George Selgin, Less Than Zero: The Case for a Falling Price Level in a Growing Economy (Institute of Economic Affairs, 1997)

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This year, inflation reached levels not seen in 40 years. The Federal Reserve spent most of 2022 trying to undo its runaway money creation in response to the COVID-19 pandemic and getting inflation back down to its 2 percent annual target. Many free market inflation hawks say that is not enough, and are pushing for zero inflation.

George Selgin, a longtime University of Georgia economist now with the Cato Institute, goes a step further. His 1997 monograph *Less than Zero* argues for a falling price level, at least when the economy is growing. Now 25 years old and something of a minor monetary classic, it is still helping people better understand inflation.

Less than Zero was originally published in London by the Institute of Economic Affairs. The Cato Institute re-released it in 2018 with a new forward by Scott Sumner, a monetary economist who holds emeritus positions at Bentley University and the Mercatus Center.

The most important part of Selgin's argument is that he does not favor bringing prices down by a shrinking the money supply, but by *increasing productivity*.

Most economists want monetary policy to target stable prices. Selgin wants the dollar to target a constant amount of *productivity*.

His argument for falling prices relies on two key insights. First, economic growth causes prices to fall in real terms. Second, nominal prices are less honest than real prices.

Inflation has two main components; the money supply and real output. The reason for today's inflation is the money supply growing faster than real output. When they move in sync, inflation is zero.

Deflation—falling prices—happens when real output grows faster than the money supply. There are two ways for this to happen. One is for the money supply to shrink. The other is for productivity to grow. Economic growth, it turns out, is inherently deflationary.

When people become more productive at making cars or furniture or anything else, their real dollar prices fall. A zero-inflation monetary policy hides these falling real prices by keeping nominal prices the same. Selgin argues for letting real prices fall, provided they are caused by higher productivity and the amount of the price decline matches the productivity increase. Essentially, his argument is for real prices only; no monetary distortions, please.

If it takes fewer units of productivity to make something, then it should take fewer dollars to buy it—dollars being a unit of measurement for productivity in *Less than Zero*'s proposed monetary system. Similarly, if productivity falls, prices should rise. Productivity targeting, Selgin argues, gives a more honest price system than traditional low- or zero-inflation targeting.

People rely on prices to make decisions on everything from what to have for dinner to whether to rent or buy a home. Removing price distortions helps people make better decisions for different situations. For businesses, honest prices mean more accurate signals for supply and demand, and less malinvestment. Over the long haul, technological innovation and other factors tend to increase productivity over time. That means that a monetary policy that targets productivity would have a falling—rather stable—price level over the long run.

Productivity targeting, Selgin argues, removes distortions that stable nominal price targeting introduces. Cleaner price signals mean more growth in the long run, because people make better-informed decisions.

Productivity targeting has its problems, though.

One is measurement. Many occupations, such as teaching, defy attempts to measure their productivity. There are proxies people use, such as willingness to pay, that can be effective, and it is better to be approximately right than precisely wrong.

Another is that productivity and monetary changes are not the only factors that move prices. Non-inflation price movements can come from supply and demand changes, tax and regulatory changes, different individuals valuing goods differently, and other factors. That makes it difficult to isolate productivity, or even define it.

The sheer number of moving parts working together to determine prices is a major reason for widespread confusion about inflation. They also make it almost impossible for a central bank to precisely hit an inflation target, whether 2 percent or any other number. There are many reasons prices can go up, but only one—monetary growth outpacing real growth—is actual inflation.

While productivity targeting has its problems, so do all other monetary systems. Perfection does not exist in the real world. The question is how tradeoffs compare to one another. Putting productivity targeting through its intellectual paces is a valuable exercise, whether one considers it a serious proposal or just a thought experiment. That is why *Less Than Zero* remains relevant a quarter century after its first publication, and will still be so 25 years from now.