to be a price to be paid.

What *you* guys can't seem to wrap your heads around is that no one is expecting a free lunch in the first place. The entire point of this exercise has been to utilize the tools at our disposal to avert a true crisis. There are costs associated with using those tools, but the benefit of relative economic stability far outweighs those costs. America is, in effect, using a credit card to make the car payment - a costly decision, but far less costly than losing the car, which then leads to losing the job, and ultimately the house and everything else.

We are only a few months into the 2 year spending package and already conservatives are acting as if it's a permanent state of affairs. I understand their motivation as the opposition party, but given their multi-$trillion spending spree of the last decade it surprises me that their concerns about the deficit are actually taken seriously.

35. *Anonymous* Says:
July 27th, 2009 at 1:48 pm

Joe Strummer: That's actually exactly the opposite of true. The Federal Reserve does not actually directly set interest rates, they just use (federal funds) interest rates as a target because it responds fairly quickly to what the Federal Reserve does, which is to literally create and destroy money.

The main tool the Federal Reserve uses are open market transactions, they buy financial assets at the going price (typically government securities, but they've been more creative recently) in exchange for newly created money, and they sell these assets to get the money back and destroy it. Now, they can't just wave their hands and make the money disappear, and the money supply is slightly more complicated than the money they create because of fractional reserve banking and whatnot, but yes, the Fed makes money, and they can destroy it.

36. *Joe Strummer* Says:
July 27th, 2009 at 1:54 pm

The period 1964 - 1974 saw the greatest sustained rise in REAL wages in US history.
http://www.econbrowser.com/archives/2005/12/declining_real.html

A period of comparatively low inflation. But debt and monetization of gov't obligations in the 60s set the path to inflation in the 1970s.

I'm not sure what you were trying to say about "monetary policy" with the wikipedia link.

We are only a few months into the 2 year spending package and already conservatives are acting as if it's a permanent state of affairs. I understand their motivation as the opposition party, but given their multi-$trillion spending spree of the last decade it surprises me that their concerns about the deficit are actually taken seriously.

I'm not a conservative. What I worry about is inflation as it affects the real lived experiences of wage employees who don't have any hedges against it.

37. *Joe Strummer* Says:
July 27th, 2009 at 1:58 pm

The Fed sets the the funds rate, right? So when it sets that funds rate, it is telling Banks the price at which they can borrow money from the Fed. When the Fed sets it low, the price of money is low. When it sets it high, the price of money becomes more expensive and credit tightens.

So no one said that the Fed goes out and instructs Bank of America, hey set your rate on 30 year fixed rate mortgages at 5.75. But when the Fed lends money at a particular rate, it is expecting that the correlating market rate will be higher given the cost of lending and other market conditions.

That doesn't change the fact that the Fed is the one setting the rate against which other credit rates in the market are pegged.

38. *Tim B* Says:
July 27th, 2009 at 1:58 pm

Personally, I wasn't very convinced by @Bob Roddis' numbers since they've been debunked time and time again for the distorted lie that they are, but I was ultimately won over by his baseless, humorously fact-challenged attacks on a wide swath of the educated population.

39. *ron* Says:
July 27th, 2009 at 1:59 pm

Rightwing propaganda has been so effective over the last 30 years that even many liberals now think that the Fed is an effective manager of the economy. It isn't and it never has been.

Review a history of Fed actions after WWI, in the 1920s, in 1929. Look at economic performance from WWII to the mid 1970s, when the Fed played a very minor role. Look at the major recession caused by Fed actions in the early 80s.

And more recently, the Fed facilitated the dot.com boom and then the housing bubble right after that.

Rightwingers want the Fed to be the manager of the economy because the alternative is macro and micro policy, and those two entail government action on taxes, spending and even wage and price policies. They want to control the economy instead of government.

40. *Joe Strummer* Says:
July 27th, 2009 at 2:01 pm

The main tool the Federal Reserve uses are open market transactions, they buy financial assets at the going price (typically government securities, but they've been more creative recently) in exchange for newly created money, and they sell these assets to get the money back and destroy it. Now, they can't just wave their hands and make the money disappear, and the money supply is slightly more complicated than the money they create because of fractional reserve banking and whatnot, but yes, the Fed makes money, and they can destroy it.

Right. And how does the Fed "destroy" money? By selling assets that in turn raises the interest rate. The other poster had implied that the Fed simply makes money "disappear" off balance sheets, further implying that there was no inflationary effect from the recent credit expansion because the money would just disappear. That's nonsense, and if the Fed did that that so-called money would be valueless because if people in the market knew that money could basically be wiped off their balance sheets, they wouldn't take it in the first place.

41. *Doug* Says:
July 27th, 2009 at 2:03 pm

poptarts,

The inflation takes hold when the economy recovers and all the cash pumped into the financial sector gets pushed into the real economy. The fact that you see still mild price rises now or essentially flat prices despite the high unemployment and despite the contraction of real economic activity ought to tell you something about the influence of current monetary policy on prices.

Under pressure from the Chinese and the bond market in general, the Fed has had to lay out an exit strategy that disavows continuing to do what they have already done and essentially promises an exit strategy of tight credit and higher taxes. That part will be the hard part politically, so hard in fact that I do not think it will happen before the bond market and the foreign exchange market signal a loss of confidence in the dollar. In other words I think it is more likely that the global market will discipline our monetary policy before our domestic institutions discipline our monetary policy. That would be bad.

42. *Tim B* Says:
July 27th, 2009 at 2:05 pm

@Joe: *What I worry about is inflation as it affects the real lived experiences of wage employees who don't have any hedges against it*

Understandable. However, even if we assume that we're in imminent danger of inflation and take the appropriate mitigating steps, the unemployment rate is going to skyrocket. Thus the pain of a recession will be less widespread, but far greater for those who experience it. Is that a trade off you're willing to accept?

