9
Inflation and Sovereign Currencies

In this chapter we will examine the MMT view of inflation and hyperinflation. The usual belief is that budget deficits and full employment are prone to cause inflation, if not hyperinflation. Many critics even argue that following MMT is necessarily inflationary – the path to ruin. Let us first see how inflation is defined. We then turn to hyperinflation, to fears that Quantitative Easing might spark inflation, and finally to MMT’s views on policy to promote price stability.

9.1 Inflation and the Consumer Price Index

The most commonly used measure of inflation is the CPI (Consumer Price Index). In the United States the CPI has increased by a factor of 7 since 1966. Many inflation hawks believe that is due to errant fiscal and monetary policy, and more specifically to abandonment of a “hard currency” with gold backing. Let us look at the issue of inflation and its measurement in this section.

We can quibble about the use of the CPI as a measure of inflation; it has well-known problems we pursue in a moment. But certainly prices have risen, generally, in virtually all countries of the world since the mid-1960s, indeed on trend since World War II, and this is a problem of some concern. As Keynes argued, you need some “stickiness” of wages and prices in the money of account, or you might abandon money. That is what can happen in a hyperinflation; with money’s value falling quickly (see the next section), people try to find something else that can hold value.

But clearly except for a few goldbugs, inflation in the United States and in most countries of the world since 1966 has been sufficiently low that the domestic currency remained a useful money of account, and

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the domestic currency has been voluntarily held in spite of inflation. In truth, economists are hard pressed to find significant negative economic effects from inflation at rates under 40 percent per year. But clearly people do not like inflation when it gets to double digits, and policymakers usually react to double-digit inflation by adopting austerity programs in an effort to reduce aggregate demand.

The question is whether austerity is the right policy. If an economy is operating beyond full employment, then by Lerner’s first principle of functional finance, government needs to dampen demand by reducing spending or raising taxes. There are instances in a variety of countries over the past half-century in which demand probably did get excessive, raising production beyond the full employment level. Big wars are the typical trigger for inflation, but in most developed countries, demand has not usually been sufficient to move the economy beyond full employment since World War II. Instead, inflation has mostly occurred in positions of substantial unemployment. Indeed, economists came up with the word “stagflation” to describe this typical position: simultaneous inflation and unemployment. They even came up with a “misery index” that adds inflation and unemployment together, an index that is really adding apples and oranges, but it resonated with voters in the United States in the late 1970s.

In the previous chapter we have argued that we can ameliorate the unemployment problem without worsening the inflation problem by creating a JG/ELR program. We won’t rehash the arguments here, but such a program would most likely even enhance price stability. But it would be too much to claim that the JG/ELR program would eliminate inflation.

Let us try to understand why measured inflation is likely to persist in the modern capitalist economy. We need to know a little about the construction of a price index. To be sure, the following discussion is quite general. Every nation has its own experience, its own structure, and its own institutions that affect wage and price setting behavior. To really understand inflation in any particular case, we would need to undertake a detailed study of the particular conditions driving prices (and wages) in each institutional context.

Let’s first look at the CPI as a measure of the purchasing value of a currency before proceeding since it is always a concern when we talk about money. To measure price changes, we must compare prices in one year – a base year – with prices in later (and earlier) years. This is much harder than it sounds, because not only do prices change, but products and services change, too. We must adjust the CPI or other measures