DOCUMENT RESUME

ED 225 903 SO 014 478

TITLE Inflation. National Issues Forum.
INSTITUTION Public Agenda Foundation, New York, NY.
SPONS AGENCY Domestic Policy Association, Dayton, OH.
PUB DATE 82
NOTE 51p.; Some pages may not reproduce clearly in microfiche.
AVAILABLE FROM Domestic Policy Association, 5335 Far Hills Avenue, Dayton, OH 45429 ($3.00).
PUB TYPE Guides - Non-Classroom Use (055)

EDRS PRICE MF01 Plus Postage. PC Not Available from EDRS.
DESCRIPTORS Adult Education; *Citizenship Education; Controversial Issues (Course Content); Economic Factors; *Economics Education; Government Role; *Inflation (Economics); Political Influences; Political Issues; *Public Affairs Education; Resource Materials; Social Problems

ABSTRACT

This booklet is designed to help citizens understand public issues concerning chronic inflation and to work toward acceptable solutions for ending inflation. There are seven chapters. Chapter one provides a brief explanation of the nation's inflation problem. The psychological, social, and economic impact of inflation is the topic of chapter two. The role that government plays in the inflation problem is the focus of the third chapter, which discusses how elected officials often promise more than the electorate is willing to pay for. Chapter four examines the trade-off between inflation and recession. Discussed in chapter five are ways to stop the wage-price spiral which occurs with every price increase, when millions of people scramble to raise their incomes to protect themselves. Chapter six deals with growth, suggesting that if we could return to the days of sustained growth, it would be easier to achieve stable prices. Four options for dealing with inflation are provided in the concluding chapter. Further reading materials are also listed. (RM)

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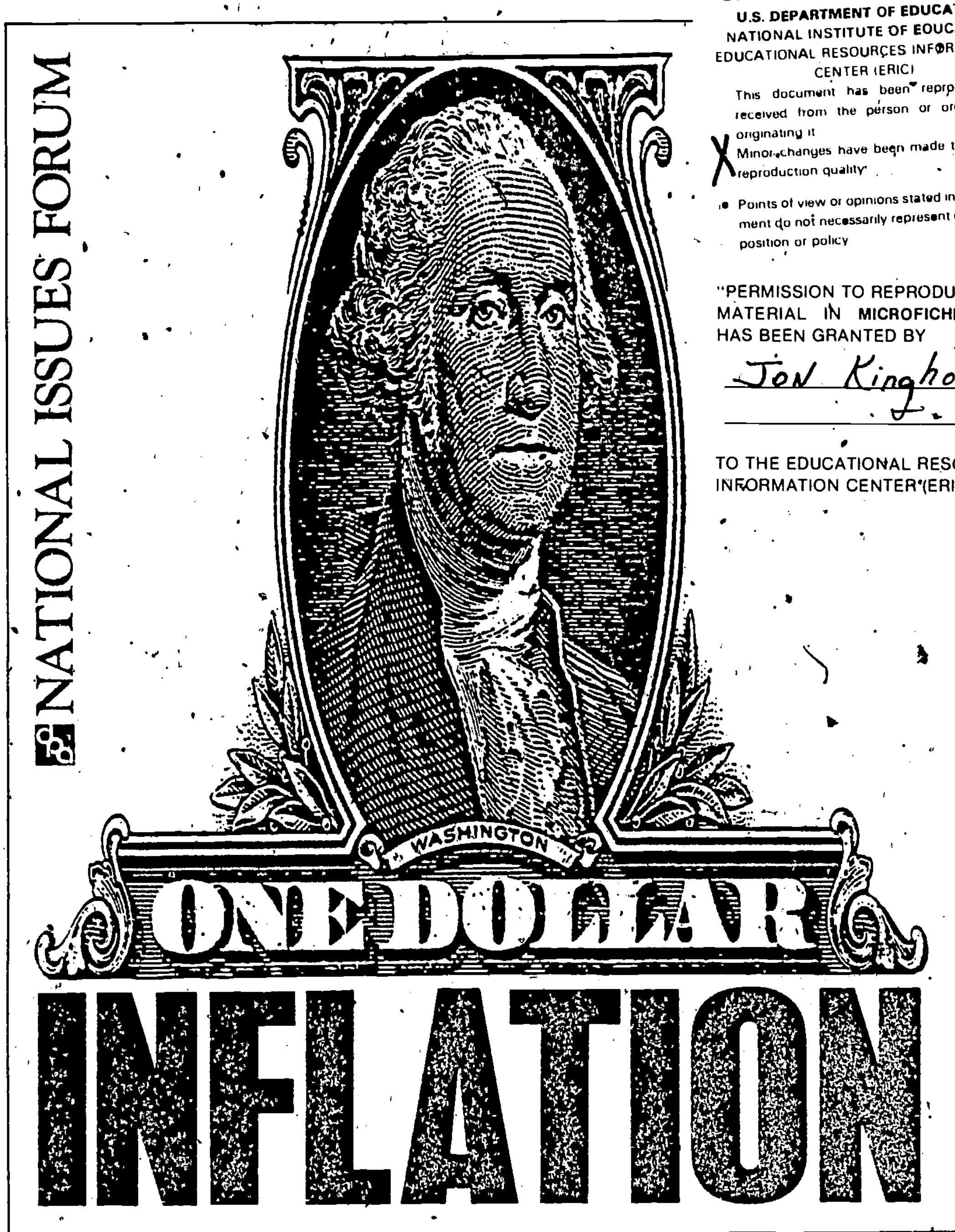

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INFLATION.

Prepared for the
Domestic Policy Association
by the
Public Agenda Foundation

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As you begin to read this booklet from the Domestic Policy Association, you are joining thousands of Americans who are participating, in communities all over the country, in the inaugural season of the National Issues Forum. This is a collaborative effort to achieve an ambitious goal — to bring Americans together every year to address urgent domestic issues.

The issues that the Association's members have chosen to explore in 1982 are inflation, retirement and Social Security, and jobs and productivity. There is a brief introductory booklet like this one for each of those issues.

Like the old town meetings, this series provides a forum where concerned citizens can discuss specific public issues, air their differences, think them through, and work toward acceptable solutions.

The Domestic Policy Association, which has organized the National Issues Forum, represents the pooled resources of a nationwide network of organizations — including libraries and colleges, museums and membership groups, service clubs and community organizations. It is a nonpartisan group. It does not advocate any specific solution or point of view. Its interest is in exploring, in unbiased fashion, the costs and benefits of various alternatives, and making explicit the values that each of those alternatives reflect. Its goal is to identify our common ground.

This is the first in what will be an annual series, convening each Fall in communities all around the country. Each year, several issues that are of particular concern to the nation will be addressed, as policy makers and citizens join together. But the National Issues Forum doesn't begin and end in those local meetings. The DPA also schedules a series of meetings in which the consensus that emerges from those forums will be conveyed to the nation's leaders. A culminating meeting of senior national policymakers will be held this coming February at the Gerald R. Ford Presidential Library in Michigan. There, with former Presidents Ford and Carter presiding, a group of national leaders will sit down to examine what these community forums have yielded.

So that your considered judgment about these issues can be recorded and conveyed in those meetings, we have provided a short "Issue Report" at the beginning and the end of these booklets. I would ask you to fill it out and mail it in.

I am pleased to be a participant in the National Issues Forum, and I'm honored to welcome you to this common effort. A democratic society works best when public discussion is an integral part of the decision-making process, when citizens have a realistic sense of what the alternatives are, and what they mean in their own lives and their children's lives. I am confident that this will provide an effective vehicle for stimulating thought and discussion, and for conveying the considered judgment of the public to the nation's leaders.

David Mathews
President
The Charles F. Kettering Foundation

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NATIONAL ISSUES FORUM

No. 00493

1. INFLATION REPORT

The Domestic Policy Association has promised to communicate a sense of your thinking on the topic of inflation to leaders and policy-makers, locally and at the national level. Therefore, we'd like you to fill out this short questionnaire — so that we can get a "profile" of the way people here are thinking about this important issue. They are also going to be interested in the way that forums like this help us all to "think through" such complex problems.

For that reason, we'd like you to answer one set of questions *BEFORE* you talk with your fellow citizens at the forum meeting (or before you read this booklet, if you buy it elsewhere), and another set of questions *AFTER* the forum (or after you've read and thought about the booklet).

Some of the questions are the same on both halves: some are different.

The leader at the forum meeting will ask you to hand in these question sheets at the beginning and at the end of the meeting. If it is inconvenient to do that, or if you can't attend the meeting, please send the questionnaire, together with the questionnaire at the end of the booklet, to the DPA in the stamped, self-addressed envelope that is attached.

I Different people have different ideas about who's to blame for inflation. Using a scale of 1 to 10, where 1 means *not much of the blame*, and 10 means *a lot of the blame*, rate how much blame you'd place on each of the following. Record your answer on the line across from each item.

1. The President — 1 2 3 4 5 6 7 8 9 10
2. Unions — 1 2 3 4 5 6 7 8 9 10
3. Congress — 1 2 3 4 5 6 7 8 9 10
4. Small business — 1 2 3 4 5 6 7 8 9 10
5. Individual consumers — 1 2 3 4 5 6 7 8 9 10
6. OPEC — 1 2 3 4 5 6 7 8 9 10
7. Large Corporations — 1 2 3 4 5 6 7 8 9 10
8. The Federal Reserve — 1 2 3 4 5 6 7 8 9 10
9. Liberals — 1 2 3 4 5 6 7 8 9 10
10. Conservatives — 1 2 3 4 5 6 7 8 9 10
11. Foreign countries such as Japan and West Germany — 1 2 3 4 5 6 7 8 9 10
12. Homeowners with large mortgages — 1 2 3 4 5 6 7 8 9 10
13. Salaried employees — 1 2 3 4 5 6 7 8 9 10

II Here is a list of things that some people think the government should do, but each of them would have an impact on the economy. Rate each proposal on a scale of 1 to 10, where 1 means *the government should not do it at all* and 10 means *the government should certainly do it*. Record your answer on the line across from each proposal.

14. Lower interest rates — 1 2 3 4 5 6 7 8 9 10
15. Reduce Federal taxes — 1 2 3 4 5 6 7 8 9 10
16. Enact measures such as a public service jobs program to reduce unemployment — 1 2 3 4 5 6 7 8 9 10
17. Strengthen antipollution and product safety regulations — 1 2 3 4 5 6 7 8 9 10
18. Make all employers provide automatic cost-of-living increases to their employees each year — 1 2 3 4 5 6 7 8 9 10
19. Make it possible for more Americans to own their own homes — 1 2 3 4 5 6 7 8 9 10
20. Provide government assistance for troubled American industries such as automobiles and steel — 1 2 3 4 5 6 7 8 9 10
21. Maintain cost-of-living increases in Social Security payments — 1 2 3 4 5 6 7 8 9 10

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III This is a list of anti-inflation policies that have either been tried or talked about. For each one, check if you favor or not.

	Favor it	Oppose	Not Sure
22. Raise federal taxes to reduce the federal budget	☐	☐	☐
23. Cut government spending on social programs	☐	☐	☐
24. Keep interest rates high	☐	☐	☐
25. Accept higher rates of unemployment	☐	☐	☐
26. Regulate wages and prices	☐	☐	☐
27. Encourage investment by giving tax reductions to those with the means to invest	☐	☐	☐
28. Increase government assistance for "growth" industries such as computers and telecommunications while at the same time refusing to bail out "no growth" industries such as steel and automobiles	☐	☐	☐

IV Now we would like to ask some questions about how you feel now.

29. On a scale of 1 to 6, where 1 means that the issue affects you personally *very little* and 6 means that you really feel *deeply involved*, where would you place yourself on the issue of inflation?

1 2 3 4 5 6

30. On some issues people feel that they really have all the information that they need in order to form a strong opinion, while on other issues they would like to get additional information before solidifying their opinion. On a scale of 1 to 6, where 1 means that you feel you definitely need *more* information on the issue and 6 means that you do *not* feel you need to have more information on the issue, where would you place yourself?

1 2 3 4 5 6

31. On a scale of 1 to 6, where 1 means that you and your friends, and family *rarely, if ever*, discuss the issue and 6 means that you and your friends and family discuss it relatively *often*, where would you place yourself on the issue of inflation?

1 2 3 4 5 6

32. People have told us that on some issues they come to a conclusion and they stick with that position, no matter what. On other issues, however, they may take a position, but they know that they could change their mind *very easily*. Using a scale of 1 to 6, where 1 means that you could change your mind easily and 6 means that you are likely to *stick with your position* no matter what, where would you place yourself on the issue of inflation?

1 2 3 4 5 6

V These last few questions are for statistical purposes only.

33. Which of these age groups are you in? Circle the appropriate number across from the group.

Under 18 .... –1
18 to 29 .... –2
30 to 44 .... –3
45 to 64 .... –4
65 and over .... –5

34. What is the last grade of school you completed?

8th grade or less .... –1
1 to 3 years of high school .... –2
High school graduate .... –3
Some college .... –4
College grad or more .... –5

35. Are you registered as a Democrat, Republican, an Independent, or are you not registered to vote?

Democrat .... –1
Republican .... –2
Independent .... –3
Other .... –4
Not registered to vote .... –5

36. What was your total family income for 1981?

Under $10,000 .... ☐
$10,000 to $20,000 .... ☐
$20,000 to $30,000 .... ☐
$30,000 to $40,000 .... ☐
$40,000 to $50,000 .... ☐
Over $50,000 .... ☐

37. Do you have children?

Yes .... ☐
No .... ☐

38. Are you male or female?

Male .... ☐
Female .... ☐

39. What is your zip code? ______________

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Contents

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INTRODUCTION: BREAKING THE INFLATION HABIT

In his first televised address to the nation, just a few weeks after the inauguration, President Reagan focused on the nation's economic troubles. He warned that the nation faces "an economic calamity of tremendous proportions." To dramatize the impact of chronic inflation, which has been both the primary cause and a chief effect of America's other economic ills, he held up a dollar bill to represent the value of a dollar earned in 1960. Then he held out his other hand, which contained a quarter, a dime, and a penny — the purchasing power of a dollar twenty years later.

Most of the President's audience did not need to be persuaded of the severity of the nation's economic problems. Polls showed that Americans regarded inflation as the nation's most pressing issue, with unemployment running a close second.

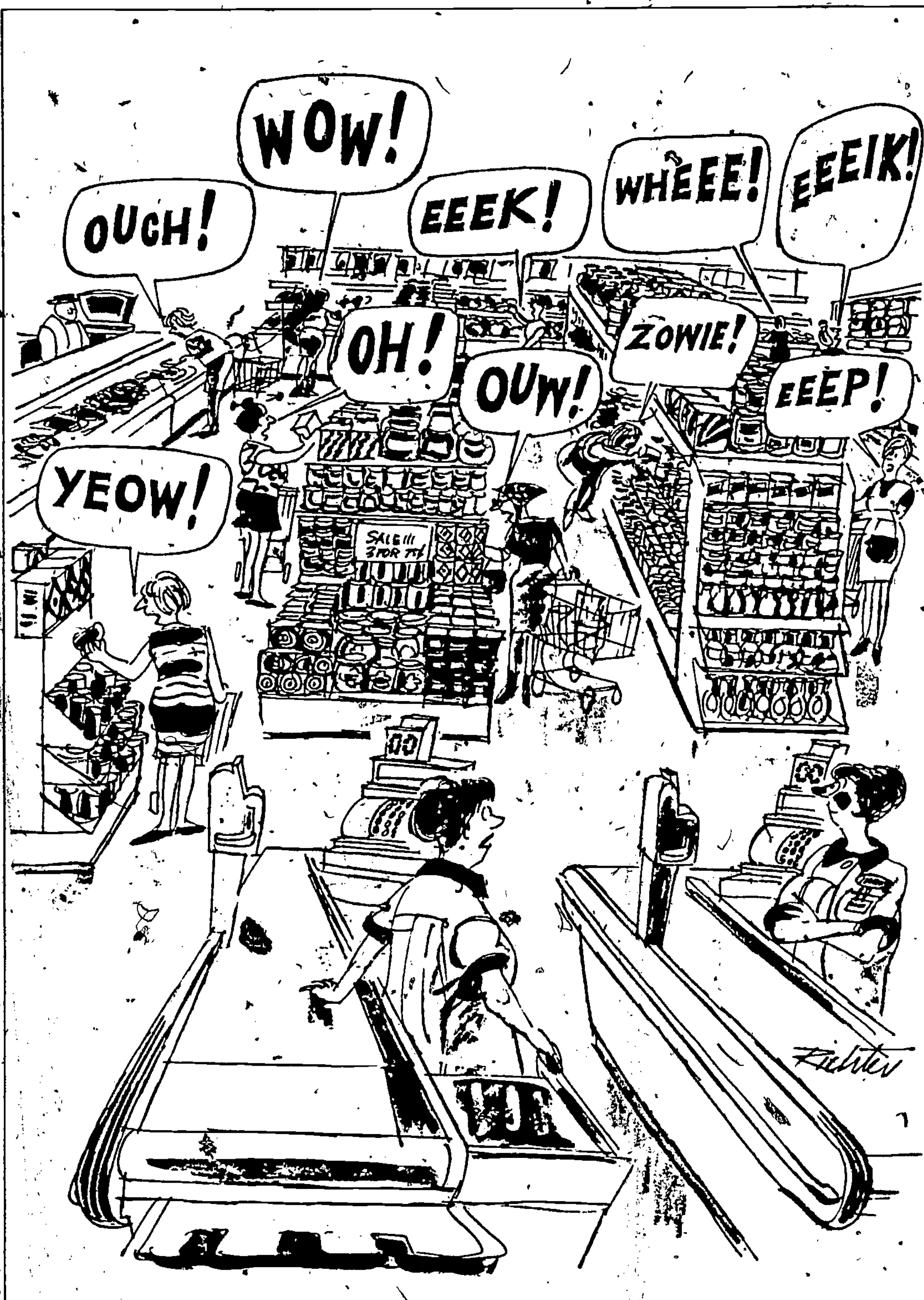
During the year after President Reagan's speech, the economic outlook changed. By Spring 1982, there was both good news and bad news. The welcome news concerned inflation. Various factors — including a glut on world oil markets, moderation in the rise of housing costs, and bin-busting crop production — combined to hold prices down. In the first few months of 1980, the Consumer Price Index — a widely used gauge of the average price of goods in the market-place — registered its highest peace-time level in history. The average price of goods went up at an annual rate of more than 17 percent. Just two years later in March 1982, average prices actually declined for the first time in seventeen years. In retrospect, that decline may look like a striking exception to a well-established pattern. But it seemed to indicate a slowdown in the rate of inflation. And it held out the prospect that for the year as a whole the inflation rate might be no more than half of what it had been the year before.

> "We live in a society in which both wage-earners and price-setters have some protection against the uncertainties of the market — and it is precisely for that reason that our economy has become so vulnerable to inflation."

The bad news was what had been necessary to reduce the inflation rate. If some people interpreted the economic news of Spring 1982 as a victory over inflation, it was a crude and a costly one. Prices had gone down because the country was in an economic slump, and as a result some ten million workers were out of work. A slump normally dampens inflationary pressure: when sales are low and there are stockpiles of unsold goods and commodities — ranging from aluminum and grain to cars and unsold houses — many sellers resort to dumping their goods at bargain rates. That was one of the chief reasons for the unexpectedly good news on inflation. But the other side of the coin is that when goods aren't being sold, people aren't being employed to manufacture them.