43. *Joe Strummer* Says:
July 27th, 2009 at 2:06 pm

Rightwingers want the Fed to be the manager of the economy because the alternative is macro and micro policy, and those two entail government action on taxes, spending and even wage and price policies. They want to control the economy instead of government.

EXACTLY! But it isn't, has never been, and can never be. So left-liberals have this belief that monetary policy is some black box into which good things happen because of the mystery of it.

Hey, if you want to fix health care - I do, something like France's would be great - or have a welfare system - I do - then fine. But pay for it without messing with the money supply.

A lot of people on the left are attracted by credit bubbles because they can get some of the welfare programs they like without having to raise nominal tax rates. But this is all an illusion, because these programs must be paid for.

We should HAVE a progressive tax system. But when we have high inflation because programs are funded by credit expansion, all we get are PROGRAMS that in turn are paid for by an implicit tax on wage earners who see the value of the money they earn devalued.

44. *ron* Says:
July 27th, 2009 at 2:07 pm

I'm not sure what you were trying to say about "monetary policy" with the wikipedia link.

I was saying that reading (and understanding) that or other links would apparently be a good use of your time, since it explains that the Fed does indeed create and destroy money.

45. *Joe Strummer* Says:
July 27th, 2009 at 2:14 pm

Tim:

Understandable. However, even if we assume that we're in imminent danger of inflation and take the *appropriate mitigating steps, the unemployment rate is going to skyrocket. Thus the pain of a recession will be less widespread, but far greater for those who experience it. Is that a trade off you're willing to accept?*

Look, the problems are here, the question is what can be done about it. I was opposed to the credit expansion of the last 15 years that created them. If we want to have welfare programs, and we do, then they must be paid for. Matt's complaints about the American political system are right-on. The chief problem is that the gov't continues to create programs that are unfunded liabilities. That means that they must be paid for by the issuance of debt, which is expansionary.

If we want a redistributive economic and tax system, then we need to redistribute. Tax the wealthy, and give to the poor. But when you simply give to the poor by creating debt and unfunded liabilities, then you get inflation at some point that erodes the beneficial effects of those programs on the poor.

So yes, I'll take more unemployment (and good benefits to help people through that period) rather than the inflation.

46. *Jasper* Says:
July 27th, 2009 at 2:14 pm

There is no evidentiary, historical or logical basis to either fear deflation…

Right. The hopelessness, hunger, disease, poverty and misery of the 1930s was awesome. So, too, was the global political instability flowing from this period.

…or to expect Keynesian "stimulus" to produce anything other than misery, poverty and economic dislocation.

Right. The quarter century of booming prosperity, rising wealth, and widely shared improvements in living standards ignited by the largest stimulus plan in history totally sucked.

47. *Don Williams* Says:
July 27th, 2009 at 2:31 pm

Re Bob at 33: "The problem with you Krug-tards is that you are too intellectually dull, incurious and conformist to even begin to understand the Austrian Business Cycle Theory "

————————-

(snicker)

48. *Ed Smithe* Says:
July 27th, 2009 at 2:34 pm

DTM,

I agree with borrowing to make a timely investment…The problem is that you can't define the investment.

What did the stimulus invest in? What is the health care bill going to invest in? What is Cap and Trade going to invest in?

The problem with your theory is that it isn't working…Employment is going to continue to rise, inflation is going to continue to rise (although I'd take that 15% bet as well). At some point we're going to have to recognize that you can't square a circle.

Businesses aren't going to hire people when they don't know what's around the corner to pay for all of this spending. You guys have made it far more difficult for the unemployed in this nation. Your predictions (or at least the Administration's predictions) were wildly (and predictably) bogus. Either the administration was lying (which makes them look like a bunch of morons) or they had no idea what they were doing in the first place.

Things at the margin will probably get better…The problem is what did it cost to make them marginally better. The price, is going to be in the form of massive inflation (lest the Fed head it off) down the road.

How do you guys plan to pay for all of this? Can you answer me that question? Taxes? Cuts? What's it going to be.

If you haven't noticed, other countries (most prominently China) don't believe a word of this bullshit. They're not looking to expand their long-term portfolios, they're buying short and slowly but surely dumping dollars. Why? Because they think we're toast. The Chinese don't have anything invested in our politics, which is why they can make a decision like that. For them it's the bottom line. Shouldn't it be for you as well?

49. *Don Williams* Says:
July 27th, 2009 at 2:42 pm

Re Joe Strummer at 24: "You can all bitch about people who are "obsessed" about inflation etc., but the point is that INFLATION IS A REGRESSIVE TAX."
——————-
Actually, it seems to me that Inflation can be a HIGHLY PROGRESSIVE tax.

During times when the plutocrats' whores are in power (e.g., the Bush Administration), the Superrich can accumulate great wealth via various transfers from the US Treasury and convert the income into After-Tax Wealth via low tax rates.

Under the Fifth Amendment ban on government taking, Ill-gotten gains converted into After Tax Wealth can't be taxed (or clawed back.) So When the Rich temporarily lose power, they can simply stuff money under the mattress and live on the interest.

But with inflation , you can convert, for example, $1 Million in Ill_Gotten Wealth into $2 Million. Then you TAX the $1 Million in capital gains at 50 percent –thereby diluting the Real Value of the Robber Baron's money bag.

In my opinion, one reason for the Reagan Revolution was that the rich were seething over the fucking they got from the high inflation of the Jimmy Carter era.

All this depends, of course, on taxing the capital gains from inflation at high rates.

50. *Kropotkin* Says:
July 27th, 2009 at 2:45 pm

So Matt, are you going to blog on that idiotic Ron Paul bill that will take away the independence of the Fed? I haven't heard a peep about it here. I see it as a back-door libertarian effort to effectively ruin the Fed, because they really, really, really, hate the Fed.

