

The deflation of 1873-1896

by [Tyler Cowen](#) on August 28, 2011 at 12:53 pm in [Uncategorized](#) | [Permalink](#)

I believe this period in economic history deserves a closer look, starting with [S.B. Saul's book The Myth of the Great Depression](#).

1873-79 was quite turbulent, but afterwards the global economy adjusted to deflation. Those years were among the most beneficial in human history, as the foundations of the modern world were laid.

This is one reason why I become suspicious when deflation is blamed for Japan's current problems, or when we are told that weak AD could lead to two lost decades in the United States. I do not favor deflation but its curse need not last forever.

If we are mired in the muck for two decades or more, as Japan has been, I blame low rates of productivity and technical progress. A simple comparison with North Dakota and Nebraska drives home the point. For the globe as a whole, increased resource prices are not the same as a productivity boost, but for a single region they can be.

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[John Papola](#) August 28, 2011 at 1:38 pm

Even before that historical book, I'd recommend reading "Less Than Zero, the case for a falling price level" by George Selgin. Rising productivity should cause deflation under a regime of stable nominal spending / stable money supply. It's a feature, not a bug.

And the most interesting aspect of George's analysis is that productivity norm deflation is being driven by innovation. The firms which make improvements are knowingly doing so. As such, they fully anticipate the reduced cost of production from their innovations AND expect competition to ultimately drive down the final price to customers (if they aren't cutting their prices themselves to undercut competitors with their new cost advantage). Given this process, productivity-driven deflation needn't lead to money illusion where some firms see falling nominal demand and are unable to know if it's nominal or real. Rather, the drivers of the deflation know what's happening and other firms are likely to see INCREASED demand (via Say's law and the release of purchasing power to other areas).

Here's the cliff notes version:

<http://old.nationalreview.com/23mar98/selgin032398.html>

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mw August 28, 2011 at 1:43 pm

sins of omission & false equivalencies, though par for the course with this stuff. wherein does the massive,