It appears that we merely exchange one symptom of our economic troubles for another. When unemployment increases, inflation decreases. Every time we try to push the rate of unemployment down, we set off a new inflation.

For millions of Americans, the discomfort caused by high inflation is very real indeed. It is the discomfort of realizing that if inflation continues for another decade at the rates of recent years, you will have to triple your income just to keep up.



"The cost of living sure keeps going up and up and up!"

Drawing by Richter; © 1968. New Yorker Magazine, Inc.

We haven't found ways to reduce the inflation that accompanies full employment. So the issue facing the country is why we are no longer able to attain the objectives of stable prices *and* sustained economic growth. How did we get into our inflationary dilemma, and how can we get out of it?

For millions of Americans, the discomfort caused by high inflation is very real indeed. It is the discomfort of going to the grocery store and realizing you have just spent $30 for a bag of food. It is the discomfort of realizing that inflation has badly reduced the value of what you have been saving for retirement. It is the discomfort of the young

MEASURING INFLATION

The most common measure of inflation in the United States is the Consumer Price Index (CPI), a number published each month by the government's Bureau of Labor Statistics.

The CPI does not measure "prices" as a whole. Even if that were possible it wouldn't make much sense: you wouldn't know how much weight to give automobiles, say, as opposed to transistor radios or dental services. Instead, Bureau of Labor Statistics researchers attempt to determine what a typical household spends its money on. The bureau then ascertains the prices of these items from month to month, weighting them according to their share of the family budget. If they cost 1 percent more this month than they did last month, the CPI goes up 1 percent.

The inflation rate as measured by the CPI is not quite the same thing as an increase in the cost of living. For one thing, the CPI doesn't include taxes. For another, the index measures the price of a specific collection of goods and services over time. Real families, however, don't buy the same mixture of goods and services over time. In 1972 and 1973, for instance, gasoline was still cheap. So our typical family probably owned an Oldsmobile V-8 and took it for a spin in the country every Sunday. Today the same family probably owns a Honda Civic and goes jogging on Sunday instead of driving. Its expenditures on gasoline may have risen only a little, despite the steep price increases. The CPI, however, assumes the family is buying just as much gasoline as before, and the "inflation rate" reflects that assumption.

Also, it is hard for the CPI to separate out inflation — price increases for the same item — from changes in the items themselves. Suppose Sears brings out a newly designed Kenmore dishwasher priced $50 higher than last year's model. Only part of that increase, presumably, is inflation. Another part should represent improvements in the product's quality, attractiveness, or features. The Bureau of Labor Statistics uses various methods to "correct" for quality improvements so that it is always comparing a similar market basket from one year to the next. But the calculations are rough and the judgments sometimes subjective, particularly when a service like medical care is the item in question. Over several years, an apparent increase in the cost of living may represent a higher standard of living (more efficient cars, better medical care) as much as it represents inflation.

Finally, the way the CPI calculates the price of owning a home overstates the cost of living for most families. The price people pay for their homes reflects not only how much they would be willing to pay in rent (if rental housing were the only kind available) but how much they want to invest in real estate. Sharply rising home prices are therefore quite different from sharply rising gasoline prices or clothing prices in their impact on the cost of living.

The Consumer Price Index undoubtedly overstates the inflation that most families experience; nevertheless it is a useful measure of how prices are changing from one period to the next. In any event, the best solution to inflation is not to worry about how it is measured but to do something about the rate at which prices go up.

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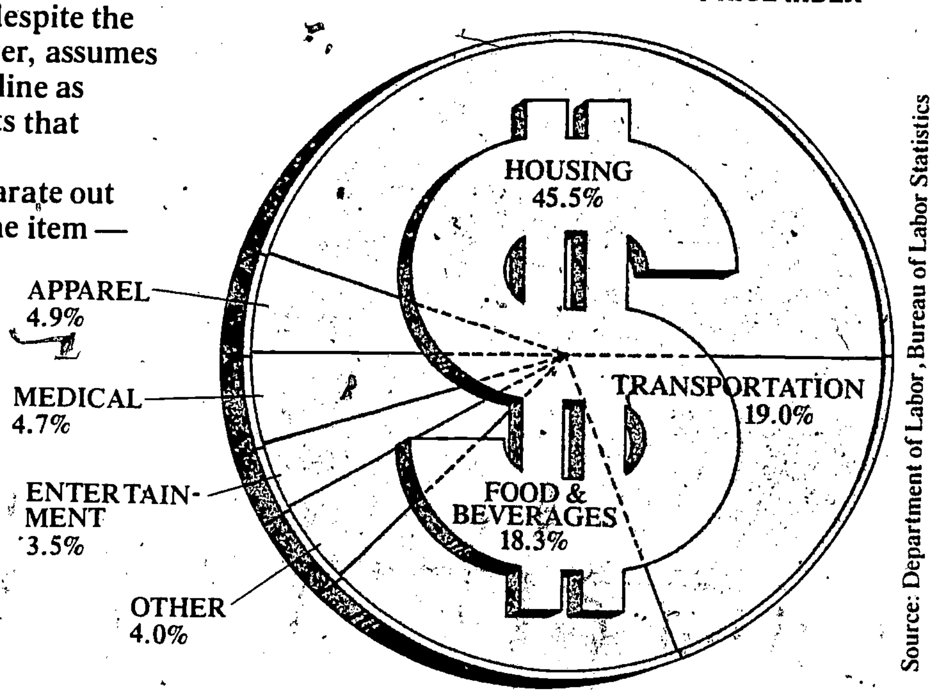
COMPONENTS OF THE CONSUMER PRICE INDEX



GLOSSARY OF ECONOMIC TERMS

Economics is no longer the exclusive domain of specialists. As our country has encountered increasing economic difficulties, what was once considered economic "jargon" has become front page news. Anyone wishing to understand inflation, therefore, should be familiar with the following terms:

Budget Deficit: When what is spent by the government is greater than what is collected in taxes.

Business Cycle: A recurring sequence of changes in the level of business activity. Beginning with a period of prosperity, business activity declines until a low point is reached. A period of recovery then follows when business becomes more and more active until prosperity is restored and the cycle is completed. Prices and wages normally rise and fall with business activity.

CPI (Consumer Price Index): A measure of price changes in the United States for goods and services considered essential to maintaining the standard of living for a "typical urban household." A rise in the index means prices are higher; a drop means they are lower.

Deflation: A decrease in the general price level; or an increase in the purchasing power of money in terms of goods and services, which amounts to the same thing.

Depression: A lengthy period of low business activity when real GNP declines significantly and unemployment is high.

Double-Digit Inflation: When average prices rise more than 9 percent (and less than 100 percent) a year.

Downward Price Stickiness: The tendency of certain prices to continually rise in the face of market pressures which should force them to fall.

GNP (Gross National Product): The value, at current market prices, of all the goods and services sold in the national economy during a given year.

Inflation: A sustained rise in the average price of goods and services, or a decrease in the purchasing power of money in terms of goods and services, which amounts to the same thing.

Law of Demand: The economic law which states that as the price of a good falls the quantity purchased (or demanded by buyers) will increase, and as the price of a good rises the quantity purchased will decrease.

Law of Supply: The economic law which states that as the price of a good or service increases, more people will produce (or supply) that good or service.

Money Supply: The amount of money available for spending in the economy, including cash and money held in checking (or demand deposit) accounts.

Real GNP: A measure of the Gross National Product adjusted to take account of inflation. It measures the "real value" of the economy's goods and services, instead of their dollar value.

Recession: A mild decline of business activity, usually defined as a drop in real GNP for a period of at least six months.

Single-Digit Inflation: When average prices rise less than 10 percent a year.

Stagnation: When the economy seems to stall, with frequent recessions followed by weak recoveries. Stagnation results in sluggish economic growth.

Triple-Digit Inflation: When average prices rise by at least 100 percent a year.

couple who feel cheated by skyrocketing housing costs that have come between them and their dream of owning a house. It is the discomfort of realizing that if inflation continues for another decade at the rates of recent years, you will have to triple your income just to keep up.

THE CHANGING CAPITALIST ECONOMY

What, exactly, is inflation? Economists define it as a sustained rise in the average price of goods and services. That is something that is not supposed to happen in a

It can be quite confusing trying to figure out what our choices are in dealing with inflation when there are so many explanations as to its origins.

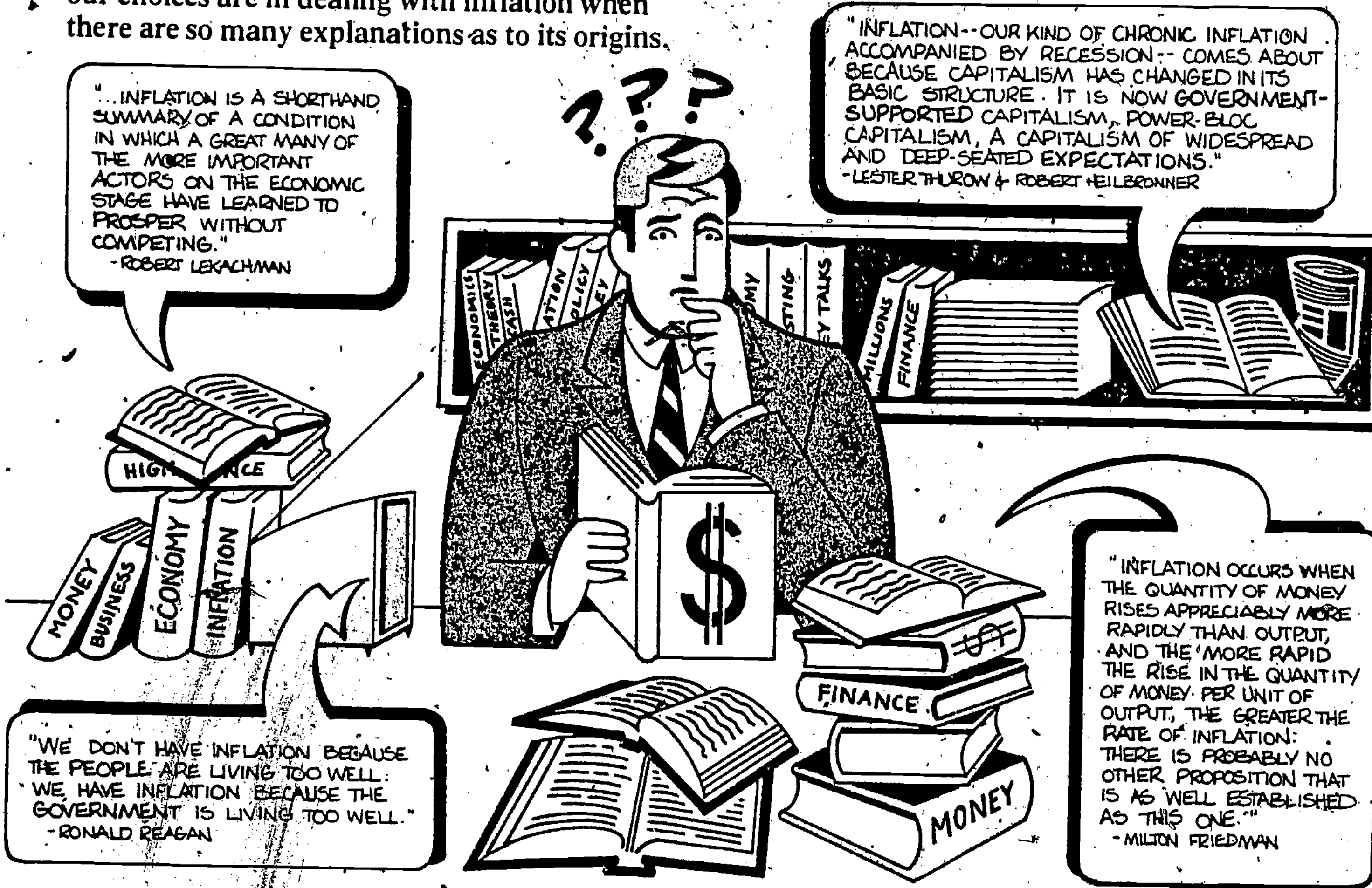


Illustration by Jean Tuttle and Deborah Hosking

competitive free-market economy where prices rise and fall depending upon supply and demand. If demand for a particular product is greater than the supply, its price rises. A rise in the price of any one item does not by itself constitute inflation. If the price of certain goods increases and people continue to purchase them, those buyers will have less money with which to buy other goods. When the demand for those goods drops, *their* prices should then fall — which means that the *average* price of goods remains the same although the price of certain commodities has risen.

By and large, this was how our economy worked until a few decades ago. Inflation was not a problem. Like a car without springs going down a bumpy road, our free-market economy did not offer a very smooth ride, but it brought buyers and sellers together, and kept prices fairly stable. Inflation occurred, but it was temporary. It accompanied economic booms. But boom periods were followed by economic declines when wages and prices fell. That series of booms and crashes was assumed to be the normal rhythm of capitalist economies. Until the 1930s, government wasn't expected to do anything to alleviate the pain of economic downswings, for the simple reason that no one had any very good ideas about what the government might do to intervene. For much of the workforce, the system was neither comfortable nor particularly humane, but it was immune to chronic inflation.

Over the past half-century there have been some fundamental changes in the way the economy works. Ours is no longer a society in which most people are at the mercy of economic cycles, nor is it an economy in which wages and prices are as likely to fall as they are to rise. Unions generally protect workers against wage cuts and many firms manage to avoid price cutting, even when the economy is slow. The government has become deeply involved in the economy through such measures as agricultural price supports, protection for the steel industry against its foreign competitors, and a sharply increased minimum wage.

In brief, we live in a society in which both wage-earners and price-setters have some protection against the uncertainties of the market and for that reason our economy has become highly vulnerable to inflation.

If taming the booms and crashes, and protecting Americans from the bumpy ride of earlier days has made the economy more inflation-prone. why, you might ask, don't we simply return to the "good old days" when there was no inflation? The answer is simple. In the past there was no chronic inflation, but the economy was plagued by other serious problems. Depression, unemployment (without unemployment insurance), bank failures, bankruptcy and unsafe working conditions were also part of the "good old days." As prices and wages fell dramatically during economic slumps, many farms and businesses went under and millions of individuals were left poverty-stricken. We could try to go back to earlier days by breaking up the unions and big companies, by eliminating government regulations, and subsidies that protect and benefit different groups. We could stop trying to prevent depressions, and drastically reduce government intervention in the economy. But we must recognize that this will cause intense hardship for millions of Americans, and will severely disrupt the economy. Today's economy is different from yesterday's because we have attempted to tame American capitalism — and we have in large part succeeded.

As a result, what goes up no longer comes down; it continues to go up indefinitely. Corporations don't *need* to cut their prices. And unions can go on asking for new wage agreements because there's unemployment compensation to fall back on. Each group scrambles to make sure that *it* will not be the one to experience falling prices, falling benefits, and falling incomes. And every group demands that the government do something to guarantee its economic security. Each concession — a wage hike, increased federal benefits — makes some group think that it's ahead of the inflationary game.

The basic problem, however, is that if you add up all those demands, they have exceeded our collective resources. In an economy where demands exceed resources, inflation serves as the means by which everybody's gains are scaled down.

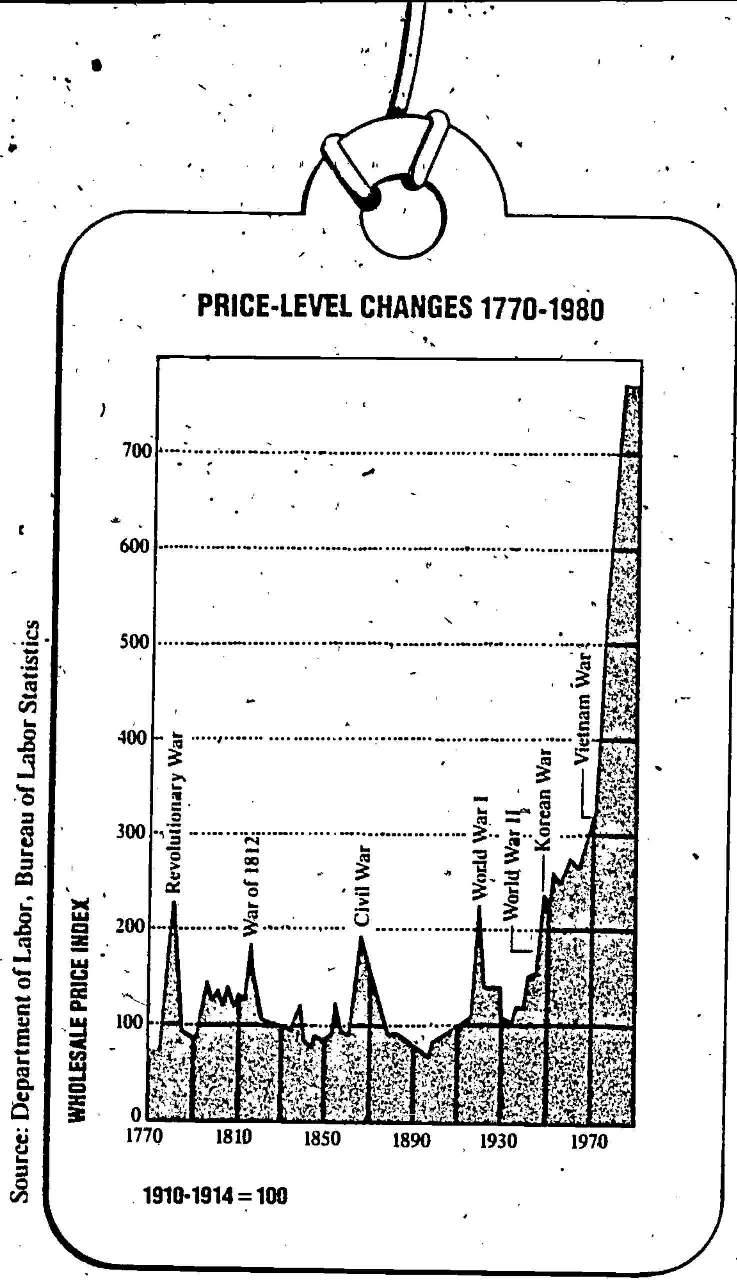
THE RISE OF INFLATION

Still, inflation did not become a cause for public concern until the late 1960s when circumstances combined to create a new and unprecedented problem — a chronic rise in prices.

First, President Lyndon Johnson decided not to impose new taxes to pay for an unpopular war, so the government either had to borrow extravagantly or had to print more money. All across the economy, prices rose as demands exceeded production capacities. American troops, for example, needed boots. When the government placed its order for millions of boots, the price of civilian shoes rose because both shoe leather and shoemakers were in short supply.

Then, in the early 1970s, supply fell even further behind demand. Because of bad harvests farm prices rocketed upward — at a rate of 66 per cent between 1971 and 1974. Many industries experienced shortages of raw materials. Panic buying triggered by the fear that prices would rise even higher compounded the problem. The final blow was the OPEC price increases, which tripled the price of crude oil and sent shock waves through the economy as everyone tried to adjust to higher energy prices.

Choosing policies to fight inflation means making difficult choices about issues that directly touch upon personal values and preferences. Any serious and sustained effort to defeat inflation will impose some pain, some tradeoffs. What is needed is a wider recognition of such costs, as a first step toward a new consensus.