51. *Bob Roddis* Says:
July 27th, 2009 at 2:45 pm

Dear Jasper:

Since it was the Fed and the government that caused the Great Depression, what's your point? Once it began, Hoover ran huge deficits and the Fed slashed interest rates to record lows. Hoover raised taxes to idiotic rates. No wonder the depression lasted until FDR finally died.

General prosperity only returned once the slope on your chart headed downwards. Congress slashed expenditures from 1945-1948 by 2/3. The budget was in surplus for 1947 and 1948. It was the Keynesians who predicted a continued depression after WWII. However, slashing spending created the first return to prosperity since 1929. The boom started with a lack of stimulus (and BECAUSE of a lack of "stimulus") even though the old accumulated debt had to be paid down. Paying down that debt just made everyone poorer than if it hadn't be incurred.

The idea that your beloved military Keynesianism creates prosperity is absurd and baseless. Military Keynesianism leads to impoverishment and the fire-bombing of Tokyo civilians (another great Progressive legacy).

I also note the curve on your chart heading upwards for this decade. Therefore, we should have reach Keynesian Nirvana by now. Instead, we are faced with climbing out of the huge economic hole dug by 65 years of Keynesian debt and monetary dilution.

52. *chris* Says:
    July 27th, 2009 at 2:48 pm

    @46: You're wasting your time. Neo-Austrians are as impervious to factual argument as creationists or astrologers.

53. *Don Williams* Says:
    July 27th, 2009 at 2:49 pm

    Re Ed Smithe at 48: "You guys have made it far more difficult for the unemployed in this nation. Your predictions (or at least the Administration's predictions) were wildly (and predictably) bogus"

    ———

    Actually, what made it difficult for the unemployed was Republican Whores selling out the Country to their rich patrons.
    Telling the policemen at the SEC etc to take the night off while the crooks went a stealing.

    You're lucky I'm not President — I would have the military shooting thousands of crooked sonabitches on the National Mall and stacking them up like cordwood.

54. *Benny Lava* Says:
    July 27th, 2009 at 3:06 pm

    I love it when Paultards start whining about inflation!

    We're going to have bad inflation. Get used to it.

    Oh really? Paultards, include Dr. Paul himself, have been predicting hyperinflation since the 80s. Guess what, it didn't happen. Why can't you New Austrians admit that your inflationary bugaboo is a fraud. Your predictions haven't come true in 30 years of chicken little hollering.

55. *Bob Roddis* Says:
    July 27th, 2009 at 3:21 pm

• Kropotkin:

It will be pretty funny when Ygley chimes in on Ron Paul's heroic bill, seeing that Ygley, as a typically clueless Krug-tard, doesn't understand the ABCT whatsoever and has no intention of trying to understand it.

#52 Chris:

How would you know whether or not Austrians are impervious to factual argument when you Krug-tards never have any facts or argument?

Plus, what are you poor Krug-tards going to do if and when the public actually catches on to the fraud that is the Fed and Keynesianism? Of course, since the financial elite and the media are on your side, the public may never come to understand. However, I note that you establishment defenders don't even try to understand the ABCT. If the public starts to catch on, you establishment whores are going to be behind the 8 ball when you haven't even tried out various BS attempts at refuting the ABCT amongst yourselves.

56. *Bob Roddis* Says:
July 27th, 2009 at 3:28 pm

Benny Lava:

A 1971 dollar is now worth $0.19 (for now) which could not have happened without Fed monetary dilution. We are in an economic catastrophe as predicted by Dr. Paul, Peter Schiff, Tom Woods etc….

Your point?

57. *DTM* Says:
July 27th, 2009 at 3:31 pm

I agree with borrowing to make a timely investment . . . The problem is that you can't define the investment.

Sure I can. Let's watch:

What did the stimulus invest in?

Employing people.

What is the health care bill going to invest in?

More efficient provision of health care.

What is Cap and Trade going to invest in?

That's just a first step, but ultimately in reducing the carbon intensity of the world economy.

The problem with your theory is that it isn't working.

Actually, the stimulus is working: it is quite likely more people are employed now than would have been employed if not for the stimulus, and the most efficient forms of stimulus (direct spending) are just getting started.

Employment is going to continue to rise, inflation is going to continue to rise.

Assuming you meant UNemployment (rising employment would be good), this combination of outcomes is pretty unlikely. There very likely won't be serious inflation until unemployment rates are much lower than they are now.

Businesses aren't going to hire people when they don't know what's around the corner to pay for all of this spending.

Businesses are going to hire people if they see a competitive advantage in doing so. Anything else would be foolish–you're not going to do better no matter what is coming from losing market share to your competitors.

Either the administration was lying (which makes them look like a bunch of morons) or they had no idea what they were doing in the first place.

This is childish ranting, not real analysis. Both the Administration and the private consensus of economists underestimated how bad unemployment was going to get. What that shows is that predicting the macroeconomic future with precision is extremely difficult, particularly when facing dynamic and somewhat unprecedented situations. That does not, however, show that they were wrong about the stimulus–indeed, the stimulus is measurably helping, and now we just know it probably should have been much bigger.

The price, is going to be in the form of massive inflation (lest the Fed head it off) down the road.

But they are in fact going to try to head it off. And they will probably be at least mostly successful, subject to some relatively small and correctible error.

How do you guys plan to pay for all of this? Can you answer me that question? Taxes? Cuts? What's it going to be.

In a nutshell, the Fed is going to tighten monetary policy by selling assets back off its balance sheet. As for the federal government, the real problem is the inherited structural deficit, not this cyclical deficit, and dealing with that structural deficit is going to take many years (and even then only if we don't elect another Reagan, Bush, or Bush). Personally, I would favor a combination of cuts and taxes to that end.

