Preface to the second edition

The first edition of Monetary Regimes and Inflation enjoyed a favourable reception. More important, all the hypotheses presented in the book have been confirmed by additional empirical evidence since its publication in 2003. This has been true for moderate inflations as shown by developments for instance in Venezuela and Argentina up to 2014. Moreover, all results for hyperinflations have again been confirmed during the course of the hyperinflation in Zimbabwe during 2007/08: the real value of the inflating money in circulation, M/P, shrank to insignificant magnitudes, and currency substitution led to an undervaluation of the Zimbabwe dollar, which meant that the exchange rate for the dollar increased more rapidly than the domestic price level. Thus Thiers’ Law that good money drives out the bad in high inflations was fully at work, and as the government proved unable to introduce a successful currency reform, the Zimbabwe dollar was entirely driven out, mainly by the US dollar and the South African rand. As a consequence the government had to legalise the foreign money in 2008, as otherwise tax revenues would have fallen to zero.

This additional empirical evidence implies that nothing has to be changed in the second compared to the first edition except for minor corrections. So, given this situation, what reasons can warrant a second edition of the book? Fortunately, events related especially to the financial crisis since 2007 provide sufficiently challenging problems to be discussed in a new Section 2.1 and an additional Chapter 9. First, during the crisis such a dramatic increase of the monetary base M0 (the number of banknotes in circulation and of short-term deposits of the banks at leading central banks) took place as had formerly only been observed before high or hyperinflations. But this time it happened without leading to inflation. On the other hand, broader money as used by the public—namely banknotes in circulation and checking accounts held at banks—saw no unusual increase during the financial crisis. This leads to problems, namely which type of money could be responsible for later inflation and whether a growth of the money supply exceeding that of real Gross Domestic Product (the real value of all goods and services produced) is indeed a necessary and (or) sufficient reason for inflation. These questions will be discussed in Section 2.1.

Second, other problems that were only partly analysed in the first edition
concern the conditions under which inflation-stable monetary regimes (that is, regimes allowing no or only negligible rates of inflation) will emerge or can be maintained for long periods; and also under which conditions such regimes are in danger of being eroded or abolished. This will be discussed and supported by empirical evidence in Chapter 9. As will be shown, these latter conditions occur usually during crises in which governments and politicians feel strong enough to declare an emergency with the purpose to violate or reinterpret laws and constitutional provisions. An example is provided during the financial crisis after 2007 by the decision led by French President Sarkozy and German Chancellor Merkel to break the no-bailout article of the Maastricht and Lisbon treaties of the European Union when the Greek government moved towards bankruptcy and was saved by the member states of the Union.