A REVIEW OF *IN DEFENSE OF DEFLATION* BY PHILIPP BAGUS (SPRINGER, EE.UU. 2014, 233 PAGES)

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The world often seems to be scared of deflation and, arguably, this creates an asymmetric bias towards inflation. For example, at the beginning of the 21st century, after the dotcom crash, there was widespread fear of deflation in the US for no obvious reason. The response to this fear was several years of loose monetary policy which arguably contributed significantly to the financial crash of 2008.

In much of the commentary in the UK in recent years, we have avoided «deflation phobia» and we have also managed to distinguish «good» from so-called «bad» deflation. Indeed, the fall in the price level (or, strictly speaking, the fall of inflation to below target) that we have experienced recently has been caused by the fall in commodity prices and so is not really deflation at all —it is an adjustment to supply-side conditions that only brings benefits in terms of lower prices for consumers and lower costs for businesses.

But, Philipp Bagus' book, In Defense of Deflation, deals mainly with what is widely believed to be «bad» deflation. This would involve a continuing fall in the price level caused by monetary deflation. The book is excellent and timely.

Bagus begins by noting that there was very little concern about deflation amongst economists in past centuries (before the 20th century) despite the fact that deflation happened relatively frequently. In other words, in the current era, we are fearing something that we have not experienced whereas, in past eras, the reality did not seem worth writing about. Sometimes the issue of sticky prices causing problems in times of deflation reared its head in economists' writing, but overall they seemed quite sanguine.

After this discussion of the historical context, there is an excellent section on the functions of money balances which is accessible to

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any student of economics, though I disagree profoundly with the author on the apparent «legal privileges» of fractional reserve banking. Indeed, this section could be applied to help our understanding of fluctuations in the value of digital monies such as Bitcoin.

The book moves on to knock down the theoretical arguments for opposing deflation. Bagus then notes —using public choice reasoning— that the gainers from deflation are widely dispersed (in general, they are households who benefit from falling prices but whose wages may not fall as fast) whilst the losers tend to be powerful interest groups (generally firms for which the value of debt rises in real terms).

There is no question, in the reviewer's mind, that Bagus is right both to raise this issue and also to argue that there are many myths surrounding the costs of deflation. Recent experience in the UK supports Bagus. In recent years, there have been big falls in real wages and, for many people, falls in nominal wages. Because of this, unemployment rose much less and for a shorter period than people expected in the recession. The labour market was able to cope with shocks which is important in times of deflation.

However, in knocking down the myths, perhaps the pudding is over-egged. The impression is sometimes given that monetary disturbances are part of life that entrepreneurs and other households have to deal with and can deal with. If that is so with deflation, then it is also the case when it comes to inflation. But the Austrian case against inflation is that the process distorts investment decisions in a particular way that is highly damaging. The same must be true of deflation —though the distortions will be different (and not necessarily as serious).

The book finishes with excellent case studies which illustrate all the points made earlier in the book. It examines the US between 1865 and 1896. In fact, this was a «growth deflation» whereby economic growth in the context of stable monetary policy allowed prices to fall —in many ways another type of «good» deflation. The German deflation of the 1930s is also discussed. This is interesting in that it followed a bout of inflation. Bagus argues that the problems arising during the deflation were largely inevitable after the distortions caused by earlier inflation and, in fact, deflation speeded up adjustment. He does note that adjustment would have been faster still had labour markets been much more flexible.

This is an excellent book. A student e-edition is available now for just €25. To my mind, Bagus has put together a highly effective defence of deflation in most circumstances. A second edition (or perhaps a different book by the same author) would benefit from a discussion of, for example, present-day Japan and also the euro zone. In the euro zone, if deflation is not accepted in some countries at some times, there will be a very strong bias towards inflation because the ECB will loosen monetary policy to avoid deflation anytime, anywhere. A sequel would also benefit from more explanation of the economic reforms that would reduce the costs of deflation. Indeed, the author has the potential to be something of a «deflation guru» in the current economic climate.

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