If you haven't noticed, other countries (most prominently China) don't believe a word of this bullshit. They're not looking to expand their long-term portfolios, they're buying short and slowly but surely dumping dollars. Why? Because they think we're toast.

The Chinese have been expressing the same concerns for a long time, and that is precisely because they know as well as I do that the structural deficit created by Reagan, Bush, and Bush has to be dealt with eventually. In other words, the party Reagan, Bush, and Bush threw for the Chinese is coming to an end.

But who cares? As long as the Chinese cut back their investments slowly, which they have every incentive to do, that is fine with me.

58. *winstongator* Says:
[July 27th, 2009 at 3:39 pm]

The argument is that Bernanke is 'printing money' which will eventually cause inflation. But:

We have a fractional reserve banking system.
In such systems, banks can create money.
The amount of $ created is a function of their leverage ratio.
Higher leverage, more $ created.

Where did we see higher leverage, and when? Why was it OK for investment banks to create money, but not the Fed? The Fed's actions are only stemming deflation because the money created by the IB's deflated along with the housing bubble.

59. *winstongator* Says:
July 27th, 2009 at 3:55 pm

The other argument is that it is now accepted that for 2004 and some of 2005, Greenspan kept interest rates significantly lower than they should have been. This DID cause inflation, but not in the generally accepted way we measure it. It inflated home prices, which if recalculated into the CPIs shows a +7% rate during that time period.

http://2.bp.blogspot.com/_nSTO-vZpSgc/Slwpr_ost3I/AAAAAAAAGds/96fAxwPHnCo/s1600-h/cpi-case-shiller-2009-06.png

Problems from inflation can lag the growth that low interest rates can bring. Why would Greenspan have wanted to shift growth from the 2005- period into 2004, making 2004 have more growth at the expense of the time period of 2005 and after? Why all of the sudden the desire to de-politicize the fed?

60. *rfv* Says:
July 27th, 2009 at 3:56 pm

Is there any way we can get Bob Roddis, et al some girlfriends? It would give them something more useful and real to do with themselves.

61. *sycophant of the bourgeois* Says:
July 27th, 2009 at 4:17 pm

Do any Krugtards understand that the Fed was created by the very people they hate?

The owners of banks and the largest industries whose expansion relied on credit extended from the banks and from their friends at the Fed.

To say that libertarians are shills for the rich when the Fed predominately helps the richest is beyond absurd.

62. *DTM* Says:
July 27th, 2009 at 4:19 pm

Is there any way we can get Bob Roddis, et al some girlfriends?

You can lead a horse to water, but you can't make the water stick around when the horse starts ranting at a dinner about Krug-tards.

63. *Ed Smithe* Says:
July 27th, 2009 at 4:34 pm

DTM,

Sorry, you're correct…Unemployment is continuing to rise. The stimulus isn't employing anyone yet.

As for health care, more efficient (assuming that happens) doesn't necessarily mean more jobs.

As for Cap and Trade, your taking from Peter to pay Paul. Jobs lost in "dirty industries" will be replaced by "clean industries." And that assumes that it's a 1:1. I'd venture to say that it won't be a 1:1, not the least of which is because our manufacturing industry can't compete any longer thanks in large part to fixed costs. As for cutting carbon. Even the most bullish of estimates pin carbon cuts as so small to be insignificant…and again, I'm not really sure how taxing people creates jobs or improves the economy.

As for businesses, that's not much of an answer. We're probably at 10% (or higher) unemployment. No one wants to go out on a limb…not the least of which is because they don't know how much this health care bill is going to cost them. This is not going to continue ad infinitum, but it's not going to get much better over the next couple of years (depending upon what passes).

As for the administration. They came into power (partially) to fix this. They have not. You can argue that it could have been worse, but that doesn't change the central reality that they haven't done anything to make things better. Better than they could have been is not progress. Moreover, your argument assumes that they're on the right track. How can you argue that when they didn't even know how bad things were to begin with? Some conservatives understood that this wouldn't make things better. They were right.

As for the Fed. Tell me, who's going to buy those assets? And with regard to all of this being the fault of Republican Presidents…my question is why are the Chinese suddenly changing their investment strategy now? Moreover, if Obama and Co. are going to fix things, then why aren't the Chinese jumping back in. If you hadn't heard, when Geithner went to China to reassure them, they laughed at him.

Finally, with respect to cutting back their investments, I've got to ask you again…If Asia isn't going to finance our profligate spending, just who will?

And that's where we get back to inflation.

64. *Bob Roddis* Says:
[July 27th, 2009 at 4:41 pm]

I'm running a contest to find the lamest excuse for the intellectual incuriosity and dimwittedness which expresses itself in Krug-tards being congenitally unable to analyze the ABCT and/or express any kind of intelligent response thereto.

At this point, rfv is in the top five.

65. *Sock Puppet of the Great Satan* Says:
[July 27th, 2009 at 4:44 pm]

"The inflation is coming from the government spending more and more money, bankrolled by Bernake's Fed."

As St.Milton said over and over again, inflation is a monetary phenomeneon. There is collapsing demand in the private sector. Gubmint is taking up the slack. If it did not do so, then there would be severe recession, including structural damage to the economy from long-term unemployment and loss of skills and creation of an unemployment cohort, which we saw in the U.S. and U.K. in the early 1980s recession under St. Ronnie and St. Margaret.

The costs of inflation below 8-10% p.a. overall to the economy are minimal and take a long time to manifest as expectation change. The costs of high unemployment are immediate and get more severe over time.

In summary: there's no risk of inflation, more's the fucking pity. If the economy was showing signs of inflation, that'd be the sign that the economy was picking up. And monetizing the debt, for the private sector, looks not entirely a bad idea.

66. *Sock Puppet of the Great Satan* Says:
July 27th, 2009 at 5:00 pm

"Why can't you New Austrians admit that your inflationary bugaboo is a fraud. Your predictions haven't come true in 30 years of chicken little hollering."