In the past, periods of rising prices were always followed by periods of falling prices, leaving the overall price level virtually unchanged. Since World War II the situation has changed dramatically. Because reliable early statistics for consumer prices are unavailable; this graph measures wholesale prices, which generally reflect the same historical trends.

By the mid-1970s the problem had come home to roost. For the first time, the American public was convinced that inflation was here to stay and adjusted its behavior accordingly. The very actions to which people resorted to protect themselves against the impact of inflation — a more militant insistence upon cost-of-living allowances, increased borrowing, withdrawing money from savings or stocks and reinvesting in real estate or "collectibles" (antiques, art, jewels: *things* that maintain their value) — fanned the inflationary fires. By acting on the assumption that inflation was likely to continue, people virtually *assured* that it would.

And it did. In the 1950s and 1960s the Consumer Price Index had risen at an average of about 2 percent a year. In the 1970s, it accelerated at an average rate of about 7 percent. By 1980, the nation had experienced two successive years of "double-digit" inflation — an average rate of more than 12 percent.

Many groups and activities contributed to the current inflationary problem, including OPEC oil ministers, Big Labor, profligate consumers, real estate speculators, corporate profiteering, excessive government regulations, social welfare spending, and even the failure of the anchovy crop off the coast of Peru (which forced cattle feeders to shift from fish meal to more expensive American grains). Indeed, most of us are both inadvertent villains and unwilling victims of inflation. Even so, exchanging lists of villains on whom the inflation problem can be blamed, while it may make us feel better, doesn't take us far toward an understanding of our choices in resolving it.

LOOKING FOR A SOLUTION

The most frequently repeated formulas for describing inflation — such as "too much money chasing too few goods" — suggest that this is a strictly economic phenomenon, a problem for experts to address. And economists propose a bewildering variety of initiatives in the name of reducing inflation. It is useful to gain some understanding of those explanations and proposed cures; but, contrary to popular impression, a solution to the problem of chronic inflation will require considerably more than finding the "correct" economic policy. Inflation can undoubtedly be stopped in several ways, and a workable solution may well involve elements from several different proposals.

How then could a solution be found? It often seems as if, like the weather, everyone complains about inflation, but nobody *does* anything about it. Candidates for national office rail against it and promise to bring it under control, but there is very little in campaign speeches to explain how it happened, what it means and what ought to be done.

National leaders repeatedly announce their commitment to fight inflation, and their willingness to take the political risks required to do so. Once in office, however, they encounter forces that make it difficult to get inflation under control and fail to provide solutions that are politically and socially acceptable. Since the mid-1960s, political pressure has forced successive administrations to pursue inflationary policies. Policies that might have curbed the rate of inflation have been postponed or pursued half-heartedly.

The aim of this booklet is to show that there *are* solutions to our inflation problem. There just aren't any easy ones. That is the political problem of inflation. In the following pages, we will discuss serious options that hold out real promise. But each of them involves pain. They would all impose losses, a reduction in the standard of living for a substantial part of the population. The political problem of inflation is this: who wants to be the first to accept a lower standard of living for the good of the country?

Although the American public is deeply concerned about inflation, there is as yet no consensus that a solution must be found, that the severity of the problem justifies what may be a painful and prolonged cure. And there is no consensus either about how the burden of a cure to inflation should be distributed. That is why politicians, though they may rail against inflation in campaign speeches, can do so little about it when they are in office.

The nation got into its inflationary dilemma as a result of hundreds of separate decisions made on the basis of the short-term benefits they promised. For all the differences among economists about other aspects of the inflationary problem, most of them would agree that inflation is the result of our inclination to resort to the "quick fix," to ignore the long-term problems of the economy, and to defer any concerted effort to deal with them.

The "quick fix" metaphor is appropriate, for the nation's inflationary habit has several of the characteristics of an addiction. At the beginning of an inflationary binge, there are short-term "highs": an increased quantity of money allows more government expenditures for a variety of programs without raising taxes to pay for them, and business is brisk as those dollars flow through the economy. But then, as prices start to rise, workers find that even their increased wages are not high enough to pay inflated prices, and businessmen find that because of higher costs sales are not so profitable as they anticipated. So the bad effects start to set in.

The parallel between inflation and addiction applies as well when we consider the available cures. Entering an inflationary era, a society first experiences the good effects. The main reason why political leaders have been so reluctant to do what is necessary to break the inflationary habit is that a cure produces painful effects long before any benefits come. During the painful first steps of the cure, a very firm resolve is necessary to convince the reluctant patient that it is worth the pain to break the habit.

What we need to do first is to understand why inflation poses such a threat to our well-being as a society, to ask what policies are in the public interest, and to examine the costs and benefits of various proposals for fighting inflation. There are no "good choices" in fighting inflation, no easy and politically popular solutions. If there were, the problem would long since have been solved. Deciding what to do about inflation requires a judgment about which strategy is fairest to everybody, most compatible with one's beliefs about the government's role, and about the obligation that we owe to future generations. In short, choosing policies to fight inflation means making difficult choices about issues that directly touch upon personal values and preferences. For example,

★ Is it worth reducing inflation from ten percent to five percent if several million American workers are thrown out of their jobs as a result?

★ Is it better to have a huge government deficit (which contributes to inflation) or to reduce that deficit by cutting either military spending or programs for the poor, or both?

★ Is it better to tolerate inflation or to allow the government to set wages and prices?

Any serious and sustained effort to defeat inflation will impose some pain, some tradeoffs, some difficult choices. What is needed is a wider recognition of such costs, as a first step toward a new consensus. With regard to inflation, as with other pressing issues we face as a nation, hard choices cannot be avoided; they can only be deferred — at the cost of even harder choices in the future.

In the following sections, we consider our options. First we examine the "do nothing" option and assess the costs of living with chronic inflation. Next we examine the government's role in inflation in order to weigh the costs of reducing that role and, more specifically, reducing the government deficit. Then we discuss the costs of combatting inflation with recession. After that, we consider the efficiency and fairness of proposals to end inflation by government-imposed wage and price controls. Finally, we will focus on the pros and cons of fighting inflation by revitalizing the economy with increased savings and investments.

2

DOING NOTHING: THE COSTS OF LIVING WITH INFLATION

> "One problem with trying to live with inflation by protecting against its consequences is that the techniques for coping with it tend to perpetuate the problem."

In Israel, it is not unusual for families to buy two refrigerators, even if they live in a small apartment. One of the refrigerators preserves food. The other, a hedge against inflation, keeps its value far better than the currency at a time when inflation has been running in excess of 100 percent a year. In Argentina, which shares with Israel the distinction of having one of the highest inflation rates in the world, ordinary citizens play the interest rates the same way that some of us play the horses — and with many of the same risks.

Inflation — a sustained rise in the average price of goods — is an international problem, and one that has been far more severe in some countries than in others. Since nations such as Israel and Argentina seem to be coping with much higher rates than any the U.S. has experienced, why then don't we just learn to live with the rates that we have? Certainly, this is one of our options: to do nothing to stop inflation. But if this is what we decide, we should be aware of the costs and dangers of such a choice.

Judging from the rapid acceptance of cost-of-living adjustments over the past decade, it would appear that living with inflation and doing nothing to stop it is exactly what we have chosen to do. Over the past decade most people have sought to protect themselves from the uncertainties of rising prices. Unions began to push harder for cost-of-living escalators, with the result that more than half of all unionized workers are now covered by such clauses. The recipients of federal subsidies fought harder to protect themselves against inflation. This led, among other things, to a Congressional decision in 1972 to tie Social Security payments to the Cost-of-Living Index. Although we are far from a system of universal indexing — in which wages, prices, assets, liabilities and taxes automatically move up and down in response to the changing rate of inflation — adjustments of this sort do make inflation more tolerable, and encourage a certain shoulder-shrugging acceptance of it. When, for example, OPEC hiked up the price of crude oil in 1973, the cost of living increased sharply. For a while, everyone felt the pinch. And then, as cost-of-living allowances reflected those higher prices, income was pushed upward too, and things seemed to balance out.

The problem is that such indexing arrangements make the process of unwinding inflation far more difficult and also create a certain complacency about price shocks. If inflation is nine percent this year, wages will go up nine percent next year. Prices rise accordingly. These changes increase the likelihood that inflation will be at least nine percent next year, which in turn means that wages and prices will increase by that amount in the following year. So one problem with trying to live with inflation by

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protecting against its consequences is that the techniques for coping with it tend to perpetuate the problem.

THE PSYCHOLOGICAL COSTS

But so what? Even if inflation gets higher and higher, why can't we learn to live with that too? The answer is that inflation kindles resentment as it erodes purchasing power.

To some extent, that resentment is fueled by an illusion. Most people see their income rising, assume that they deserve every penny they get, and resent the fact that something they would have been able to afford in non-inflationary times has now been "stolen" by inflation. Even though the standard of living for most American families continued to improve throughout the 1970s, despite inflation, many Americans feel bitter because inflation has widened the gap between their expectations (nourished by even-larger paychecks) and actual purchasing power.

The resentment that so many people feel about the effects of inflation has another source too, the belief that inflation causes wealth to be distributed inequitably. Inflation has the potential to create winners and losers, making a few of us relatively richer, while the rest of us become poorer. Someone wins whenever prices go up.

Who have been the winners, who the losers? Who has been protected against the ravages of inflation, who has shouldered its burden? Analysis of the impact of inflation shows some surprising results, sharply at odds with the popular belief that inflation's main victims have been the groups that are most vulnerable — like the poor and the elderly. In fact, due largely to the insulation against inflation provided by cost-of-living clauses which lift wages and benefits when prices rise, the groups that have been hurt least over the past decade are union workers in major industries, the poor and the elderly. According to one study, prepared by the Brookings Institution, those who earned less than $20,000 in 1970 experienced no loss of buying power over the next decade. Because of cost-of-living escalators in the Social Security program, the average elderly family actually *improved* its position over that decade. Workers in unionized trades — such as steelworkers and teamsters — won substantial cost-of-living allowances that provided increased real wages over that period.

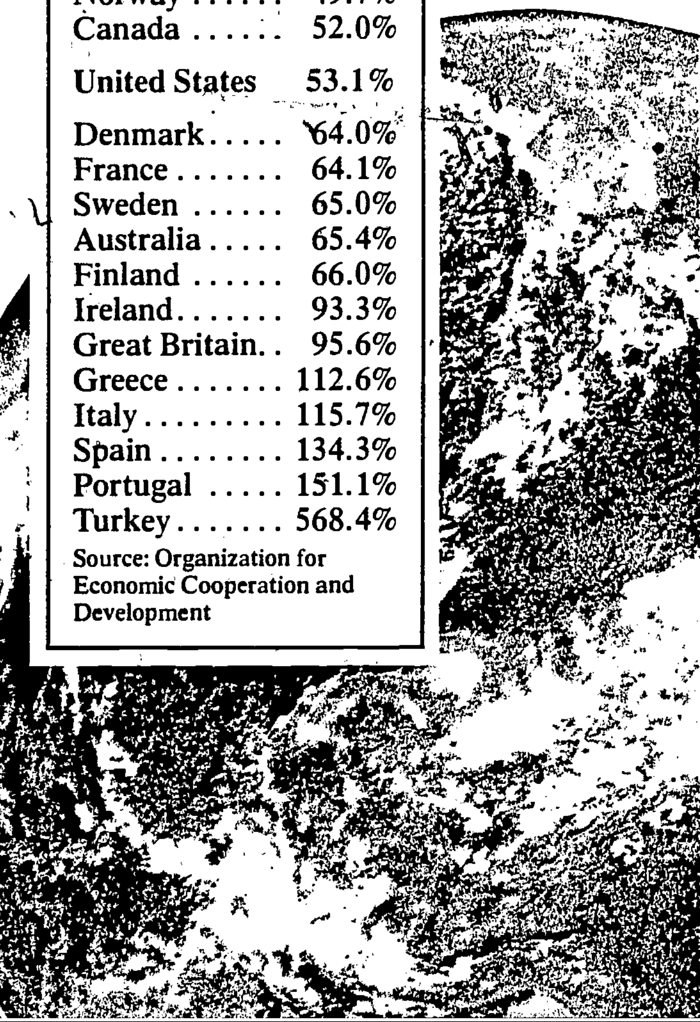
Other groups have not fared so well. Many white-collar workers and middle-class professionals have lost ground. According to Labor Department studies, the salary of a typical attorney with several years' experience climbed from $26,277 in 1971 to $54,792 in 1981. Adjusted for inflation, that meant an earning *loss* of 4.4 percent. In several respects, the nation's wealthier families have been losers. Inflation has not only pushed them into higher tax brackets, it has also eroded the value of their savings and investments. They are the ones who have suffered the most from the fact that the value of corporate stocks has fallen more than 50 percent since 1968. But they have also been winners to the extent that the value of real property, minerals, commodities and homes has risen faster than inflation.

Overall, then, inflation probably has had little impact

GLOBAL TOLL OF HIGHER PRICES

	Consumer Price Increases 1975-80
Switzerland	12.2%
West Germany	22.3%
Austria	29.4%
Netherlands	33.8%
Belgium	36.0%
Japan	37.2%
Norway	49.7%
Canada	52.0%
United States	53.1%
Denmark	64.0%
France	64.1%
Sweden	65.0%
Australia	65.4%
Finland	66.0%
Ireland	93.3%
Great Britain	95.6%
Greece	112.6%
Italy	115.7%
Spain	134.3%
Portugal	151.1%
Turkey	568.4%

Source: Organization for Economic Cooperation and Development



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INFLATION MAKES ARGENTINES GAMBLERS IN RISKY GAME

In the last 30 years many countries have risen and fallen in the inflation ranks, but Argentina has remained near the top. The rate of increase in consumer prices peaked at nearly 450 percent in 1976. In 1980, it was under 90 percent, and some Government officials crowed success. But this year many economists expect the rate to shoot back up.

Inflation has contributed to a cost of living that the State Department ranks second only to Japan's. The daily newspaper costs 60 cents. A cup of coffee in an ordinary coffee shop costs $1. Rents for a two-bedroom apartment in areas equivalent to Manhattan's Upper East and West Sides begin at $2,000 a month.

The causes are lost in mounds of statistics and competing economic theories. The effects are found in jammed stores and crowded psychiatrists' offices, in a national cynicism and — sometimes — individual sadness that has helped replace the country's reputation for gaiety.

Argentines have turned to ingenuity, creating a country of speculators and moonlighters, of fast money and hard luck.

Playing the interest rates has become a national pastime. Thirty-day savings certificates — and no one commits his money for longer — pay interest at an annual rate of about 100 percent.

People punching pocket calculators stand outside bank windows daily, studying the day's posted rates. In the last year more than 40 small banks and financial houses have collapsed in the wheeling and dealing. While rumors that a place is about to fold lead most people to start a run on the institution, the more daring increase their deposits, hoping to reap higher rates and be saved by Government guarantees on deposits.

But then consumers pay even more for mortgages, automobile loans and the like. Interest is usually indexed to inflation, so buying on credit is an adventure into the unknown on payments.

The new middle class hedges in the panoply of imported appliances such as juicers and color televisions that have been flooding stores. The military government has been dropping import tariffs in the hope that the competition of cheaper and better imported goods would cut prices on domestic goods.

Factory workers, who have benefitted from erratic past protectionist policies, are thus less fortunate this time around. Their companies are strapped by the competition and the interest rates on loans. Some have closed, and even the military fears workers' reaction.

The pressures have contributed to what many psychiatrists and psychologists say is an explosion in recent years in the number of people who seek their help.

"You do not learn to live with inflation," the owner of a fabric shop said. "You learn how to adapt to live with the constant economic anxiety."

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on the distribution of income, and some of the suggested cures — such as a severe recession — have more adverse effects on the distribution of income than the disease itself.

Another problem of living with inflation is that it has led to increasing anxiety for millions of Americans. Here, as in countries such as Israel and Argentina that have experienced rampant inflation, there are dozens of ways in which inflation affects our everyday lives. For millions of Americans who don't know from one year to the next what they will owe on variable rate mortgages, or how much they will have to save for a secure retirement, the anxieties that accompany high inflation are very real indeed.

The probability is that throughout the 1980s it will be harder to keep up with inflation than it was in the 1970s. Over the past decade, the impact of inflation was cushioned by several factors. Disposable income continued to grow during the 1970s because there was a rapid increase in the number of families with two wage earners, and because payments from government programs continued to rise — financed by government borrowing and reduced spending on defense. Today, those cushions are no longer available to soften the shock of inflation. Even if the rate of inflation is no higher than it was in the 1970s, many Americans are likely to feel its impact to a greater extent, with an accompanying rise in hardship, resentment, and anxiety.

THE SOCIAL COSTS

Inflation has at least one more devastating effect. It can tear the very fabric of society and erode public confidence in government and the future.

As an international phenomenon, high inflation has been synonymous with social unrest and the instability of governments, particularly democratic regimes. In 1954, triple-digit inflation in Brazil led to a military government. High inflation led to the overthrow of Salvador Allende in Chile in 1973, and of Isabel Peron in Argentina in 1976, followed in both cases by the rise to power of a military junta. In the period between 1963-1973, 38 nations whose inflation rates exceeded 15 percent abolished their democratic institutions. Where democracy has remained intact despite high inflation the economic situation has led to electoral defeat for one national leader after another, as it did for both the leaders of the Irish government and Britain's Prime Minister James Callaghan in 1979, for America's President Jimmy Carter in 1980, and for France's President Giscard d'Estaing in 1981.

Inflation also loosens the social bond and feeds cynicism. It is not coincidental that as inflation has worsened over the past decade, more Americans have come to doubt the legitimacy of the system. Today, a large majority of Americans (81 percent) feel that those who follow the rules inevitably get cheated, while those who know the angles and ignore the rules do well. More and more people apparently feel justified in resorting to the underground economy to evade taxes. There is a widespread sense that if the government is so fraudulent as to steal personal assets by allowing inflation to continue, then people are justified in going "off the books" in order to avoid taxes. The feeling, in other words, is that in order to stay even, you have to get even.

Weimar Germany after World War I provides the most frightening example of how "living with inflation" can loosen a nation's social bonds, leading to chaos and disaster.

