Inflation Isn't the Path Out

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Money does not drive economic growth, investment does. Growing the money supply in relation to production (inflation) can influence investment, and hence economic growth, by lowering the price of money (interest rates) and by shifting more of the nation's income away from labor and toward capital, but these are not the factors currently constraining investment. Regime uncertainty, that is government policy, is killing the incentive to invest. Furthermore, government borrowing is diverting the income our nation has allocated to invest away from investment and toward government sponsored consumption.

Would the American people support the government if it understood that "limited inflation" is designed to lower wages? Inflation devalues a currency and forces all prices to adjust upward in response. However, not all prices adjust with the same speed: some faster (commodities) and some slower (wages – the price of labor). It is the differential in adjustment speed that offers inflation a path to potentially promote economic growth. If wage increases lag other prices, employers keep more income for a given level of production. If employers invest their increased share of earnings in acquiring more physical capital or labor, production and the economy can grow with inflation. If employers do not acquire more physical capital or labor with their increased share of income, stagflation will develop.