Here's the deal: always predict doom at all times because . As the business cycle has a 5-7 time period, you're always going to a only a few years away from another recession. Then your followers can point to your predictions as proof of your prescience. Eventually, your predictions of doom will always be right (somewhat). Just don't make any investment decisions based on them.

There are a limited number nuggets of wisdom in Austrian theory looking at an economy in the long term, but the cultish fanaticism and pomposity of followers of Austrian theory makes wading through the crap not worth it. Most of all, Austrians don't realize there's been 60 years of work since the heyday of the Austrian school. Distrust of economic data and empiricism was a justifiable stance when the statistics were sketchy, limited and with short histories. But macroeconomic statistics are better now, and can be used in analysis and assessment of theories. Austrians anti-empiricism makes their school of thought polemical, not a basis for policy.

67. *rapier* Says:
July 27th, 2009 at 5:38 pm

I'm in the small school of one that respects the fundamental tenets of the Austrian School and dismiss most of the rest.

Of course fractional reserve banking and fiat currencies are inflationary to their core. There are several billion more people in the world and twice as many Americans since Mises day. No Austrian has ever explained to me how to deal with this simple fact. If money is essentially static with a rising population it isn't too difficult to see there is going to be a problem with the money economy or to be more succinct, the political economy.

In the tug of war between money as a store of value and money as a medium of exchange democracies will always favor the latter.

All that said the mother of all markets in our system is the credit market. The belief that one man, Greenspan, controlled this market and actually knew what he was doing is the exact opposite of every single idea that markets stand for. Credit expanded at a breakneck rate for 25 years, 20 under Greenspan and Bernanke and the result has been a mess. Mad mindless consumption and an ever more skewed distribution of assets and income. The low interest rate fetish has punished savers and savings. First we were told stocks were the new savings. When that didn't pan out we were told real estate was the new savings. Now prudent people who against all market signals insisted on savings in simple bank instruments and money markets are seeing returns approaching zero. Forced to liquidate liquidate liquidate their capital, so that we might again, somehow, inflate stocks or some other thing again, with leveraged speculation. It's nuts.

Perhaps the debt to GDP chart can go to 400% or 1000% or 10000%. Borrowing ever more to pay off the old debt in a Ponzi manner. Just don't call it a market.

Lehman Brothers love low rates. They had almost $1 trillion in assets in 07 and with leverage at low rates were tuning it over several times a day. Yes, a day. And everyone called it investment and had orgasms every time Al or Ben said we will be loose when needed. Little wonder it fell apart. The market was corrupted.

68. *JonF* Says:
[July 27th, 2009 at 6:31 pm]

Re: There are two kinds of inflation — demand pull or "the wage-price spiral" and monetary dilution

Actually, monetary dilution boils down to demand pull since the reason printing money can cause inflation is that people have more money so demand goes up before supply can increase to compensate. However that's not a danger right now. The US economy has lost somewhere around 6 trillion dollars– excatly as if some Joker clone has shoveled a huge pile of cash into a mountain and set it on fire. All we are currently doing is replacing what was lost.

69. *Jeffrey Davis* Says:
[July 27th, 2009 at 6:49 pm]

I'm in the small school of one that respects the fundamental tenets of the Austrian School and dismiss most of the rest.

So, how are you and Rational Markets getting along?

70. *rapier* Says:
[July 27th, 2009 at 7:07 pm]

Economics is invented. A bunch of complex abstractions built upon the abstraction that is money which itself is an ever evolving more complex abstraction.

Money must serve the maximum amount of people to the maximum extent possible. Any call for society to serve the money system is utilitarianism and is necessary incorrect if not ultimately evil. No system is perfect or perfectible. A better system is always possible. The system that came out of the Great Depression was pretty darn good. Unsound credit has hurt the system badly and could destroy it. The Fed has corrupted the market system. It is not independent because it serves to favor powerful banking and financial institutions and thus the select few who control them. On some level almost everything Greenspan since his ascension to the chair of the Fed is wrong or a lie. He got away with it because it is undemocratic. That the political sphere was his partner is no excuse.

If monetizing crappy assets was the answer to economic growth then throw capitalism and markets out the window.

71. *Benny Lava* Says:
[July 27th, 2009 at 7:42 pm]

Bob Roddis,

1971 is not the 1980s. Given your demonstrated innumeracy, I doubt you would understand that inflation over the last 25 years has been mild, and since the alarm calls of Paul and his Tards in the 1980s we haven't had hyperinflation. In fact since their alarm calls of last year we had deflation. Why can't they ever get their predictions right? Nostradamus is more reliable than paultards.

72. *Benny Lava* Says:
July 27th, 2009 at 7:55 pm

To say that libertarians are shills for the rich when the Fed predominately helps the richest is beyond absurd.

What's beyond absurd is to pretend that libertarian policies will not further enrich the wealthy, or that they will in any way benefit the poor. What is the first tax bracket that libertarians wish to cut? Why, the top tax bracket. How curious. Why are you pretending that cutting taxes for the rich isn't a policy set to benefit them? Isn't that the cornerstone of libertarian thinking?

Doesn't deflation help creditors? Why can't you even acknowledge this?

Doesn't deflation hurt debtors? Why can't you admit that this will hurt the average American?

73. *Glaivester* Says:
July 27th, 2009 at 8:02 pm

#8: *Inflation reduces the value of money for those that have lots, and reduces the value of debt.*

You're assuming that the rich are not in debt (e.g. highly leveraged), and that none of the poor or lower middle class have savings.

#10 *Inflation helps debtors, deflation helps creditors. Therefore conservative thinktanks like Cato (can I start calling them "the Cato"?) will champion deflation because they favor banks.*

You are forgetting that inflation is the printing (or virtual printing) of new money, and the banks are the first ones to get their hands on the new money. So the banks can make out like bandits from the new money even if their former loans are devalued - and they can always raise the interest rate on adjustable rate loans.