Germany's problems began — as inflationary episodes so often do — in wartime, as the country overextended itself to pay the costs of World War I. By the end of the war, the German economy was just limping along. By 1919, government spending far exceeded tax revenues, and the debts run up by wartime borrowing created a staggering burden. Under severe pressure to finance its deficit, the government gave in to the temptation to use its power to create money. During the four years following the war, the money supply rose six times over — with inflation as the inevitable consequence. By 1922, Berliners were paying prices 100 times higher than they had been paying a decade earlier, before the war. The entire nation was engaged in a race to convert money of steadily decreasing value into tangible goods that retained their value. Government printing presses ran day and night, literally

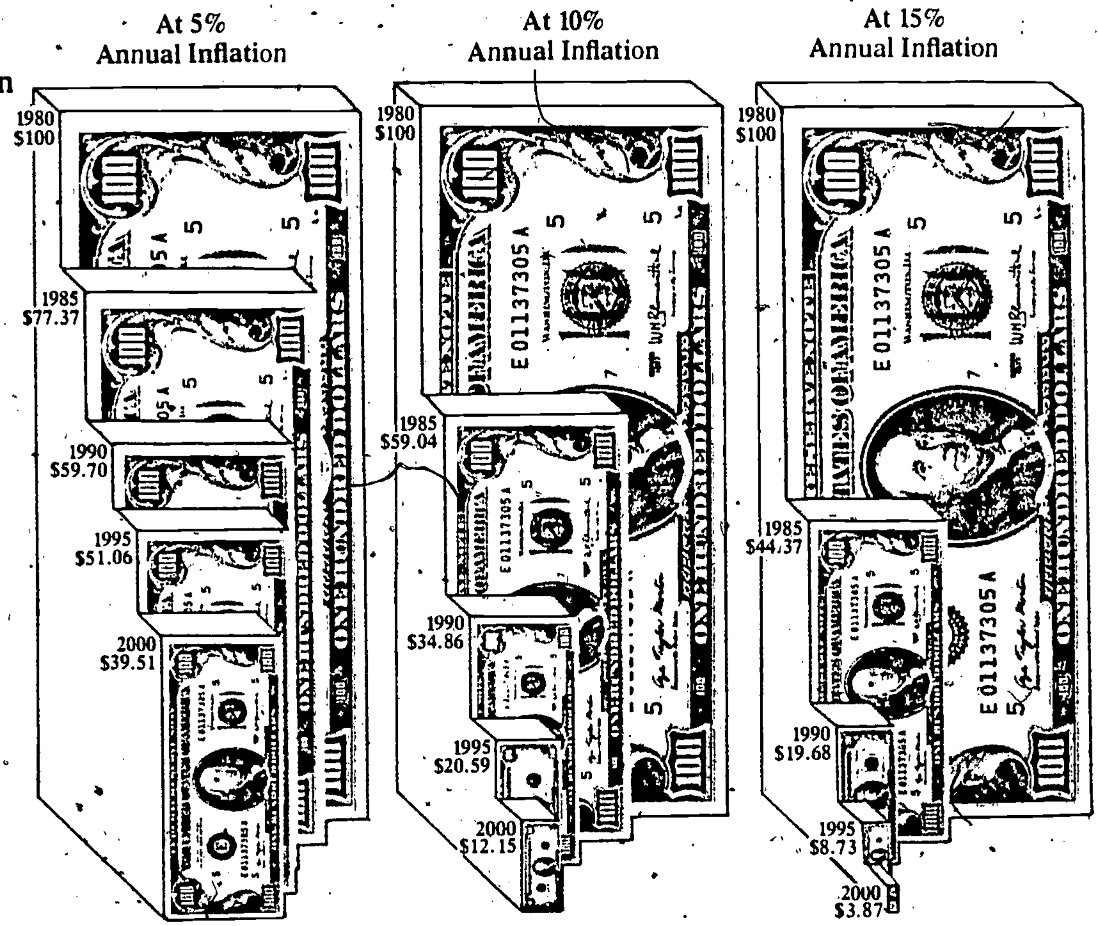

United Press International Photo

Workers in Weimar Germany collecting bales of German marks. By the early 1920s hyperinflation had reduced the real worth of the mark to less than the value of the paper it was printed on.

INFLATION'S BITE

If the difference between 5 and 10 percent inflation doesn't seem worth worrying about, consider what will happen to your purchasing power if inflation continues at 5, 10 or 15 percent for the next two decades.

PURCHASING POWER OF $100— AFTER INFLATION



creating a mountain of new Reichbank notes, steadily devaluing the currency in the process. By the Autumn of 1923, with the value of the currency depreciating precipitously, prices literally exploded. A half dozen eggs, which before the war had cost less than half a mark, now sold for some 3 million marks.

Stories of the bizarre effects of Germany's hyperinflation are legend. People had to carry their money around in wheelbarrows. The experience of a Berlin housewife who left a basketful of money for a moment and on returning found the money safe and the basket stolen, typified the nation's chaotic condition. In the absence of a reliable currency, businesses went bankrupt, trade came to a virtual standstill except where people could resort to barter, and both food shortages and rampant unemployment resulted. Savings that people had accumulated over a lifetime were wiped out in a single day. "The result of the inflation," wrote historian Alan Bullock, "was to undermine the foundations of German society in a way which neither war, nor the revolution of November 1918, nor the treaty of Versailles, had ever done. The real revolution was the inflation."

It was a revolution that undermined basic values as well, including a belief in self-reliance and hard work. "Never," as Thomas Mann wrote,

> have those who wanted to make money without working found such favorable conditions.... Honest work, however skilled, brought nothing. Consequently, even ordinarily honest people were infected with the fever of speculation .... It was during the inflation that the Germans forgot how to rely on themselves and learned to expect everything from "politics." from the "state," from "destiny." They learned to look on life as a wild adventure, the outcome of which depended not on their own effort but on sinister, mysterious forces.

Chaotic conditions created a desperate yearning for a reliable currency and social stability. In this way, the experience of hyperinflation paved the way several years later for Adolf Hitler, who promised to achieve the prosperity and order that so eluded the Weimar Republic.

Germany's experience in the 1920s was the most dramatic instance in this century of what can happen when inflation rages out of control, and it offers both a warning and a lesson. Though it is a vivid example of the social, political, and economic damage that can result from inflation, it is not atypical.

WANTED: A SOCIAL SOLUTION

For most Americans, inflation is now a given. We don't ask whether there will be more inflation, but rather how much more. After a decade of rising inflation rates, many people are convinced — no matter how substantial their resources — that this is a battle they can't hope to win, that the best they can hope for is to come out even.

That attitude is summed up in the comments of a 32-year old electrical engineer in California. He and his wife together earn more than $45,000 a year, which means that their income is higher than nine out of ten American families. But he still feels that inflation has created a situation in which he has to run faster and faster to stay in the same place. "It's not possible to get ahead of inflation," he told a reporter for the *New York Times*. "Fifty thousand dollars just won't be $50,000 tomorrow. It's a battle to stay where you are. Things only get higher."

Like so many others, he has resorted to a "bunker mentality," trying to protect himself and his family from the erosion of their resources. Since inflation makes borrowing unusually attractive because debtors ultimately repay their loans with dollars that are worth less, he — like many Americans — is borrowing as never before.

But the very strategies that people use to protect themselves against inflation often exacerbate the problem. The net result of a surge in consumer borrowing has been to push prices even higher. At the same time, reduced personal savings have contributed to the scarcity of capital for investment purposes; and that shortage means that lenders can charge higher interests, and higher interest rates choke off economic growth. As President Carter said, "All of us are caught on a treadmill which none can stop alone. Each group tries to raise its income to keep up with the present and anticipated rising costs; and eventually we all lose the inflationary battle together."

These are, then, two dangers in trying to live with inflation. First, it makes our other economic problems worse. Even if we manage to protect ourselves with indexing and cost-of-living allowances, inflation saps the strength of a healthy economy. In the long run, it stalls economic growth and leaves us all poorer.

Perhaps more importantly, the psychological and social effects of inflation can tear a society apart, as they did in Weimar Germany. The insecurity and resentment that today are the product of our unstable currency threaten to undermine the moral foundations of our society as well as its democratic institutions.

"Isn't this exciting? Now let's see what your next month's mortgage payment will be!"

Ed Gamble courtesy *Florida Times Union.*

HAVE YOU BEEN A WINNER OR A LOSER IN THE RACE AGAINST INFLATION?

"Real" wages are a measure of what your wages are worth after accounting for the effects of taxes and inflation. By subtracting Federal, state and local taxes from your "gross" earnings, you can derive the total amount of your "spendable" earnings — your take-home pay. And by converting that amount from current to constant dollars, you can find out whether or not the purchasing power of your "spendable" earnings has been affected by inflation.

In order to calculate whether the buying power of your earnings has improved since 1977:

1. **Take your 1977 after-tax wages (you may use a weekly, monthly or annual figure) and multiply it by 1.5. That's because it takes $1.50 today to buy what $1.00 bought in 1977.**

(a) ____________ × 1.5 = (b) ____________
(Your 1977 after-tax wages) (What your 1977 wages would be in 1981 dollars)

2. **If figure (b) comes out to be *greater than* your 1981 take home pay, then your "real" wages have declined — you've fallen behind in the race against inflation. If figure (b) is less, you're ahead of the game.**

"Real" wages are important in measuring how inflation has affected you, but they're not the whole story. You also need to consider the value of your home, government benefits and other assets such as stocks and bonds, to determine how you are doing in the race against inflation.

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GOVERNMENT AS THE VILLAIN: GOOD INTENTIONS, BAD MONEY

On Tuesday night, October 28, a week before American voters went to the polls, the 1980 presidential campaign reached a climax. Under bright lights, and in front of television cameras which brought their images to 120 million Americans, the Democratic and Republican candidates squared off for a last-minute debate. President Carter explained that the country faced difficult economic problems, ones that would not be solved overnight. Then candidate Reagan replied:

> President Carter has blamed the people for inflation, OPEC, he has blamed the Federal Reserve System, he has blamed the lack of productivity of the American people, he has then accused the people of living too well and (said) that we must share in scarcity, we must sacrifice, and get used to doing with less. We don't have inflation because the people are living too well. We have inflation because the government is living too well.

Every Presidential candidate in recent memory has pledged to bring down inflation, restore full employment and economic health, and reduce the budget deficit. But no recent president has been able to achieve those goals. Presidents are elected by a political process. Every presidential act has political impact. With regard to inflation, every recent president has faced the same excruciating political dilemma. To get elected, a candidate must convince people he will do something about inflation, and to get reelected he must not disappoint them. But a sustained battle against inflation comes at a high political cost. Some individuals and groups will suffer as a consequence and this will erode the President's political support.

> **"Every Presidential candidate in recent memory has pledged to bring down inflation, to restore full employment and economic health, and to reduce the budget deficit. But no recent president has been able to achieve those goals."**

Take the problem of the Federal budget deficit. Most Americans rightly feel that the government *does* contribute to inflation by deficit spending. The process works this way. In an effort to meet the various demands of the public, the government for many years has spent more than it has collected in taxes, and has accumulated a huge debt. When the government decides to spend more than it receives, essentially it faces many of the same choices you do when you need additional money: It can "earn" more by raising taxes, it can reduce spending, or it can take out a loan.

PAYING THE BILLS

But all these choices are difficult. Higher taxes lose votes for elected officials. Cutting back on spending means reducing funds for programs such as Medicaid, welfare, unemployment insurance and student aid that affect millions of people — and this generates stiff political

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Courtesy The Federal Reserve Bank.

opposition. Those who would ultimately benefit from reduced spending, while often willing to accept the idea of cutbacks, unite vigorously to oppose specific cutbacks that endanger their interests.

In the very short run, borrowing money is the least troublesome choice. When the government borrows money to cover its debts, it reduces the amount of money that is available for banks to lend. Soon enough, the result is a rise in interest rates, and the rest of us are able to borrow less — which of course creates political problems. With high interest rates, you may find it harder to afford a mortgage for a new home. Businesses find it harder to get loans for expansion or new investment. Eventually, government debt and high interest rates threaten the health of the economy. Pressure mounts for the government to do something. But what can it do?

There is one thing the government can do that doesn't provoke immediate political reactions: It can expand the

"Lenin is said to have declared that the best way to destroy the capitalist system was to debauch the currency. By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. By this method, they not only confiscate, they confiscate arbitrarily. . . . As the inflation proceeds and the real value of the currency fluctuates wildly from month to month, all permanent relations between debtors and creditors — which form the ultimate foundation of capitalism — become so utterly disordered as to be almost meaningless; and the process of wealth-getting degenerates into a gamble and a lottery. . . . [Inflation] engages all the hidden forces of economic law on the side of destruction, and does so in a manner which not one man in a million is able to diagnose."

John Maynard Keynes,
Essays in Persuasion.

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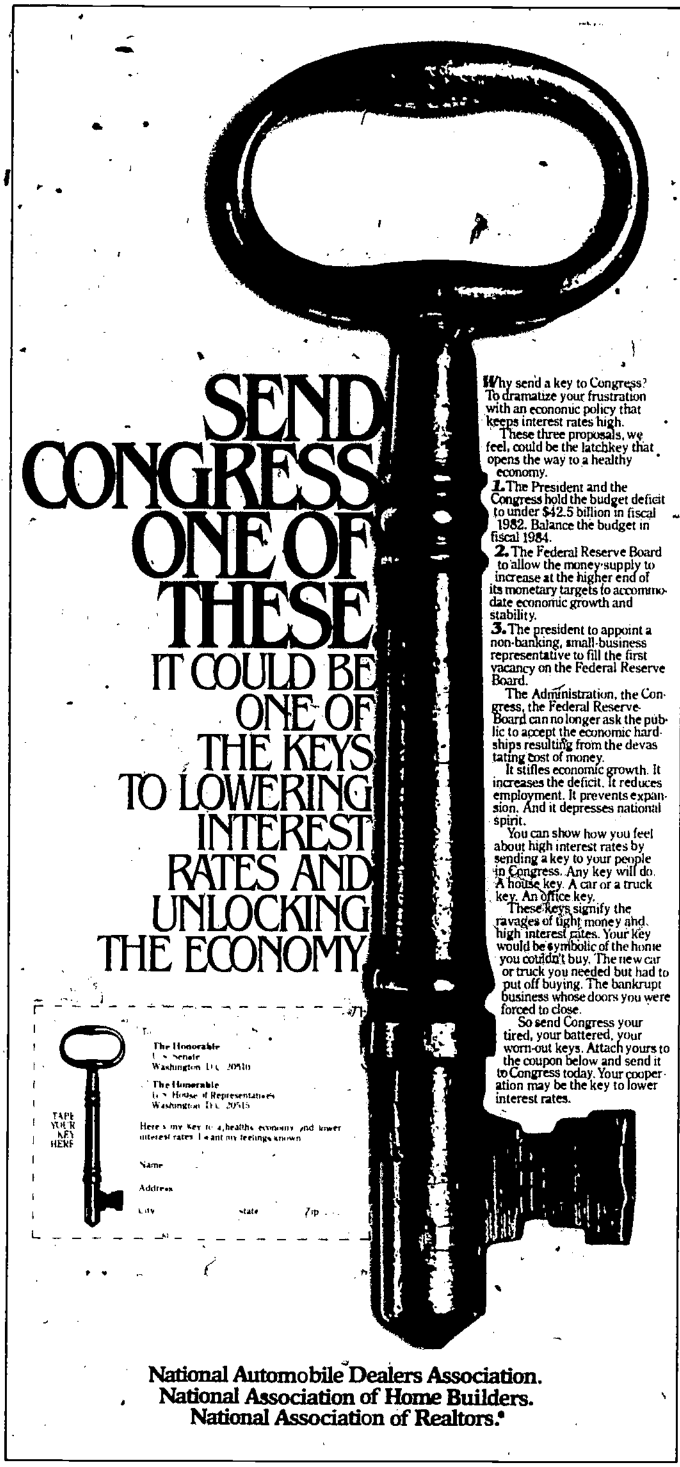

Courtesy National Association of Home Builders, © 1981.

money supply. The United States government, like most governments, has the sole authority to "coin money and regulate the value thereof." And since 1913, the government has also used the Federal Reserve System as a separate mechanism controlling the amount of money in the economy by encouraging or discouraging banks to lend. When the government expands the money supply more rapidly than economic output grows, it causes inflation. That may sound complicated, but basically it's common sense. Imagine that you are at an auction selling your mule and everyone bidding had only ten dollars. Chances are that you'd sell your mule for ten dollars or less, or you wouldn't sell it. Now imagine the same auction where everyone had twenty dollars. The price would be bid up.

The situation is exactly the same in a growing economy. There is only so much money and so many things to buy, and prices rise or fall — become inflationary or not — depending on whether the amount of money or the amount of things grows faster.

When the government expands the money supply in order to cover the cost of its commitments, everyone is happy at first: Politicians avoid raising taxes; constituents get higher spending on their favorite programs; and no one suffers from higher interest rates. It seems too good to be true — and it is. By increasing the money supply the government increases economic activity, and satisfies more constituents, but it also increases the amount of money available in the economy compared to the amount of goods and services which the economy is producing. This causes inflation by definition: more money and the same amount of "things" force prices to rise.

When you spend beyond your means for too long the result is bankruptcy. When the government spends beyond its means to satisfy the electorate, the result is inflation. By "inflating" the money supply, the government avoids other actions which would hurt some voters more directly. It is a way to appear to give voters more than they really get. Americans get more of what they demand from government but in the end they find themselves with less, because inflation erodes the value of rising incomes and higher benefits.

By tolerating inflation, by allowing increases in the money supply, politicians can temporarily avoid making unpopular decisions. But they can't forever escape the political dilemma posed by rising voter demands: On the one hand, cutbacks or tax hikes trigger an avalanche of protests; and excessive borrowing brings high interest rates or inflation or both. On the other hand, when inflation grows fierce, politicians are held responsible and voted out of office. Either way, they lose. Sooner or later politicians are blamed. The next candidate makes more promises, gets elected and invites the same fate.

WHY THE GOVERNMENT OVERSPENDS

How did we reach the point where thousands of special interests can succeed in wrenching more benefits from government than we, as taxpayers, have been willing to

DO DEFICITS REALLY MATTER?

As proposals for a constitutional amendment to balance the budget come before Congress, the debate about whether deficits cause inflation has intensified. Here are two opposing views:

Deficits Do Matter...

To begin with, deficits raise operating costs. If the Government runs a deficit of $100 billion and borrows to pay its bills, then (assuming an average interest rate of 12 percent) annual expenditures are $12 billion higher than if taxes had been increased to cover the deficit.

Second, deficits breed deficits. By boosting annual interest payments, each successive deficit increases the difficulty of achieving a balanced budget and forces the Government to borrow more, just to cover the interest on the debt.

Third, deficits spur inflation. To expand the permanent national debt is to increase demand. Unless the supply of goods and services rises commensurately, the result can only be higher inflation.

Fourth, deficits raise interest rates. If the substitution of deficit induced borrowing for taxation will accelerate economic activity, it will surely raise the private sector's demand for capital. Private and public-sector borrowing requirements will then collide, sending interest rates soaring.

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Deficits Do Not Necessarily Matter...

There is no doubt that big budget deficits can, at times, generate inflation, as long as the Fed is willing to expand the money supply accordingly. But the matter is not as simple as it sometimes seems. In principle, you want to run a deficit whenever the economy is running well below capacity and there is widespread unemployment. The only question is how big the deficit should be. Economists try to estimate it by figuring what the budget would look like if everyone were working and paying taxes; that high-employment budget, as it is known, should be roughly in balance. For most of the 1970s, the high-employment budget was in deficit, though not by large amounts. Ironically, one year in which the high-employment budget was in surplus was 1974 — the year, until 1979, of the worst inflation ever. So the connection between deficits and price increases is not always clear.

Other comparisons also undermine the apparent link between deficits and inflation. "We had inflation in 1920," notes the historian Arthur Schlesinger Jr. in an article in *The Wall Street Journal*, "when the federal budget ran a surplus. In 1975-76 inflation declined from 12% to 4.8% while the budget ran deficits of $112 million. West Germany today has a budget deficit at least two and a half times as large as ours in relation to gross national product — and an inflation rate of one-fourth of ours."