#54 *Oh really? Paultards, include Dr. Paul himself, have been predicting hyperinflation since the 80s. Guess what, it didn't happen.*

That's largely because of huge interest rate hikes by Volcker.

#57 What did the stimulus invest in?

Employing people.

"Employing people" is not an investment. You invest in producing something. What did the stimulus invest in that will produce something? That is, what are all these people employed to do?

74. *Benny Lava* Says:
July 27th, 2009 at 8:12 pm

So the banks can make out like bandits from the new money even if their former loans are devalued - and they can always raise the interest rate on adjustable rate loans.

Really? How did that work out for banks over the last year?

That's largely because of huge interest rate hikes by Volcker.

So Volcker kept interest rates high over the last 25 years? Oh wait no…try that one again.

75. Glaivester Says:
July 27th, 2009 at 8:15 pm

Matt: *Doesn't deflation help creditors? Why can't you even acknowledge this?*

Yes, but how many of the rich are in debt, leveraged up to their eyeballs? How many working and middle class people are there who have savings that will be wiped out by inflation?

Matt again: *But where is this inflation going to come from? And if it does miraculously arise, why can't the Fed start reducing liquidity then?*

When the inflation comes, those who argued for more liquidity now to prevent deflation will likewise argue against fighting inflation because it will create more unemployment. What makes you think that when the inflation comes, the political situation will allow the Fed to reduce liquidity?

Your entire argument is based on the assumption that money devaluation will not occur until until after the employment situation improves, so that we will be able to deal with it then. It is not necessarily so.

DTM #20:

What you can't seem to wrap your head around is that sometimes borrowing to make a timely investment is a good idea.

True. So what is your investment?

In this case, we are borrowing to help put people who would otherwise be involuntarily idle to work.

Uh, I don't hear an investment here. What is it that these people will create that would not have existed without the stimulus? You don't invest in "providing jobs," you invest in producing a product (good or service).

(Oh, wait. I forgot. You believe that employment is a product that you invest in to make more of, rather than a resource used for making product.)

Will these people only be using resources that would have otherwise been idle? Will we make certain that we only employ people who do not have specialized skills or who only have specialized skills that are in low demand? Will we make certain that the projects we employ them on do not also require resources that are not in a glut or people with skills that are in high demand?

Generally, the fact that there is no such thing as a free lunch doesn't mean you can't realize a net gain from more efficient allocations of economic resources. In this case, lot of involuntarily idle workers is an inefficient allocation of economic resources, so the gain we get from addressing that problem isn't a free lunch, just sound economic policy.

Well, assuming that these workers are creating a useful product that does not wind up using a lot of non-idle resources.

76. *Benny Lava* Says:
July 27th, 2009 at 8:20 pm

Yes, but how many of the rich are in debt, leveraged up to their eyeballs? How many working and *middle class people are there who have savings that will be wiped out by inflation?*

Why don't you tell me, what percentage of the top 10% are in debt, and what percentage of the bottom 50% are not.

Also, my name is not Matt, and you are confusing my post with someone else's.

77. *DTM* Says:
July 27th, 2009 at 8:37 pm

Sorry, you're correct . . . Unemployment is continuing to rise. The stimulus isn't employing anyone yet.

You do realize that is a non sequitur, right? The stimulus is already employing people, just not enough to outweigh the jobs otherwise being lost. And no one ever promised otherwise at this stage, although the gap is indeed worse than originally predicted.

As for health care, more efficient (assuming that happens) doesn't necessarily mean more jobs.

I haven't claimed the health care bill is about job creation. The same with cap and trade.

As for businesses, that's not much of an answer.

It wasn't much of a question. There are always lots of uncertainties in business, but once market opportunities start picking up, businesses will start pursuing them, uncertainty or no.

You can argue that it could have been worse, but that doesn't change the central reality that they haven't done anything to make things better.

This doesn't even make sense. If things would have been worse but for what they did, then they have done something to make things better.

How can you argue that when they didn't even know how bad things were to begin with? Some conservatives understood that this wouldn't make things better. They were right.

Again, this is just a logical mess. Being able to predict with perfect accuracy the future track of the economy and being able to do things which bend the track of the economy in a better direction are really two different things. If "conservatives" need to promote such logical confusions to make their argument, they don't have much of an argument to make.

Tell me, who's going to buy those assets?

People with savings to invest. These days, that may well include a lot of Americans. Since your sense of reality is constrained by your ideology, you may not be aware that under the right circumstances, Americans will actually save.

my question is why are the Chinese suddenly changing their investment strategy now?

They're not. They are following the same track but grumbling about it a lot.

Moreover, if Obama and Co. are going to fix things, then why aren't the Chinese jumping back in.

Fixing things ultimately means starting to pay down the structural deficits inherited from Reagan, Bush, and Bush. This was always going to require the Chinese to shift their position gradually. Again, Reagan, Bush, and Bush threw a big party for the Chinese, and the party is coming to an end. Plus, the Chinese really need to be spending and not saving themselves right now, and they know it.

If Asia isn't going to finance our profligate spending, just who will?

As I suggested, long term we can pay down the structural deficits passed along by Reagan, Bush, and Bush through a combination of taxes and spending cuts.

78. *DTM* Says:
July 27th, 2009 at 8:49 pm

    You're assuming that the rich are not in debt (e.g. highly leveraged), and that none of the poor or lower middle class have savings.

    While there are individual exceptions, on the whole the rich tend to be net lenders and the poor and middle class tend to be net borrowers.

    That is, what are all these people employed to do? . . . What is it that these people will create that would not have existed without the stimulus?