Excerpted with permission from *Understanding Inflation*, by John Case, William Morrow and Company, Inc. 1981.

pay for? The answer lies in the government's current economic role. Until the 1930s, the Federal government played a relatively minor part in economic management. When bad times brought bankruptcy and unemployment, no one expected the government to provide assistance to those affected, or to pull the economy out of its slump. Bad times and good times were accepted (and expected) as part of the natural business cycle of a capitalist economy.

The Great Depression radically altered most people's view of the economy. For the first time, it seemed paralyzed by a severe crisis. The slump was worldwide, and it seemed permanent. Instead of the country finding its own way to recovery, the depression grew worse. Economic activity nearly came to a standstill, while a quarter of the nation's workers were unemployed. Public pressure mounted for the government to do something, and the British economist John Maynard Keynes proposed revolutionary policies that were eventually adopted. Keynes did not believe that depressions were "natural," inevitable, or necessary. He thought they were caused by the failure of spenders — consumers, business investors, and the government — to buy enough goods and services to keep the economy producing at full employment. To lift the economy out of a depression, Keynes argued, the govern-

WHY IT'S SO HARD TO BALANCE THE BUDGET

In March of 1980, President Carter announced he would press Congress to balance the budget as part of his new anti-inflation program. As budget cuts were being discussed on Capitol Hill, Democratic Senator Thomas B. Eagleton returned to his home state of Missouri where, according to newspaper reports, he encountered a number of good reasons to oppose a balanced budget:

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★ A leader of the Missouri State Nurses Association said she would refuse to support the senator if he "persists in cutting the nursing aid budget."

★ A man rushed up to him at an airport and announced he was counting on Eagleton to help "increase federal support for diabetic research," and at another airport the board of directors of a Kansas City anti-poverty program waylaid Eagleton to demand more money for their projects.

★ In Hannibal, a Laborers Union official announced bluntly that Senator Eagleton was "going to have to reconsider his thoughts" about budget cutting.

★ A black minister pleaded with him, "Please don't let them cut the youth program for this summer."

★ A building industry group applauded him for bringing hundreds of millions of dollars in federal construction projects to Missouri; the group's president also told *The Wall Street Journal* it would "do its best to see that the budgetary axe falls somewhere else."

★ In St. Louis, a Job Corps director urged him to defend federal employment programs.

★ At a pig farmers' convention, a top official urged him not to let Washington cut the pork research budget.

★ An International Association of Machinists official wanted to make sure Labor Department programs didn't get cut.

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ment simply had to increase its spending. It could and should spend beyond its income. When an economy was in a slump, deficit spending would not result in inflation; instead it would stimulate demand and economic activity and relieve unemployment.

To a remarkable degree, Keynes' prescription for ending the Depression worked. Massive government spending during World War II brought rapid economic growth and full employment. But ever since, there has been a different relation between the government and the economy. Once people realized that the government could do something to prevent depressions, they demanded that it be done. A political Pandora's box was opened. Since the war, Americans have come to expect that the government will do all it can to avoid another 1930s-style depression; they have also come to expect full, or nearly full, employment, as well as a rising standard of living; and they have demanded — and received through the political process — protection from many of the other hardships and insecurities of the free enterprise system. Social Security now shelters those unable to provide for their own old age. Unemployment compensation protects workers from disruptive changes in the economy. A host of regulations protect the health and safety of consumers and workers. Federal insurance and subsidies stave off bankruptcy and the rigors of the free market for many businesses, farms

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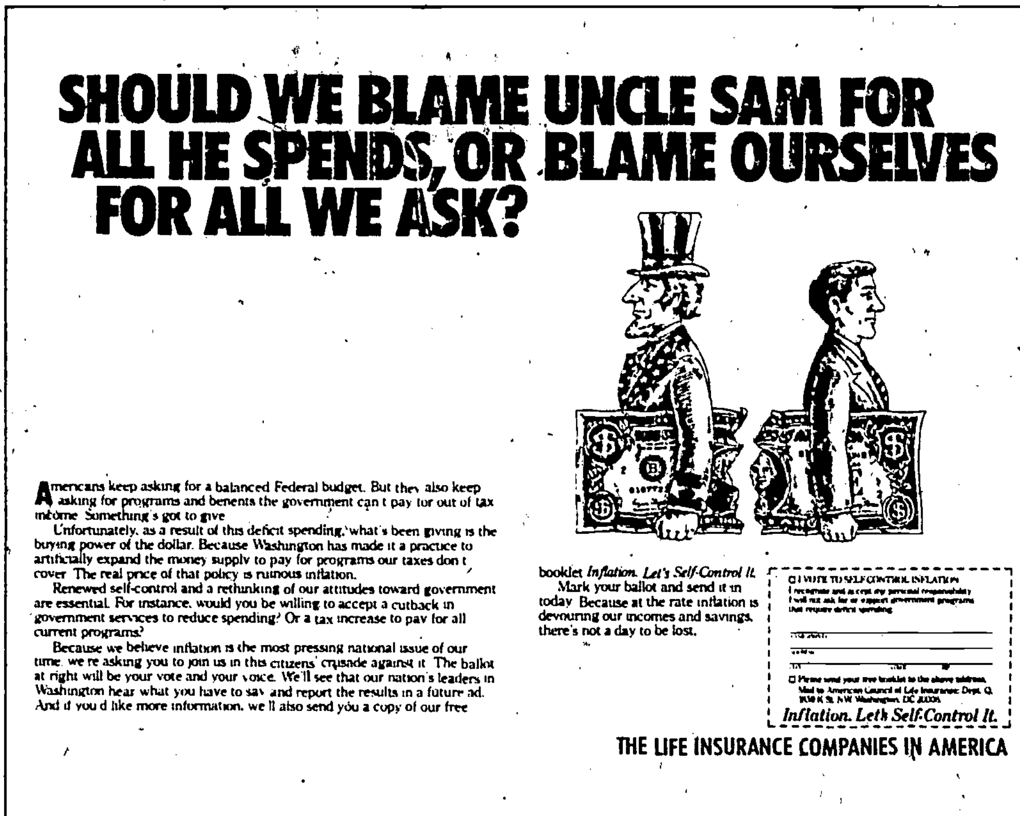

Courtesy American Council of Life Insurance, © 1980.

and banks. And welfare provides a "safety net" for many individuals facing grim economic circumstances.

Since World War II massive government intervention has become an economic fact of life in the United States. Some people view it as the humanization of capitalism. Others view it as the end of free enterprise and the first step towards state socialism. But nearly everyone agrees that the new government role has emerged because of political pressure.

Postwar prosperity nurtured the attitude that everyone is "entitled" to a rising standard of living and a clean environment, and unemployment benefits and welfare payments and federally subsidized home mortgages and a strong military and good roads and Social Security and hundreds of other things. Since the war, individuals and groups have learned how to organize and lobby for their demands through the political system. To meet these demands, government has grown enormously. It has become more complex and expensive, weaving itself into almost every facet of our lives.

The result has been an economy much more susceptible to inflation in a number of ways:

★ By taking steps to avoid severe recessions, the government has hampered the free-market cure for inflation: In an economy that experiences vigorous expansions and severe contractions, prices can be expected to rise and fall. In today's economy, the government tolerates rising prices during expansion, but cannot accept the political liabilities of the unemployment and business failure that accompany slumps and falling prices.

★ The establishment of unemployment insurance has contributed to inflation by making workers less fearful of losing their jobs and more reluctant to accept wage reductions during recession.

★ Price supports for agriculture and government subsidies to ailing industries undercut by foreign competition contribute to inflation by protecting these groups from the cruel discipline of the free market.

★ Government regulations in the health, safety and environmental fields have also contributed to inflation, according to some, by adding to business costs.

★ Finally, all government programs contribute to inflation to the extent that they contribute to deficits which require inflationary financing.

So the government deficits are only a symptom of the problem. Government has contributed to inflation by intervening to tame a capitalist economy that virtually everyone — workers, farmers, the elderly, businessmen — found uncomfortably ruthless. It has contributed to inflation through deficit spending and by expanding the money supply, but it has done both on our behalf. At the root of the problem is a political dilemma: we vote for politicians who promise to provide more without increasing taxes, yet we punish politicians who cause inflation by doing what we ask of them.

Going back to a time when government was not so large may help to reduce inflation, but getting there will mean giving up many of the things that the government does to benefit all of us. The question is whether we are willing to make that sacrifice.

4

THE RECESSION STRATEGY: IS IT THE LESSER OF TWO EVILS?

Millions of Americans have felt confused in recent years because of the trade-off between inflation and recession, or, in other words, between inflation and unemployment.

"Recession is good news, they tell us in the papers, because it will bring down prices. But how can recession be good for us when it puts ten million people out of work?" says George Petropoulos, a maintenance engineer for Eastern Airlines in San Francisco. "It doesn't make sense." Millions of Americans share this sentiment. With the country suffering from the highest unemployment rate since the Depression, most people do not feel that the government should just sit back and watch the recession deepen — or worse, deliberately prolong it — in the name of fighting inflation.

In the 1960s, Americans tolerated moderate inflation, but as inflation accelerated in the 1970s and its destructive impact on the economy deepened and became more widely recognized, public opinion shifted. Forced to choose between the twin evils of inflation and the high interest rates that might lead to recession and unemployment, Americans have reluctantly accepted the latter.

We are not alone. Other industrial nations, too, have resorted to the recession strategy when inflation threatens to run out of control. Britain provides the clearest example. When Margaret Thatcher became Prime Minister in May, 1979, she declared that England's twenty percent inflation rate could be brought under control only by tightening the reins on the money supply and deliberately engineering a recession. It will not be pleasant, she explained, but it will work.

She was right on both counts. Britain's tight money policy raised interest rates and choked off economic growth. Unemployment now exceeds ten percent. In the midst of economic hardship, Mrs. Thatcher has been claiming victory. "The battle against inflation is being won," she explained to a crowd of angry jobless protesters outside 10 Downing Street.

"With the country suffering from the highest unemployment rate since the Depression, most people do not feel that the government should just sit back and watch the recession deepen — or worse, deliberately prolong it — in the name of fighting inflation."

Economists have known for years that sustained recessions bring prices down. But in the past this strategy seemed impractical because of the political opposition it stirs up. Like George Petropoulos, most Americans feel that the side-effects of recession are intolerable, that the cure is worse than the disease. When inflation is extreme, we accept recession as a short-term remedy; but once the inflation rate moderates, or once the unemployment rate surpasses "reasonable levels," Americans endorse "full employment" policies even if they will entail additional inflation.

This see sawing of public opinion has made a long-term solution to our inflation problem extremely difficult. With their fate hinging on their popularity at the polls, America's elected officials have found it almost impossible to pursue a consistent anti-inflation strategy. As an election approaches, they feel the pressure to stimulate the economy even if the effort is likely to fan the inflationary fires.

Take, as an example, President Nixon's course during the 1972 election season. He chose to stimulate the economy to reduce unemployment before the elections. Simultaneously, he instituted wage and price controls so that the expansion wouldn't trigger higher inflation. (At the time the inflation rate was a "worrisome" 3.4 percent.) President Nixon succeeded in temporarily sustaining both low inflation and low unemployment, but once wage and price controls were lifted, inflation worsened. The OPEC oil embargo made this situation even worse. In 1974-75 the country suffered a recession and unemployment rose appreciably. By the time Mr. Nixon's successor, President Ford, sought reelection in 1975, the unemployment rate was about five percent and inflation was up to an unprecedented ten percent.

Political pressures make it almost impossible for a president to stick to a recession strategy (which is necessarily painful, slow and gradual) if they hope to get reelected. In other countries like England, West Germany, and Japan, government leaders have been more successful in reducing inflation with recession because they have longer terms of office, allowing them time to let a recession do its work and still leave time for economic recovery before the next election.

In every country though, recession strategies breed political opposition, especially among those most affected — the unemployed. Switzerland and West Germany, two countries with an excellent record of holding down prices by deliberately encouraging recession, have managed to avoid paying the political price because of their large population of foreign workers. When recession hits these two nations, "guest workers" from Turkey, Yugoslavia, Greece, Italy, Spain and elsewhere, are "sent home" in large numbers. A large part of the burden of recession is thus borne by foreigners, who don't vote. In the United States, where there are few foreign workers, we have no such option. Thus we face a hard choice in trying to pick the lesser of two evils — higher unemployment or high inflation.

IS A RECESSION A SOLUTION?

While most Americans wrestle with the *moral* issue surrounding the recession strategy — whether it is right to throw people out of work for the benefit of everyone who is hurt by inflation — a number of economists question the

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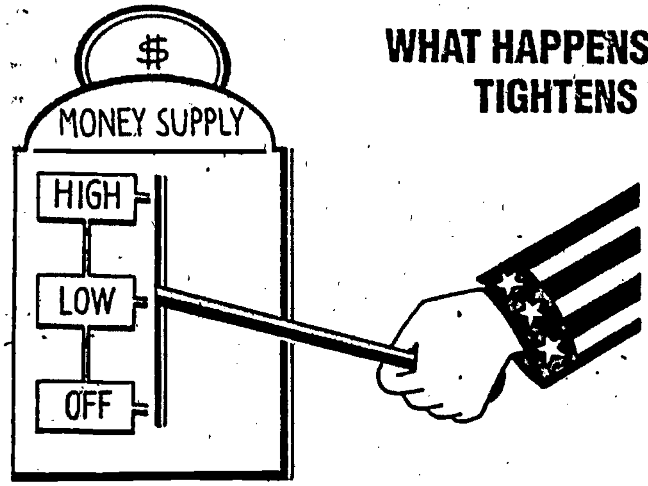
"If a recession is to be used to stop inflation, we draft inflation fighters in a very uneven pattern. In proportion to their size in the labor force, sixteen to twenty-four year olds are three times as likely to be drafted as adults. Females are 38 percent more likely to be drafted than males; blacks are twice as likely to be drafted as whites; and Hispanics are 75 percent more likely to be drafted than whites."

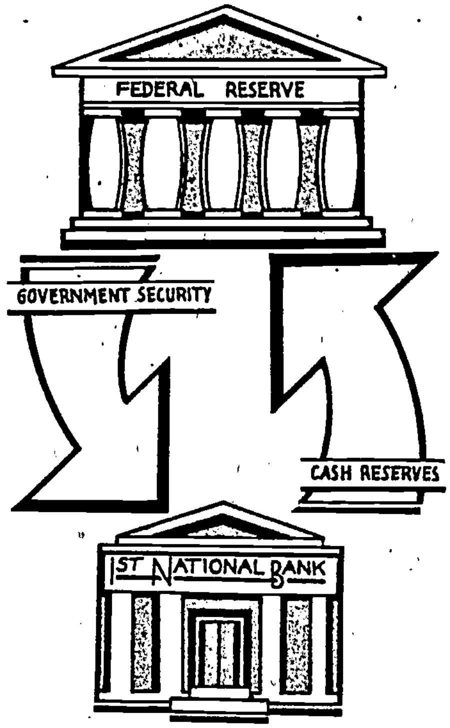
Lester Thurow,
The Zero Sum Society.

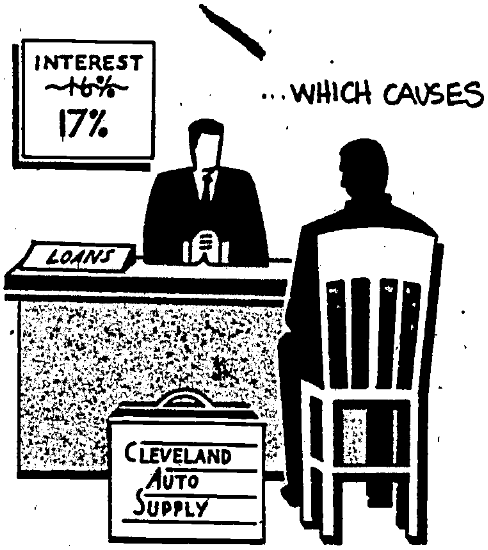
WHAT HAPPENS WHEN THE GOVERNMENT TIGHTENS THE MONEY SUPPLY



THE GOVERNMENT REDUCES THE MONEY SUPPLY

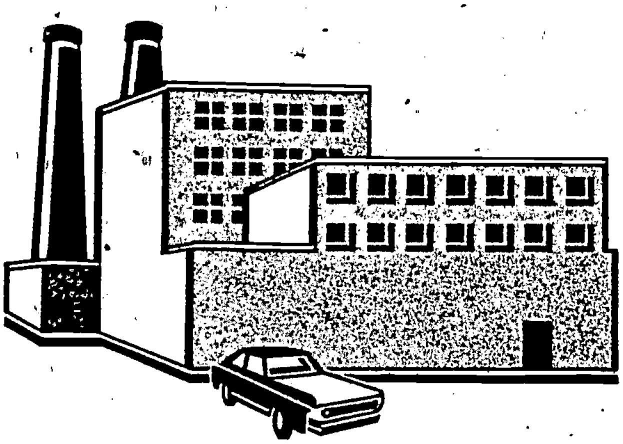
The Federal Reserve decides that the economy is too inflationary. To reduce the amount of money in the economy and bring down prices, it sells government securities.





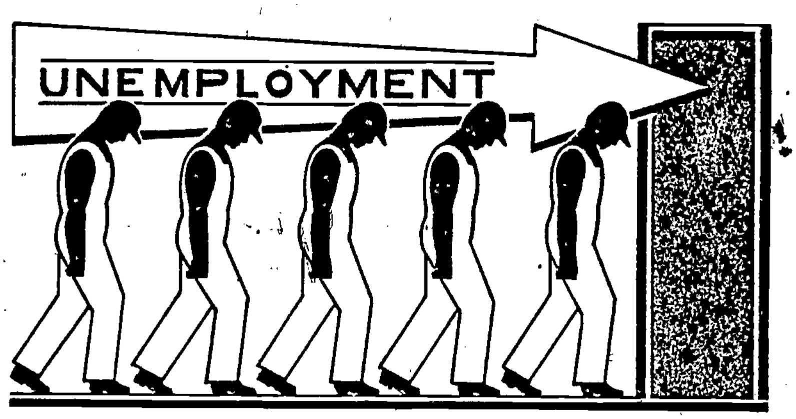
...WHICH CAUSES INTEREST RATES TO RISE

The First National Bank of Cleveland buys the government securities which reduces its cash reserves at the Fed. With less reserves, the First National is legally required to reduce its lending. Less lending means less money and lower demand in the economy. This brings some prices down. Less money also pushes interest rates up.



...AS A RESULT, BUSINESS ACTIVITY DECLINES

Higher interest rates make Cleveland Auto Supply Company decide to postpone its plans to build a new warehouse. This, in turn, means less work for the Ohio Construction company which bid on the warehouse job. Desperate for work, the firm bids lower on its next job. Prices fall somewhat more.



...AND UNEMPLOYMENT RISES.

The Construction firm lays off two welders and three carpenters because business is slow. Lower spending by unemployed workers further reduces demand in the economy, leading to lower prices.

Illustration by Jean Tuttle and Deborah Hosking

ERIC

HERE IS WHY YOU LOST YOUR JOB

Dear Joe:

I was sorry to hear that you had lost your job. If it is any comfort, you may think of yourself as a foot soldier, wounded in our country's battle against inflation.

The Administration and the Federal Reserve, whose tight money policy helped to put you where you are, are counting on your plight to serve as a scary example to business and to labor so that they will go easy in raising wages and prices.

Furthermore, the Fed knows that in your present situation you are going to spend less in the stores, and that will also put the screws to the business community. It may also increase the number of people laid off.

I'm afraid that I cannot refrain from reminding you that you were pretty loud in your complaints against inflation in the last few years. In fact, it was loud complaints like yours that nerved up the Fed to reduce the money supply growth and bring on the recession.

Of course, everybody was complaining against inflation, you may well say. Well, I am sure that it has struck you by now that the solution to the inflation problem we have backed into does not spread the misery at all evenly. But rest assured, you are suffering for the benefit of the rest of us.

Very Truly Yours,

Your Favorite Economist

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recession strategy's *practical* aspects. In our economy prices don't necessarily fall during a recession. Companies have a choice: to reduce prices or to cut back on production and lay off workers.

To end inflation with recession, these economists feel, would require much more than a mild recession; it would require staggering unemployment and a lengthy period of economic decline. A recession of this magnitude is unacceptable, they argue, because it results in an unnecessary waste of the nation's resources. When the economy produces less than it could operating at full capacity, the country grows poorer. Every idle factory and under-used machine represents a waste of our productive potential.

By Spring, 1982, with the nation in the grip of a severe recession, the burden of fighting inflation rested very heavily on the shoulders of some ten million jobless Americans.

Is this the way we want to fight inflation? By failing to agree upon any other way to fight it, Americans have, in effect, accepted a recession strategy — with all its costs. Elected officials have acquiesced because recession, despite the suffering that it causes the unemployed, is still more palatable to them than high inflation. Inflation angers all voters; recession directly affects only some.

How long are we willing to endure recession in order to bring down the inflation rate? And how much unemployment are we willing to tolerate?

5

ENDING THE WAGE-PRICE SPIRAL: SHOULD WE LIMIT OUR CLAIMS?

In the United States today, many individuals, groups, labor unions, and businesses have the power to maintain their incomes in the face of rising prices. If the price of oil rises, for instance, and the automobile companies feel their income (profits) decline, they simply set prices higher. Millions of car-owning workers also press for higher wages so that their real income will not decline. And other people who can control the price of what they sell, like doctors and plumbers, also raise prices to maintain their incomes in the context of other rising prices. The wage-price spiral is born.

America suffers from a wage-price spiral because no one wants to see their wages, prices or income drop — and many people have the power (either economic or political) to do something about it. As a result, with every price increase — no matter what the cause — millions of individuals scramble to raise their prices (and incomes) in order to protect themselves.

> "America suffers from a wage-price spiral because no one wants to see their wages, prices, or income drop — and many people have the power to do something about it."

When Dan Connally, a bus driver in Boston, felt his buying power dwindle last year because of rising prices, he went to his union with thousands of his co-workers and demanded a raise. "I'm not gonna just sit and watch my paycheck shrink," he told a reporter for the *Boston Globe*. Neither will most Americans. Seeing inflation erode their earnings, they have done just as Dan Connally did. They have demanded higher wages or "cost-of-living allowances" (COLA's), to protect themselves against the threat of rising prices.

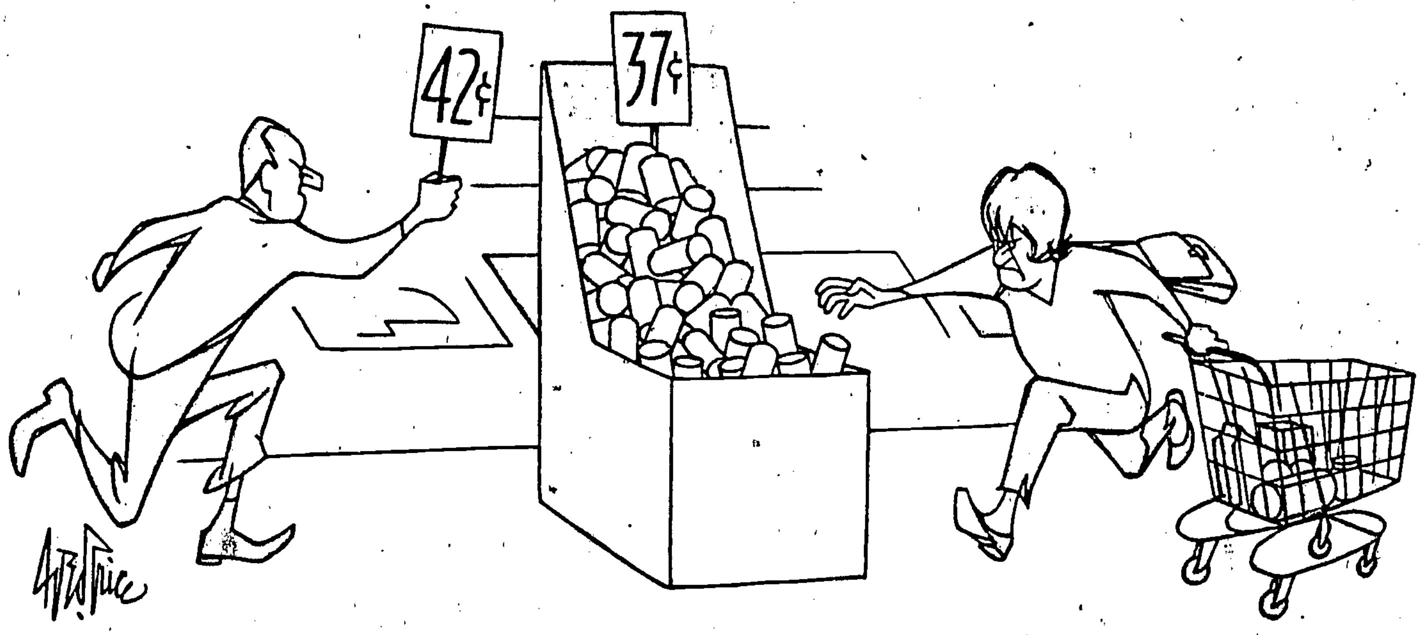
Everyone naturally wants to "keep up" with inflation in this way. But to the extent that everyone "succeeds" in keeping up, inflation worsens. If your costs rise ten percent one year, you naturally try to raise your prices (if you have something to sell) or wages (if you sell your labor). If you succeed, you feel relieved and sigh: "I've caught up." But it's an illusion: If everyone else also raises their prices or wages ten percent, prices will be about ten percent higher than when you started. No one will be better off.

It's like a parade where you try to get a better view by standing on tip-toes — you can't if everyone else does.

WHO STARTED THE SPIRAL?

But if everyone is responsible for propelling inflation forward, who was responsible for starting the whole process in the first place? Some people blame labor. Due to the rising power of unions, wages have risen "unreasonably," pushing up business costs and prices. But what is "unreasonable"? And what about the 80 percent of the labor force that is not unionized?

In the past wages rose and fell as the demand for labor fluctuated. But in this country, real wages (that is, wages in



Drawing by Geo. Price; © 1972 New Yorker Magazine, Inc.

terms of their value in goods), despite these ups and downs, witnessed a steady upward trend for over a century. The rise of real wages, however, has historically been tied to increases in production. As the output of goods increased for each hour worked, so, on the average, did workers' compensation. Businesses were able to grant wage increases and still keep prices low — as long as wage hikes did not exceed gains in productivity. In recent years, the situation has changed dramatically. Productivity in the private business sector has plunged (from an average annual increase of 3.1 percent during the period 1948 to 1965, to .6 percent in the period from 1973 to 1980). Meanwhile, pay increases in many industries, because of labor's growing clout, have risen much faster. Wage hikes in excess of productivity gains force businesses to choose between trimming profits or raising prices, thus giving tremendous impetus to the wage-price spiral.

If everyone receives a pay increase greater than the rise in productivity, continued inflation is assured. The amount of money grows (higher wages) more than the amount of goods produced (productivity), so costs rise. These higher costs then threaten profits, and are quietly "passed along to consumers" in the form of higher prices. Only when the threat of bankruptcy and job losses is imminent (as in the auto, airline, and newspaper industries in recent years) have wages been trimmed and workers accepted a drop in their income. Inflation has trapped American businesses and workers into a tragic game of economic chicken: wage demands escalate with inflation until the most dire circumstances approach.

Because many businesses know that they can "pass along" higher wage costs to consumers through higher prices, and because they are reluctant to risk strikes (which

If everyone agreed to end price hikes that are not justified by cost increases and scale down wage demands that exceed productivity increases, the wage-price spiral would unravel immediately and painlessly.

FIFTEEN YEARS OF INFLATION

While consumer prices, on average, have risen 180 percent since 1967, the cost of certain goods and services has risen much faster.

	1967	1982	% Change
Four Bedroom Suburban House	$39,000.00	$120,000.00	+208%
Pepperidge Farm Bread	$0.31	$0.89	+187%
Hospital Room	$20.00	$117.00	+485%
Two-piece Suit (Brooks Brothers)	$145.00	$320.00	+121%
Gasoline (Gallon)	$0.33	$1.29	+291%

ERIC

stop production and hurt profits) they are often quite willing to meet labor's demands. Some observers feel there is, in fact, a tacit agreement — "an invisible handshake" — between labor and business to raise wages and pass along costs at the expense of the consumer.

For every economist pointing a finger at labor and the wage side as the source of the wage-price spiral, however, there is another placing the blame on businesses and the price side. Greedy businesses that raise their prices to maintain or increase their profits are at the heart of the problem, some claim. It is higher prices that force people like Dan Connally to demand higher wages, which, in turn, raise costs and bring further price hikes — and so on.

The fact that many companies are large and face little competition makes it easier for them to raise prices without fearing a loss of business. When businesses need to raise prices — in order to cover higher costs, or higher wages, or maintain their profits — they do. When there is pressure to reduce prices — during a recession, or because of falling costs — they respond instead by cutting back on production rather than prices. In 1980, for example, when one tire manufacturer realized that its two-ply tires were not selling well, it did not cut prices; it just reduced the number of tires it made by closing six plants, putting 7000 people out of work. Not all companies, of course, have the luxury of this choice: in some highly competitive areas prices do move up and down according to supply and demand. But as long as some prices are resistant to downward pressure, they add an undeniable inflationary element to the normal ups and downs. In good times prices rise; in bad, only *some* fall; in the end, the *average* price level creeps upward a notch.

It is a useless exercise to try to figure out which came first — wage or price increases. When prices rise, people demand higher wages; when wages rise, business costs rise (especially in industries where payroll costs make up a large percentage of total costs), profits get squeezed, and prices are forced upward. Trying to determine who was the "initial" villain is beside the point. The important thing to realize is that in an economy where everyone acts to "keep up" with past or anticipated inflation, the problem inevitably grows worse.

STOPPING THE SPIRAL

Is there anything that can be done then to unwind the wage-price spiral? Is there anything that can be done so that each one of us doesn't feel, like Dan Connally, that we must raise our wages or prices to protect our incomes, which twists the spiral higher?

One obvious solution is voluntary controls. If every-

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one agreed to end price hikes that are not justified by cost increases and scale down wage demands that exceed productivity increases, the wage-price spiral would unravel immediately and painlessly. So long as everyone showed the same restraint, no one would be worse off relative to anyone else — and inflation would diminish. (Some prices, like those tied to imports, might rise, but the overall inflationary trend would halt.)

Sounds easy? There must be a catch. As H. L. Mencken once said: "For every complex problem in our society there is a solution that is simple, plausible and wrong." Would a voluntary agreement to hold down wage demands and prices be that kind of solution? Guidelines to encourage voluntary restraint have been proposed in each of the past four Administrations. Their shortcoming, however, is that unless everyone shows the same restraint, they are doomed to fail.

In inflationary times most people try to wait until everyone else lowers their prices: the longer you wait before lowering *your* prices, the better off you'll be. Again it's like the parade: If you're the first one in the crowd to stand on tip-toe (raise your prices), you'll get a better view (raise your income) until everyone else does; also, you are reluctant to lower yourself (your prices) first because the last person to get off his or her toes will enjoy a better view (higher income) for a longer period.

In 1979, under President Carter, voluntary guidelines did succeed in keeping down inflation for a few months. But because some people didn't comply, and because the staggered timing of wage contracts during the year resulted in sharply different wage settlements for workers in similar circumstances, many people came to view the guidelines as unfair. Those who did comply with the guidelines were penalized by the price increases of those who didn't. They watched their relative incomes shrink. For this reason, the voluntary guidelines eventually broke down and were abandoned, as they have been abandoned repeatedly in the past.

Photo: Bill Schleicher, District Council 37, AFSCME

Members of a union demonstrate their disapproval of the Nixon administration's wage and price controls in 1972.

Voluntary controls are not necessarily unworkable; they just require a high degree of public support. In Japan, a form of voluntary restraint has played a significant role in stemming the tide of inflation. Traditionally, all the major unions in Japan negotiate yearly wage contracts in what is known as a "spring wage offensive." Agreements to restrain the wage demands voluntarily at these spring offensives have been successful because the attention of the whole country is focused on the negotiations and there is enormous pressure to hold all wage increases to the average level of productivity gains.

The main alternative to voluntary restraint is mandatory controls — laws restraining wage and price hikes. Let's say that the government decided that wages and prices could rise this year only as much as productivity — about one percent — and passed a law to that effect. If everyone complied, inflation would plummet overnight. The catch here is that there are over ten million different businesses in the United States and any program designed to control the prices and wages of all these businesses would face unimaginably complex administrative problems. Imagine a government agency trying to decide how much a certain restaurant could raise its price for a club sandwich, for example, and then imagine what would be necessary to enforce such decisions.

Because of such nightmarish difficulties, most proponents of mandatory controls suggest that controls be limited to the largest, most powerful companies and unions. Most businesses and individuals, they explain, are already controlled by the discipline of competitive markets. A government control authority, therefore, need concern itself only with regulating the prices of the companies and unions that are unrestrained by competition and so set their own prices.

Critics complain that even limited controls would wreak havoc with the economy. Prices, they argue, regulate a free market economy. Constantly changing prices (and profit levels) serve as signals to producers of different goods that more or less of something is desired by consumers and can be profitably produced and sold. But if the government holds the prices of television sets too low, for instance, more people will want to buy them, but less companies will find it profitable to produce them. There will be too many buyers; long lines may appear outside of stores; some buyers will be disappointed; and some type of rationing scheme may be necessary.

Proponents of controls contend that a price setting authority could avoid shortages by being flexible and adjusting prices whenever necessary. Or it could limit controls to the small number of items that account for most consumer spending — food, energy, cars, clothes, etc.

They acknowledge that even such a system might have difficulties — with everyone clamoring for "adjustments" and special exceptions, some groups would object to any decision by the control authority as unfair. And even some of the most vigorous proponents of controls acknowledge that deciding where prices should be set and enforcing those decisions would require a large, costly bureaucracy to gather and process information. Nonetheless, in other countries, controls have been used successfully. In Austria, controls are limited to about 200 standard articles and administered by a commission of government, business and union representatives: that approach has succeeded in slowing inflation without destroying the price mechanism or suffocating the economy with bureaucracy.

Among proponents of mandatory controls there is considerable debate about whether controls should be used as a short-term emergency measure or on a permanent basis. Some argue that temporary controls will provide only temporary relief: once they are lifted, inflation will surge. This is what happened when President Nixon removed his wage-price controls in 1972. On the other hand, permanent mandatory controls, like voluntary guidelines, require nearly universal compliance. We witnessed this level of public support when wage-price controls were required during World War II and, as a result, controls were quite effective. But the same degree of cooperation is difficult to engineer in the absence of a national crisis.

Finally, many people object to permanent controls because the controls might require a cumbersome and costly government bureaucracy. The offices responsible for wage-price controls in the Nixon administration employed 4,000 people. An effective administration of permanent controls might require a budget of many millions of dollars. Are we willing to pay this price to stop inflation? Are we willing to enlarge the scope of government, to give it the authority to control wages and prices, when we feel determined to cut government back in other areas?

The stumbling block to finding a workable solution to the inflation problem is that everyone wants to make sure that their income rises to "keep up" with inflation. But unfortunately, unless the economy grows and produces more, everyone's income cannot rise simultaneously without aggravating inflation — which, in the end, leaves us all worse off. Solving the inflation problem by limiting people's claims to higher incomes is difficult to administer because no one is willing to sacrifice his or her income unless everyone else does so.

But what is the fairest way to limit incomes and what would be most effective? Which approach involves the least government intervention? Only when Americans come to a general agreement about the answers to these questions will limiting claims be a viable strategy to end the wage-price spiral.

Like the other strategies we have examined so far, limiting claims will impose costs on individuals and on the economy as a whole. We need to weigh these costs in comparison to the costs of the alternatives. We have one more alternative to explore — the growth solution.

Inflation has trapped American businesses and workers into a tragic game of economic chicken: wage demands escalate with inflation until the most dire circumstances approach.

6

THE GROWTH SOLUTION

> **To maintain our standard of living today, we have mortgaged our future. We have accumulated a debt that future generations will have to pay off, and we have consumed funds that we would have been wiser to invest for future prosperity.**

Persistent inflation over the past decade has led many Americans to long for the "good old days" when there wasn't any. It would be a mistake to idealize earlier times when life was simpler, slower, more family-oriented, and perhaps less perplexing. Depressions, insecurity, and a lower standard of living were also part of that earlier time. But whether we feel that the old days in the U.S. were on the whole good or bad, one thing does seem certain — there was no such thing as chronic inflation.

In the past the economy grew vigorously. There were ups and downs of course, but over the long run, Americans enjoyed a rising standard of living and unprecedented prosperity. Recessions and depressions, which desperately hurt some people when they occurred, brought falling prices and falling interest rates that stimulated consumer spending and business investment, and eventually led the way to a recovery.

The good old days were indisputably good in another sense: They left an enormous legacy of accumulated wealth from which we have all benefited. Nearly everything we see around us — roads, dams, bridges, railroads, skyscrapers, modern factories, universities — was built with the wealth of our forebears. The United States became a rich country because its economic and political system proved very efficient. The genius of capitalism as it flourished in the United States was that individuals, by striving to better themselves, created enormous wealth and contributed to the welfare of future generations through their efforts. For years it seemed to work well. There was steady economic growth and sufficient investment to allow the country to progress down a path to prosperity.

The Great Depression destroyed much of our carefree attitude about economic matters. Ever since, worrying about the economy and trying to keep it on a prosperous path has become a serious matter, and a basic concern of our government. Americans now share a distressing feeling that something has gone wrong. Inflation, unemployment, lagging productivity, and high interest rates all contribute to our current economic woes.