    Do you actually want a list? It would be extremely long, particularly once you consider multipliers. But the bottomline is that overall they are being a lot more productive than they would be if idle.

    Will these people only be using resources that would have otherwise been idle?

    I know this is your big idea, but there is no way whatever inefficiencies they might be causing through their utilization of other resources (and there may well be no such inefficiencies) are outweighing the inefficiency of leaving them idle. This is what you don't seem to understand: wasted human labor is a huge inefficiency, and you would have to work very hard at it to employ them and end up with greater inefficiencies.

79. *Glaivester* Says:
July 27th, 2009 at 9:01 pm

    Also, my name is not Matt, and you are confusing my post with someone else's.

    Sorry, my second quote was from Matt Yglesias's original posting, and for some reason when I wrote the post, I looked up and assumed that the first sentence had been from the original post as well.

    Looking back at it, it is obvious that it wasn't, so I must've had a brain-glitch or something.

80. *Bob Roddis* Says:
July 27th, 2009 at 10:37 pm

    So many misconceptions, so little time.

    1. MYTH: We must have monetary dilution because there are too many people for money to be privately held precious metals.

    The U.S. population in 1790 was 4 million. In 1910, three years prior to the creation of the Fed, the population was 92 million. The price level stayed pretty flat for that period and the world didn't run out of precious metals to be used as money. The U.S. government probably could have never entered WWI without the Fed's money dilution program. No US entry into WWI, no Hitler or Stalin.

2. MYTH: Austrians reject empiricism. No, Austrians reject conflating human beings with physics, engineering and mathematical concepts. One can predict with scientific certainty the temperature at which a particular liquid will freeze, melt or boil. You cannot predict with scientific certainty in 1985 how many Vanilla Ice CDs would be sold in 1990. Or even in 1990. Certainly, math can help to roughly predict certain future events (polling), but human beings are not molecules and do not respond like chemical reactions. The recent book by Thomas Woods, "Meltdown" looks at historical empirical data through the lens of Austrian economics, for example.

Austrians are certain that certain things that are unknowable. We do not know why a particular person wants something more than something else at a particular moment. Further, because all humans have different values, economic values are necessarily SUBJECTIVE. No one knows what anything is worth until someone actually buys it. In any transaction, the buyer valued the good or service AT THAT TIME more than the seller, who valued the money more AT THAT TIME. Austrians submit that these propositions are truisms. This analysis suggests that the concept of "aggregate demand" is absurd. Because value is totally subjective, it is impossible to know the value of anything without free market pricing.

Monetary dilution by a central bank necessarily results in a theft of purchasing power from those holding the existing money stock to those receiving the new money. This necessarily causes a distortion in the COMPLEX investment structure of the economy. If everyone in an economy had an IQ of 140 and knew that this process was occurring, such a group would still have an almost impossible task in keeping track of the monetary distortions occurring.

The distortion of the investment and capital structure through malinvestments caused by central bank credit creation is the ESSENCE OF THE ABCT. With such a government derived distortion occurring, of course such markets cannot be particularly rational.

Robert Higgs explains this here and here

If Higgs is wrong, then refute him with facts and logic.

Some Austrians always predict hyper-inflation, others don't like to predict too much at all because the future is unknowable. Some Austrians are not predicting inflation at the moment. Some Austrians missed the housing bubble collapse. The ABCT is a methodology for analyzing reality, and no claim is made that it can predict the future with mathematical certainty. I would note that a 1979 dollar is now worth 32 cents and a 1913 dollar is now worth 5 cents.

I would also point out that the basic concepts of the Austrian School are based in reality and experience. On the contrary, Keynesian concepts were created out of thin air and make no sense. Keynes simply pronounced the existence of the multiplier. He didn't argue that 500 years of scientifically collected economic data proved it to be true. That is the case with all Keynesian concepts: contrived nonsense pronounced to give profligate government spending/debt and monetary debauchery a phony "scientific" gloss.

81. *Benny Lava* Says:
July 27th, 2009 at 11:24 pm

the new Austrian myths debunked:

The price level stayed pretty flat for that period and the world didn't run out of precious metals to be used as money.

But there was dilution! We went from gold standard to bimetalism; gold and silver. If we hadn't left the gold standard, might we be in gold + silver + copper by now?

http://en.wikipedia.org/wiki/Bimetallism

Even by 1935 dollars were redeemable to silver, not gold

The U.S. government probably could have never entered WWI without the Fed's money dilution program. No US entry into WWI, no Hitler or Stalin.

The Civil War happened without the Fed's dilution, why not WW1? The Civil War was far more costly. Besides, if the US had not entered WW1 there would at least have been Stalin, possibly still Hitler. How can you disprove a fantasy?

You cannot predict with scientific certainty in 1985 how many Vanilla Ice CDs would be sold in 1990. Or even in 1990

There is a difference between empiricism and prognostication. Haven't new Austrians learned this? Besides, don't New Austrians like Ron Paul prognosticate anyways and do a reasonably terrible job at it (still waiting for the last 30 years for my hyperinflation)?

I would note that a 1979 dollar is now worth 32 cents and a 1913 dollar is now worth 5 cents.

Hardly hyperinflation. Aren't New Austrians always pointing towards Zimbabwe and Weimar Germany as examples of what will befall us? Seems that since 1913 and the creation of the Federal Reserve, and 1933 and the unraveling of the gold standard, inflation has been tepid. The bad old days of Weimar and Zimbabwe were something like 1000 percent per year.

Again I see you fail to address the salient concerns I have with New Austrian policies: chiefly that it will result in deflation which will profit creditors (banks) and those few savers left in the economy (mostly, but not exclusively in the upper 10% of wage earners) and hurt the vast majority of Americans, especially the poor.