Savings, the essential ingredient of a growing economy, have declined because of inflation. When prices rise and you expect one hundred dollars to buy less next year than it did this year, you think twice about putting your money in the bank. Unless interest rates on savings are substantially higher than the expected rate of inflation, most people feel that it is smarter to buy now rather than put their money aside and watch its value decline in "real" terms. The basic fact about inflation — that it discourages savings — is crippling to the economy. When less money is saved, less is available for businesses to invest (and interest rates on loans rise, making the money that is available less

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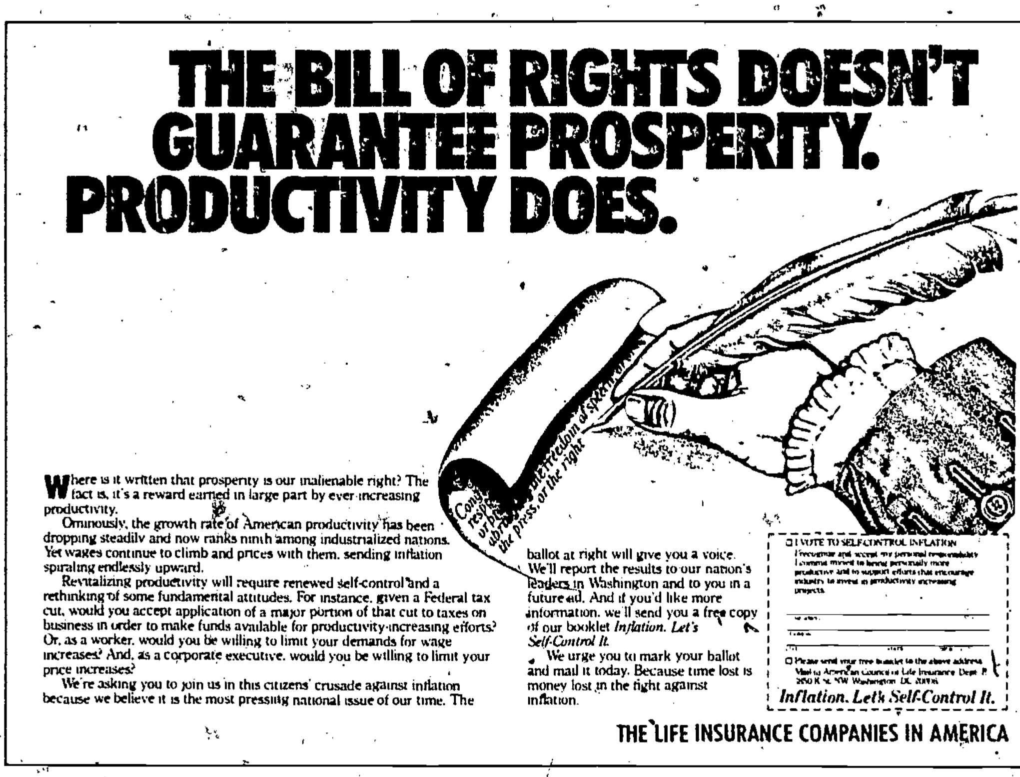
attractive to investors). This translates into fewer factories, fewer new machines, less business expansion, and ultimately less growth; only when some part of what an economy produces is set aside to be invested — not consumed — can increased production in the future be assured.

Inflation also undermines the economy by encouraging consumption and debt. In the past, if your parents or grandparents wanted to buy a car, they probably saved. Then, when they had enough, they went to the dealer and paid in cash. Things are different now. What do you do when car prices creep up constantly each year? You buy now, rather than next year, when the price will be still higher. Most Americans do the same. It is no coincidence that buying on credit has grown more popular at the same time that inflation has grown worse. The advantages of using credit during inflationary times are two-fold: first, it allows you to buy now and avoid future price increases; second, it allows you to pay off your debt with dollars that are actually worth less.



Courtesy American Council of Life Insurance, © 1980.

What has happened, though, is that to maintain our standard of living today, we have mortgaged our future. We have accumulated a debt that future generations will have to pay off, and we have consumed funds that we would have been wiser to invest for future prosperity. Instead of saving and investing to grow rich, and in the process guaranteeing society's economic prosperity, individuals — because of inflation — have come to behave in ways that only worsen our economic predicament and make long-term stagnation more likely.

Inflation leads to stagnation, unemployment and falling productivity. Economic problems do not separate easily to be scrutinized and solved one at a time. The solution to any one of them must be seen in the context of the others. Will controlling inflation with recession bring down inflation, only to result in unemployment that will create more inflation in other ways? Will using wage-price controls stop price increases, but in the process condemn the economy to prolonged stagnation? Or can we revitalize the economy, spur productivity and growth, and at the same time end inflation?

REVITALIZING THE ECONOMY

Proposals to end inflation by revitalizing the economy have originated from both conservatives and liberals. Such policies are based on the belief that spurring growth will produce a greater supply of goods and services relative to demand and therefore bring prices down.

One set of policies designed to invigorate the economy has come to be known as "supply-side economics." The core of this approach is a program of tax cuts for individuals and businesses that are intended to raise the rate of saving and investment, which will, in turn, raise productivity and growth.

Critics of the supply-side approach often contend that relying on tax cuts to spur saving, investment and growth is inherently unfair because it must favor the rich in order to be effective. Even many supporters of the supply-side approach concede that this is true, at least in the short run. If you allow businesses and the rich to keep more of their income, they tend to save more of it. In the long run, supply-siders believe, tax cuts targeted to those that save will benefit everyone — rich and poor — because it will spur growth.

More vehement critics of the supply-side approach insist that even tax cuts favoring groups who are likely to save will do little to stop inflation. There is no empirical evidence, they argue, that shows that tax reductions alone

PAYING THE COST OF GREATER SAVING

Greater saving and investment to ensure the future health of the economy, which nearly everyone wants, requires a reduction of consumption today — which no one wants. Any strategy to increase saving and investment is likely to encounter serious political opposition. Let's say the government decided to encourage saving and make more money available for investment by reforming the tax laws related to home mortgages. How would you react?

In recent years, home ownership has become the most widely used tax shelter. The tax laws encourage people to buy a house on credit, deduct the interest from their taxable income, and — after they have used the house — sell it at a capital gain, taxed at a lower rate than earned income (or not at all if the capital is reinvested in another house within a given period, or the person is 55 or older, and eligible for a one-time exclusion of $125,000). This setup, many economists argue, does nothing for the poor, who have no taxable income from which to deduct interest payments, and it provides little relief to most Americans. What it mostly does is to shower benefits on those whose income is in the bracket of $50,000 or more a year.

More importantly, tax laws like these encourage debt and discourage saving. If interest payments were not tax deductible, Americans would have less mortgage debt. This would make it easier for businesses to borrow for investment purposes. It would also encourage Americans to save in order to buy a house.

In Japan, where it is much more difficult to borrow money to buy a house, most people must save for ten or more years before they make their first purchase. Partly for this reason, the savings rate in Japan is higher than ours; and where saving is greater, more money is available for investment in industry.

Are we willing to change our tax laws to encourage saving if it means postponing the dream of home ownership for millions of Americans? If increasing saving and investment requires sacrifices, where should we make them?

---

will result in more investment. Business is concerned with making a profit. When profitable investments are scarce, business will be reluctant to invest — regardless of how much taxes are cut.

Alternative revitalization strategies, sponsored by economists and politicians who oppose the supply-siders are rooted in the belief that a concerted government effort is needed to increase investment, raise productivity and "reindustrialize" certain sectors of the economy. Inadequate investment has made our economy less competitive, less productive and more inflationary, they argue. To remedy the situation the government must act to channel investment to industries with promising growth potential, because the private sector has shown itself unwilling or unable to do so.

Those in favor of industrial policy for the United States usually point out that Japan and most European countries have benefitted from such policies for years — one reason for the increasingly heated competition of the international economy.

Opponents of a coordinated government industrial policy object, in the first place, to any expansion of the government's role in the economy. They also fear that a goverment agency involved in investment decisions and subsidies to targeted industries will be open to political pressure and abuse.

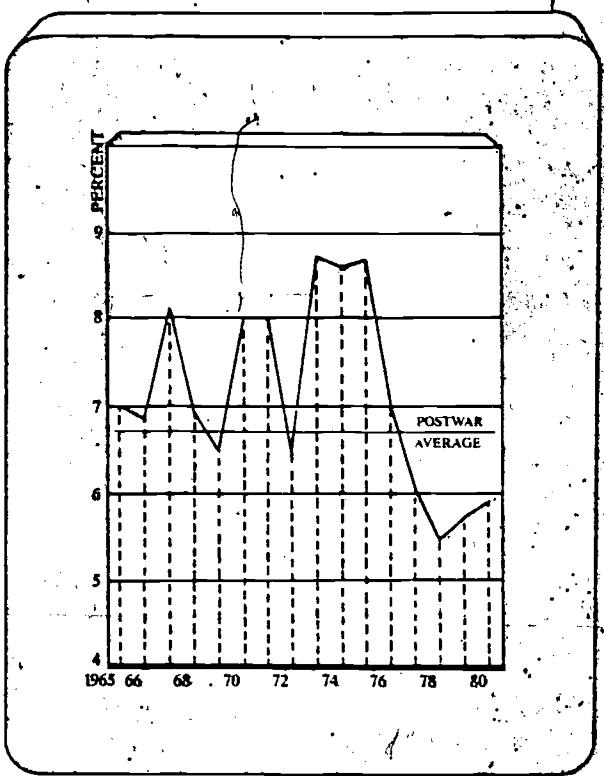
But those favoring an industrial policy question the confidence placed in the free market approach. A return to the "good old days" — if that could somehow be accomplished — is not good enough. Reducing inflation and surviving economically in today's world, they claim, require bold and pragmatic steps to reform this country's industrial policies.

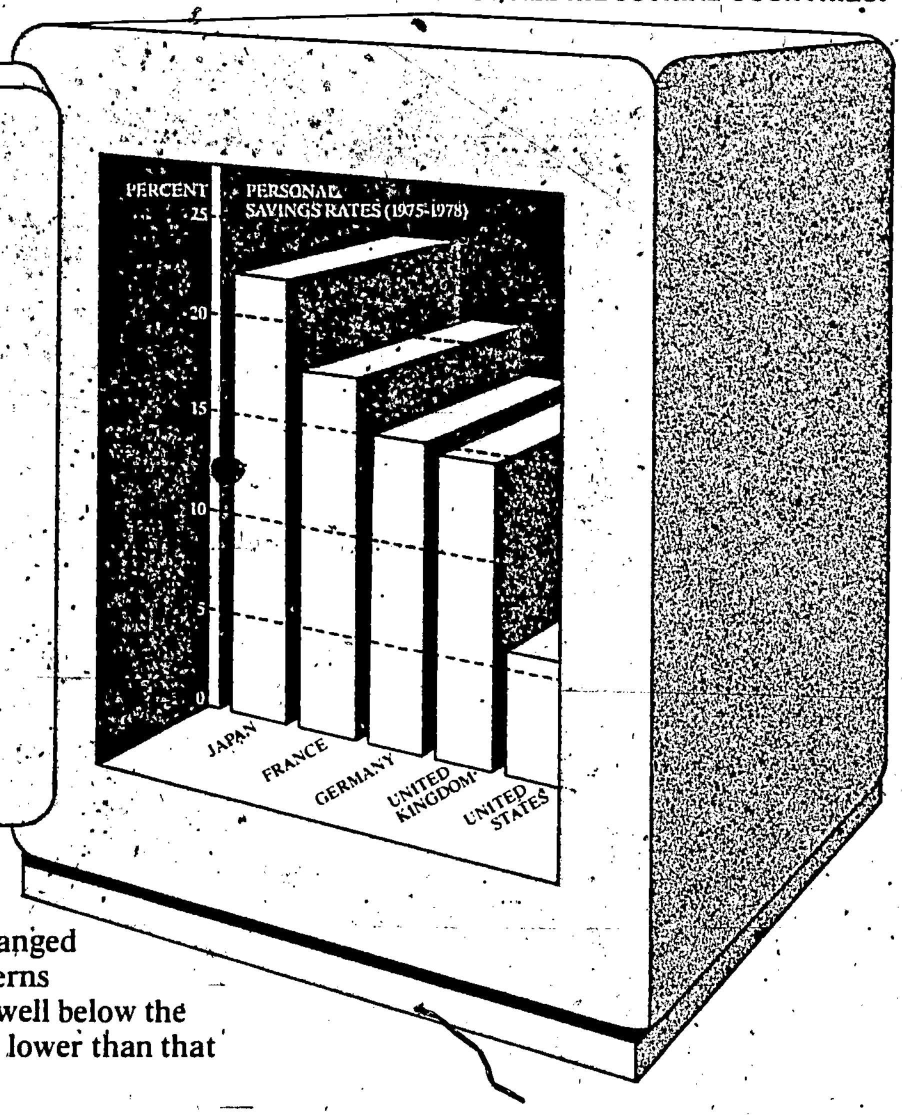
Other countries like Japan have forged fruitful alliances between government and business to foster investment and growth. But the United States cannot simply copy what has worked for Japan and West Germany. Our society is different, our history is different, and our economy has always been much more oriented to the free market. Americans tend to believe that individual freedom is, in the long run, the best guarantee of prosperity and happiness. Some people are concerned that too much government intervention will jeopardize this freedom — and this is one of the principal issues in the debate.

The question that these opponents are debating is how we should go about invigorating the economy to ~~bring back~~ the "good old days" of sustained growth and stable prices. Some favor supply-side tax cuts; some favor greater government efforts. But nearly all those who believe that we must revitalize the economy to end inflation accept one hard fact: It won't be easy. The American people will have to cut back on what we — as individuals, as groups, and through our government — consume. We must save more and consume less.

THE UNITED STATES PERSONAL SAVINGS RATE HAS FALLEN DRAMATICALLY IN RECENT YEARS...

...TODAY IT RANKS AMONG THE LOWEST OF ALL INDUSTRIAL COUNTRIES.





Since the mid-1970s, when many Americans first began to regard inflation as a chronic condition, and changed their consumption and investment patterns accordingly, the savings rate has fallen well below the postwar average. It is now substantially lower than that of other industrial nations.

Sources: United States Department of Commerce, *Survey of Current Business*, International Trade Administration.

But what is the best way to encourage greater savings and investment in order to revitalize the economy? This is the heart of the matter. Who is willing to consume less? Who is willing to sacrifice some of their income? And where do we start? The money has to come from somewhere. If the government cuts taxes to encourage investment, or provides funds for high-technology research, it will have that much less money to spend elsewhere in the economy — perhaps on public transportation, on welfare payments, on grain subsidies, on foreign aid, or on other items that affect you. Revitalizing the economy, no matter how we choose to do it, means tightening our belts. It might mean putting $500 in the bank where it will be available to investors rather than buying a new television set. It might mean taking more taxes out of your paycheck so that government can channel funds to help modernize factories. It might mean that the government spends more money on training scientists and engineers and less on improving the quality of the air and water. It might mean ending some restrictions and regulation in order to restore a free market economy.

The real difficulty is not convincing people of the benefits of greater saving and investment; it is deciding whose current consumption will be sacrificed so that we can invest for the future. What is the least painful and the fairest way? Should we tax more and direct the government to invest? Or should we tax less and let the market encourage businesses to invest? These are the key questions if we seek to stimulate growth as a way to reduce the inflationary burden.

7

DILEMMAS, DEBATES, AND DECISIONS: COMING TO GRIPS WITH INFLATION

White House speechwriter James Fallows tells a revealing story about a meeting of senior economic advisors that President Carter convened in 1978. When he ran for office, Mr. Carter — like most candidates — promised to "get the economy moving again" and nourished the expectation that government can control events. At the beginning of his term he had been more concerned about unemployment than inflation. But as time went on, and his administration responded to domestic pressures and the necessity of pleasing enough important groups to maintain his popularity and his political support, President Carter made various decisions — such as supporting a Farm Bill (which increased price and income supports) and a new Minimum Wage Bill — that added to inflationary pressures. Two years into his administration, it was clear that inflation was rising to dangerously high levels and that it threatened to undermine his other objectives. The meeting with his economic advisors was billed as a "decision meeting" on inflation. So his advisors discussed the merits — and liabilities — of one anti-inflation initiative after another. Finally, according to Fallows, the President grew visibly impatient.

> This isn't a decision meeting at all, he said ... Instead of presenting him with options, the advisors were suggesting that there was no good option to choose. Robert Strauss volunteered that perhaps he was to blame for the irritation the President was expressing, since he had thought it important for the President to hear first hand the advisors' frustrations, to take part in their conversations and understand the pessimism and confusion so many of them felt.
>
> Carter said curtly that the advisors should agree on a decision memo, indicate the choices he must make, and send it in to him. Then he left the room.

"The basic problem is painfully simple: we have tried to satisfy more demands than the economy can meet. The growth of income has outstripped real economic growth."

Perhaps President Carter, like much of the nation, underestimated the depth of the inflation problem and the extent to which it undermines other objectives. The chronic inflation of the past fifteen years is a symptom of a basic shift in the way the economy works. When the free market ruled our lives there was a cruel but efficient discipline. Whenever one person got more of the country's resources, someone else got less. As people tend more and more to turn to the government to escape the insecurity and harsh judgment of the marketplace, demands have mushroomed and the discipline of the marketplace has disappeared. Everyone clamors for more. No one wants to be the one whose wages or prices are cut back.

But our resources are still limited and real economic growth has slowed down at the same time that demands on the economy have escalated. The basic problem is

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painfully simple: we have tried to satisfy more demands than the economy can meet. The growth of income has outstripped real economic growth. That, most simply, is why we have inflation.

For all the differences among economists as to the chief inflationary villains or the most promising anti-inflation strategies, there is little disagreement about the basic point. As a nation, we have been living beyond our means, and in doing so mortgaging the future. The short-term orientation that inflation encourages undermines the long-term goal of sustained economic growth.

Both the current costs and potential hazards of chronic inflation have become quite clear:

★ It creates a sense of social and economic insecurity by reducing the value of personal assets.

★ It threatens economic activity by driving up interest rates, thus increasing the cost of doing business.

★ It imposes an unacceptably high rate of unemployment.

★ It has disturbing indirect effects — such as eroding a sense of justice, feeding a sense of resentment, and eroding confidence in the future.

★ It contributes to the sentiment that government is incompetent and as a result leads to the instability of governments.

So why has this nation walked away from the inflation problem? Because each of the proposed cures imposes a high cost on some group, and would for that reason generate impassioned resistance. Consider, for example, the personal costs, and the political resistance to four proposals we have reviewed — the imposition of wage-price controls, the recession strategy, adoption of the "growth solution," and a reduction of the government's role in the economy.

FOUR OPTIONS

Inflation might be brought under control, as we saw, by imposing mandatory wage and price controls, which would keep wage demands from exceeding productivity increases, and price hikes within reasonable limits. Aside from the problem of effectively administering such a program, many people are adamantly opposed to any such suggestion. A program of mandatory controls means that wages and prices are set by the government, not the market.

Another way to control inflation is periodically to tolerate a severe recession. But because this means tolerating high unemployment as well, the recession strategy is regarded by many people as a cure that is worse than the disease.

Few people object to dealing with inflation by promoting more rapid growth. Like apple pie and motherhood, it's universally approved. The problem is trying to figure out how to curb current consumption and expenditure in order to accumulate the capital required to revitalize the economy. Will tax cuts for the more affluent lead to results? Or should the government more artfully guide

Courtesy United Way Archive.

Faced with the dangers of wartime, the nation is willing to accept sacrifices. This poster was part of a very successful 1917 Red Cross campaign which raised well over 100 million dollars. The question is whether people can be convinced that sacrifice is necessary to overcome a domestic problem such as inflation.

WHAT YOU CAN DO TO FIGHT INFLATION

Many people believe that only government, or big business can stop inflation. Certainly they can do a lot. But so can you, provided you understand the problem and are willing to make certain sacrifices.

1) Don't ask for new government programs that require deficit financing.
It is easy to blame the government for operating in the red. Who encourages the government to spend more than it can afford? If you're serious about balancing the budget, ask yourself this question: Would you be willing to accept a tax increase of approximately 6 percent in order to pay in full for the current programs and services of the Federal government? Or would you be willing to accept a corresponding cutback in government services to reduce government spending?

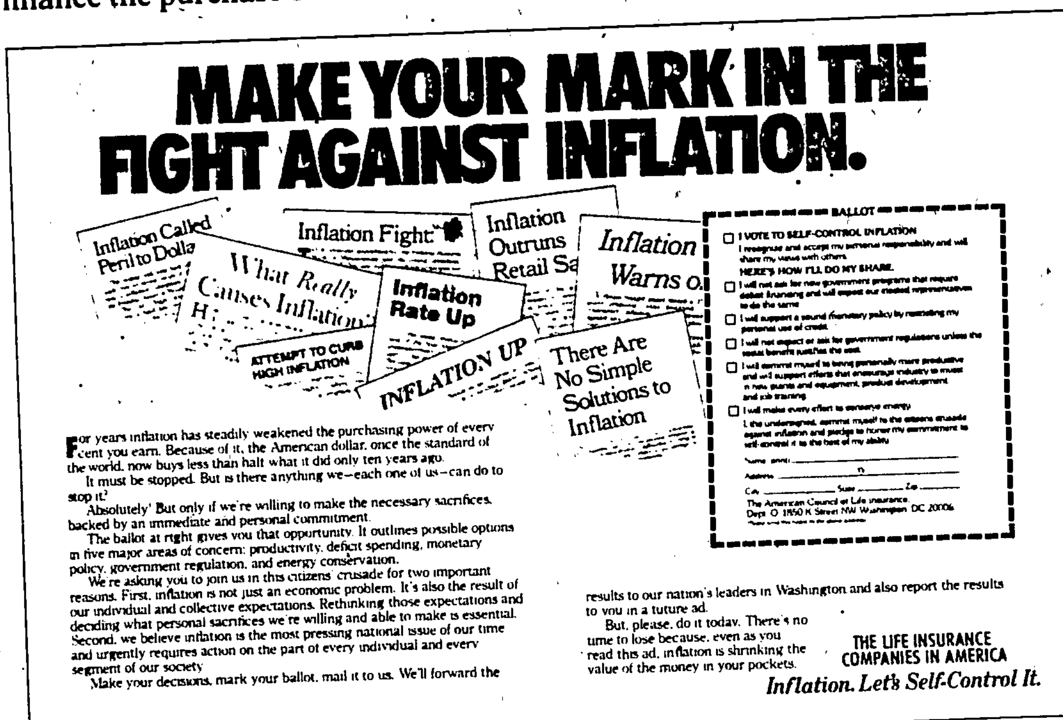
2) Don't live on credit.
Keep your spending within your income, just as you'd like the Federal government to do. If we spend our money before we get it — and we do that every time we buy something "on time" or with a credit card — we are feeding inflation. To bring down inflation, would you be willing to cut back your use of credit to finance the purchase of goods? In other words, are you willing to save ahead to buy things, rather than borrow to have them now?

3) Commit yourself to being personally more productive; increase your savings; support efforts that encourage industry to invest in new plants and equipment, product development and job training.
Unless we restore vitality to our country's productivity, we can't hope to make much progress in controlling inflation. Money not spent, but put into savings provides funds for investment in plants and equipment that can increase productivity. Are you willing to save more? In the event of a Federal tax cut, are you willing to see a major portion of the cut made in business taxes, rather than personal income taxes, if this action will increase investment and productivity?

4) Join the fight against waste — waste of private resources, waste in social programs, waste in our defense program, waste wherever it occurs.
Conserve energy. Buy only things that are essential. Let the non-essentials wait. Make better use of the things you have. Don't be part of the throwaway economy.

5) Make your voice heard.
Share your views on inflation with people you know and in organizations to which you belong. Let your elected officials know how you feel. Write them. Vote.

Adapted with permission from "The Consumer's Inflation Handbook," The American Council of Life Insurance, 1980.



Courtesy American Council of Life Insurance, © 1980.

investments into more promising industries?

Another proposal, to scale down the ways in which the government interferes with the free operation of the marketplace — would also encounter some formidable obstacles. Clearly, as indicated by a deficit in excess of $100 billion, the federal government has been living beyond its means, paying more for the goods and services it delivers to voters than it raises through taxes. And those deficits are widely, if not universally regarded as a cause of high interest rates and therefore an impediment to economic recovery. Despite that, however, it is not at all clear that Congress will move decisively to reduce the deficit. In response to the appeals of a multitude of special interest groups that want the government to attend to their needs (or at least not to cut back on their programs), deficit budgets are proposed which impose an indirect tax in the form of inflation.

Who are those "special interests"? *We* are — every time we vote for a bond issue to provide some public service or facility, every time we support increased healthcare benefits, or cost-of-living adjustments for the recipients of Social Security checks, or increased military spending — or support a candidate who proposes to reduce taxes without reducing spending.

Every time the government looks after our welfare and safety by setting standards (for clean air, for example, or safer products) or requires special equipment (such as the safety features in cars) we end up paying for them. It is estimated, for example, that an average car costs $600 more because of such government safety and environmental regulations, and that a typical home costs about $2,000 more because of construction, energy, and other regulations. Each of those regulations increases the price of the goods we buy. What tradeoffs are we willing to make between the benefits we may derive from such regulations, and the costs we pay in the form of higher prices?

We could choose to eliminate many of the ways in which the government plays so active a role in protecting groups against the harsh realities of falling wages and profits — and in doing so encourages inflation. That would mean, for example, cutting back on unemployment benefits, doing away with farm price supports, refusing pleas for trade restrictions, and turning a deaf ear to the appeals of distressed industries, no matter how many people they employ. If such measures were taken, prices would undoubtedly begin to fall as well as to rise, and we would be well on our way to a solution to inflation. But that would be accomplished at the cost of enormous insecurity, as millions of people would once again be vulnerable to the ups and downs of economic cycles.

Considering the cost — both political and economic — that would be imposed by each of these anti-inflation strategies, it is understandable why national leaders have been so reluctant to endorse them. There are no magic solutions to the inflation problem, no easy and politically popular choices.

NO MAGIC SOLUTIONS, BUT SOLUTIONS

Sacrifice is necessary. But under what circumstances — other than wartime — can national leaders effectively appeal for sacrifice, so that society can achieve an agreed-upon objective, like ending inflation?

> We all want something to be done about our problem, except for when the solutions affect us. We want to conserve energy, but not to change our wasteful habits. We favor sacrifice, so long as someone else goes first. We want to abolish loopholes until it is our loophole. We denounce special interests, except for our own.

In these final words of an address on inflation, President Carter made a plea for sacrifice, for a commitment to the common good rather than to special interest.

Unsure of just exactly what they were being asked to sacrifice, and unsure whether those sacrifices were in fact necessary, most people responded by protecting themselves against inflation's corrosive impact.

Inflation is a difficult and complex problem but it is not insoluble. If we do not have any painless choices, we still have choices. Austria has chosen mandatory wage-price controls to fight inflation. It has shown that simple, well-designed guidelines for a limited number of "key goods" can be effective in holding down prices if the guidelines have broad public support. Japan has chosen a different strategy, but in that country too, widespread cooperation has paved the way to success. By combining elements of the growth solution — high savings and investment rates — with voluntary restraint to hold wage increases to productivity gains, it has held inflation to modest levels in recent years. Other countries have chosen different strategies. Everywhere, however, the lesson is the same: Where anti-inflation programs are enthusiastically supported by the public, they have proven effective.

In the United States, each of the strategies we have examined — or some combination of them — could lead to success in overcoming inflation. What remains to be accomplished is for citizens and groups to confront the problem realistically, to recognize their responsibility in what must be a concerted effort, to begin to form the consensus required to get the nation out of its inflationary mess.

FOR FURTHER READING

Thousands of books and articles on inflation have been written in recent years, but most are difficult for the general reader. John Case's *Understanding Inflation* is a lucid and well-balanced introduction to the subject, written for non-specialists (New York: Wm. Morrow, 1981). Another short and clearly written introduction is Sidney L. Jones' *Inflation: Causes and Prospects* (New York: The Aspen Institute, 1981).

For a perspective on the problem of taming an inflationary economy, see the 1981 *Economic Report of the President* (Washington, D.C.: Government Printing Office), which was prepared by President Carter's Council of Economic Advisors. Robert Heilbroner and Lester Thurow present a particularly thoughtful discussion of the political difficulties of solving the inflation problem in a chapter on that topic in *Five Economic Challenges* (Englewood Cliffs, N.J.: Prentice-Hall, 1981).

For differing perspectives on what our choices are in fighting inflation, see for example, Barry Bosworth's "Policy Choices for Controlling Inflation," in *Controlling Inflation: Studies in Wage/Price Policy* (Washington, D.C.: Center for Democratic Policy, 1981); and Milton and Rose Friedman's *Free to Choose* (New York: Avon Books, 1979). For a more comprehensive discussion of anti-inflation strategies that have been attempted in various nations, such as Japan, Brazil, England, and West Germany, see *Worldwide Inflation: Theory and Recent Experience* (Washington, D.C.: The Brookings Institution, 1977), edited by Lawrence B. Krause and Walter S. Salant.

Irving S. Friedman provides a particularly insightful discussion of the noneconomic aspects of inflation in *Inflation: A Worldwide Disaster* (Boston: Houghton-Mifflin, 1974). For a vivid account of hyperinflationary episodes — in Weimar Germany and elsewhere — see Max Shapiro's *The Penniless Billionaires* (New York: Times Books, 1980).

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CREDITS AND ACKNOWLEDGEMENTS

These booklets for the National Issues Forum were prepared by the Public Agenda Foundation, a nonprofit, nonpartisan organization working to give Americans an opportunity to confront choices and tradeoffs on complex policy issues. Keith Melville was editor-in-chief, Jean Johnson was responsible for administration, and Richard Becker was the designer.

Writers were Richard Cohen, James Shapiro, Keith Melville, and Greg Lipscomb. Harris Dienstfrey was the editor. Marc Schulz provided research assistance. The issue ballots were prepared by Jean Johnson, Robert Kingston, Harvey Lauer and John Doble.

Charts by Rocco Alberico. Illustrations by Jean Tuttle and Deborah Hosking.

The Public Agenda Foundation is pleased to acknowledge the assistance and encouragement provided by various individuals over the course of the project. Our thanks to Jon Kinghorn and Robert Daley for their participation from the beginning. Members of the Domestic Policy Association review board — Philip Nowlen, Billie Jean Young, Ann Bracey, Lewis Carlson, and Irma Castro — provided helpful comments. Daniel Yankelovich and David Mathews provided both guidance and encouragement. We are also indebted to our friends and colleagues at the Public Agenda, especially Elizabeth Pollino and Susanne Mickles for their patience, hard work and good humor in meeting tight deadlines, and to Bob Kingston, whose advice and thoughtful concern influenced every phase of this project — and helped to improve it.

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NATIONAL ISSUES FORUM

№ 00494 2. INFLATION REPORT

Please answer the questions on both sides of this page only *AFTER* you have attended the discussion or read the booklet.

Some of these are the same as those you answered before, some are slightly different or quite new. Please answer them all without reference to your earlier answers.

Then hand in the papers to the moderator of the discussion or mail it in the attached prepaid envelope to the Domestic Policy Association.

I Different people have different ideas about who's to blame for inflation. Using a scale of 1 to 10, where 1 means *not much of the blame*, and 10 means *a lot of the blame*, rate how much blame you'd place on each of the following. Record your answer on the line across from each item.

1. The President — 1 2 3 4 5 6 7 8 9 10
2. Unions — 1 2 3 4 5 6 7 8 9 10
3. Congress — 1 2 3 4 5 6 7 8 9 10
4. Small business — 1 2 3 4 5 6 7 8 9 10
5. Individual consumers — 1 2 3 4 5 6 7 8 9 10
6. OPEC — 1 2 3 4 5 6 7 8 9 10
7. Large Corporations — 1 2 3 4 5 6 7 8 9 10
8. The Federal Reserve — 1 2 3 4 5 6 7 8 9 10
9. Liberals — 1 2 3 4 5 6 7 8 9 10
10. Conservatives — 1 2 3 4 5 6 7 8 9 10
11. Foreign countries such as Japan and West Germany — 1 2 3 4 5 6 7 8 9 10
12. Homeowners with large mortgages — 1 2 3 4 5 6 7 8 9 10
13. Salaried employees — 1 2 3 4 5 6 7 8 9 10

II Here is a list of things that some people think the government should do, but each of them would have an impact on the economy. Rate each proposal on a scale of 1 to 10, where 1 means *the government should not do it at all* and 10 means *the government should certainly do it*. Record your answer on the line across from each proposal.

14. Lower interest rates — 1 2 3 4 5 6 7 8 9 10
15. Reduce Federal taxes — 1 2 3 4 5 6 7 8 9 10
16. Enact measures such as a public service-jobs program to reduce unemployment — 1 2 3 4 5 6 7 8 9 10
17. Strengthen pollution and product safety regulations — 1 2 3 4 5 6 7 8 9 10
18. Make all employers provide automatic cost-of-living increases to their employees each year — 1 2 3 4 5 6 7 8 9 10
19. Make it possible for more Americans to own their own homes — 1 2 3 4 5 6 7 8 9 10
20. Provide government assistance for troubled American industries such as automobiles and steel — 1 2 3 4 5 6 7 8 9 10
21. Maintain cost-of-living increases in Social Security payments — 1 2 3 4 5 6 7 8 9 10

III

This is a list of anti-inflation policies that have either been tried or talked about. For each one, check if you favor or not.

	Favor it	Oppose	Not Sure
22. Raise federal taxes to reduce the federal budget	☐	☐	☐
23. Cut government spending on social programs	☐	☐	☐
24. Keep interest rates high	☐	☐	☐
25. Accept higher rates of unemployment	☐	☐	☐
26. Regulate wages and prices	☐	☐	☐
27. Encourage investment by giving tax reductions to those with the means to invest	☐	☐	☐
28. Increase government assistance for "growth" industries such as computers and telecommunications while at the same time refusing to bail out "no growth" industries such as steel and automobiles	☐	☐	☐

IV

The booklet presents a number of strategies for dealing with inflation, and each of them has certain advantages and disadvantages. After reading and talking about these ideas, which, if any, do you find *totally unacceptable?*

	Totally Unacceptable
29. Learn to live with inflation like they do in Argentina	☐
30. Make the government balance the budget	☐
31. Accept a recession from time to time to wring inflation out of the economy	☐
32. Institute wage and price controls like they have in Austria	☐
33. Use tax and investment policies to stimulate investment and growth	☐

V

Now we would like to ask some questions about how you feel now.

34. On a scale of 1 to 6, where 1 means that the issue affects you personally *very little* and 6 means that you really feel *deeply involved*, where would you place yourself on the issue of inflation?

1 2 3 4 5 6

35. On some issues people feel that they really have all the information that they need in order to form a strong opinion on that issue, while on other issues they would like to get additional information before solidifying their opinion. On a scale of 1 to 6, where 1 means that you feel you definitely need *more* information on the issue and 6 means that you do *not* feel you need to have more information on the issue, where would you place yourself?

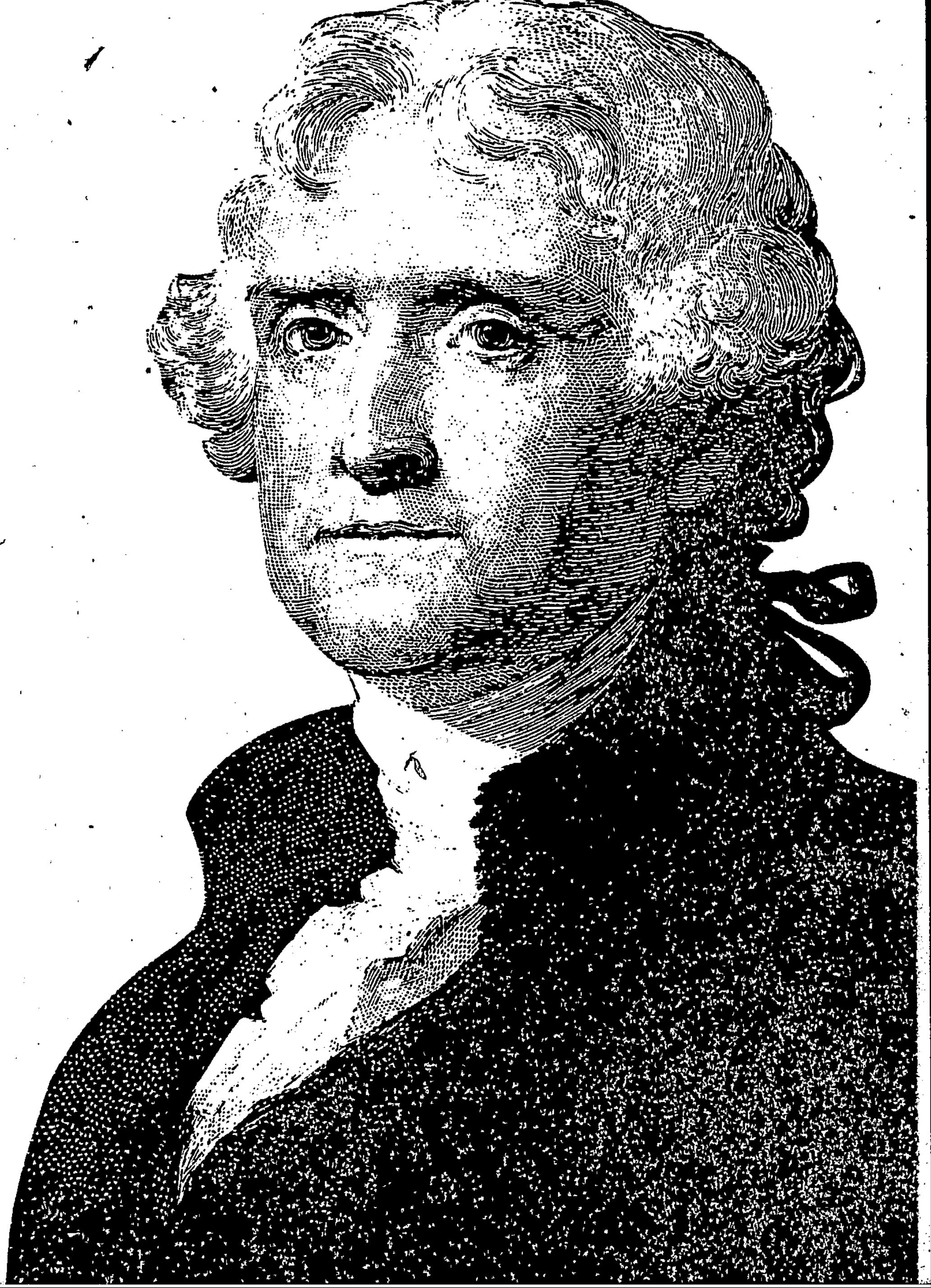
1 2 3 4 5 6

36. People have told us that on some issues they come to a conclusion and they stick with that position, no matter what. On other issues, however, they may take a position, but they know that they could change their mind *very easily* on this issue. Using a scale of 1 to 6, where 1 means that you could change your mind easily and 6 means that you are likely to *stick with your position* no matter what, where would you place yourself on the issue of inflation?

1 2 3 4 5 6

"I know of no safe depository of the ultimate powers of society but the people themselves; and if we think them not enlightened enough to exercise their control with a wholesome discretion, the remedy is not to take it away from them, but to inform their discretion by education."

Th: Jefferson



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