New Austrians can point to only one period of time that their policies worked; the post WW1 depression in America. In all the economic circumstances around the world, why aren't there more examples of this policy working? And why are there so many examples of the opposite working? In the 90s Clinton raised taxes and spending increased, yet the economy soared and the budget deficit turned to surplus. Doesn't this refute New Austrianism? It was the longest period of sustained economic growth in US history. Likewise the tax increases under Kennedy saw boom periods. The big government of LBJ saw robust growth. New Austrians can't explain this, let alone the phenomenal growth of W. Europe in these times.

This isn't New Austrians vs Keynesians. I am no Keynsian. But New Austrians seem to be allergic to facts. It is more faith than social science. Every bit of data that proves it is myth is conjured away with rationalizations. This is why we mock you.

Meanwhile, since the US became a net oil importer, it seems that oil prices have had as much an affect on inflation and economic growth as Fed policy, possibly moreso. And yet I can't get any rational explanations from New Austrians or Keynesians or whomever besides peak oil crazies (I am not necessarily a peak oiler either) that actually fits the data.

When will New Austrians admit that their theories don't fit the data?

82. *Bob Roddis* Says:

July 28th, 2009 at 11:30 am

1. CIVIL WAR -

> The beginning of 1862 found the Union unable to redeem its Demand Notes, which it was using to pay its soldiers, and the value of the notes began to deteriorate. This immediate threat spurred Congress to action. Previously, the Constitution had been interpreted as not granting the government the power to issue a paper currency, but on February 25, 1862 President Lincoln signed the First Legal Tender Act[4] which authorized the issuance of United States Notes as a Legal Tender.

It's merely a coincidence how war, slaughter and monetary dilution seem to go together. Right?

Also, I said **US ENTRY INTO WWI** was facilitated by the Fed. Although it is quite likely that the original participants would have been hard pressed to proceed without their own counterfeiting machines, I mean central banks. That's probably why there was 100 years of relative peace in Europe in the 1800s.

2. What's "New Austrian"? Is that a new tunneling method?

3. Hayek, Ron Paul and I call for a separation of money and state. There would be no "gold standard" as such. Money would be whatever the contracting parties agreed it should be. As precious metals became more scarce over time, their value would increase. People wouldn't have to put their money into real estate and sprawl to protect their wealth from dilution. There would be no ability for statist whores to steal monetary value through central bank dilution in order to finance their various wars and inflict their evil schemes.

4. To paraphrase Jimmy Carter, being mocked by establishment loving statists is like being called ugly by a frog.

83. *Sycophant of the Bourgeois* Says:
July 28th, 2009 at 2:11 pm

Again I see you fail to address the salient concerns I have with New Austrian policies: chiefly that it will result in deflation which will profit creditors (banks) and those few savers left in the economy (mostly, but not exclusively in the upper 10% of wage earners) and hurt the vast majority of Americans, especially the poor.

How does deflation hurt wage earners? Wages lag inflation and deflation. As many progressive economist have shown (as a justification for tying the minimum wage to the CPI) wages act much more slowly than other indices.

The wealthy may be largely unleveraged in their personal finances, but most of their wealth is tied up in stock holdings of companies that are leveraged up to their eyeballs. The income of the wealthy has dropped far more than the average wage earner in the last year, and without the bailouts would be gone altogether.

New Austrians can point to only one period of time that their policies worked; the post WW1 depression in America. In all the economic circumstances around the world, why aren't there more examples of this policy working? And why are there so many examples of the opposite working? In the 90s Clinton raised taxes and spending increased, yet the economy soared and the budget deficit turned to surplus. Doesn't this refute New Austrianism? It was the longest period of sustained economic growth in US history. Likewise the tax increases under Kennedy saw boom periods. The big *government of LBJ saw robust growth. New Austrians can't explain this, let alone the phenomenal growth of W. Europe in these times.*

Your entire post lacks any examination of reality. The post WWI recession was the only one where Austrian policies were actually used in full, but it doesn't mean pseudo-Austrian policies haven't helped other economic recoveries. Of course, Austrian policies are later ignored, and recessions return.

You basically list every Democratic president and say, "see it must work." From an Austrian perspective I would argue Clinton was far more conservative than Bush II and possibly Bush I. Modest tax increases met with a Congress hell bent on lowering government expenditures was a net positive to the economy. Expansionary Fed policy fed the boom to the point of bust in 2000. What is so un-Austrian about this?

It's interesting you mention Kennedy and LBJ who mired us in a war that that cost thousands of lives for little or no return. These are classic examples of Austrian economics. War boosted short term GPD, a contention that Austrians make repeatedly, but ultimately served as a drag on the US economy that could not be extinguished until much later. LBJ's later "war on poverty" set into stone a permanent impediment to future growth at previous levels.

During the 1980s it was only until Volcker essentially allowed interest rates to float did we see a recovery from the government induced stagflation of the 70s. Reagan stunted this growth with a ballooning National Debt, but I fail to see how this "disproves" Austrians.

I'm not well read on European economic history but you seem to do it little justice in just flatly saying it refutes Austrian theory.

In reality all the recoveries of the last century have seen reduction in government spending and control. Post WWII was met with returning men who quickly reallocated wasted government spending in weapons of war to more productive industries. The government reduced spending and paid down debt at a faster rate than ever seen in American history.

Let me ask you, how do you explain Japan? Trillions in government stimulus, in an economy 1/3 the size of the US and the stock market has still not recovered almost 20 years later. This is a Nominal index. Adjusting for inflation the Japanese economy is as productive as it was 30 years ago. I would certainly take modest deflation over this outcome.

84. *Benny Lava* Says:
July 28th, 2009 at 2:24 pm

That's probably why there was 100 years of relative peace in Europe in the 1800s.

Are you ignorant, stupid, or dishonest?

http://en.wikipedia.org/wiki/Napoleonic_Wars

http://en.wikipedia.org/wiki/Crimean_War