Facing Inflation

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Source: *Challenge*, NOVEMBER/DECEMBER 1973, Vol. 16, No. 5 (NOVEMBER/DECEMBER 1973), pp. 29-37

Published by: Taylor & Francis, Ltd.

Stable URL: https://www.jstor.org/stable/40719153

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Q. What is inflation?
A. A rise in prices.
Q. Can you expand on that?
A. Inflation is a situation in which prices in general are rising.
Q. So be it. What is the genesis of the current inflation?
A. You mean in the United States, I take it. The genesis of the current inflation is a more rapid rise in the quantity of money than in output. This is the immediate origin of inflation. You will ask me the next question: Why is it that the quantity of money has been rising more rapidly than output? That takes the analysis one stage further. The answer, so far as the United States is concerned, is twofold.

One reason is the tendency for government spending to increase. It so happens that inflation is the one form of taxation which can be imposed without any legislative action. When prices rise, there is in effect an increase in taxes in a double sense. In the first place, rising prices increase the burden of the personal income tax even though the tax is not changed in nominal terms. The personal exemption is stated as a fixed number of dollars. The higher the price level, the lower that fixed number of dollars in real terms. Moreover, as inflation occurs, people are pushed up into higher income tax brackets and thus are subject to higher tax rates. If your income goes up 10 percent, and if prices in general go up 10 percent, you might think that you would be left in the same spot, that you could buy the same amount as you could before. But your income taxes will go up more than 10 percent; the tax you pay will become a larger fraction of your income. Therefore, from the government point of view, inflation is one way to raise the income tax without passing a law to do so. And of course it has been a very effective way. Although there have been several explicit tax reductions in the postwar period, the true burden of the personal income tax today is higher, as the result of the automatic effect of inflation, than it was at its peak during World War II.

Inflation involves a tax in another sense. Inflation occurs because the government prints money. It gets resources by printing money. It's the equivalent of a tax on cash balances. If prices rise by 10 percent, and if you've held, let's say, an average of $1,000 throughout the year, you have less real purchasing power at the end than you had at the beginning. You have to hold $1,100 at the end of the year in order to have the same amount of purchasing power you had at the beginning of the year. That means you have to use $100 of your receipts, not for spending on goods and services, but simply to keep the purchasing power of your cash balance unchanged.

There is no difference whatsoever between this situation and one in which the government

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imposes an explicit tax of 10 percent on cash balances. Suppose that, just as you now file an income tax return, you had to file a return once a year and pay a 10 percent tax on the average amount of cash you held. That would be an explicit tax. If, instead, prices rise by 10 percent, you pay the tax, and the extra pieces of paper you hold as cash are exactly equivalent to the receipt that a tax collector might give you for your explicit tax. It follows that whenever governments increase spending and find it politically difficult to impose explicit taxes, they tend to resort to inflation in order to raise tax funds in the two ways I've described.

The other basic reason why the quantity of money has been rising so rapidly is rather different.It has to do with the so-called full employment policy that we have been following. The public of the United States has an asymmetrical reaction to inflation and unemployment. This is a heritage of the great depression. Under current circumstances let unemployment rise, and this becomes a political matter of first importance. Consequently, every time there has been a rise in unemployment—a recession—whether severe or mild, there has been strong political pressure to do something about it. One way to do something about a recession is to print money and distribute it. Economists have known for hundreds of years that it is possible to create any degree of apparent activity by printing money at a rapid enough pace.

So you have a recession; the recession causes political pressure to do something. That political pressure produces, on the one hand, an increase in government spending and an increase in government deficits, which the government prefers to finance by printing money rather than by borrowing from the public at whatever interest rate it would have to pay. On the other hand, the monetary authority in the United States, the Federal Reserve System, is under pressure to increase the rate of money creation. The result is to set in motion inflationary forces on both the fiscal and the monetary side.

In my opinion, monetary forces are dominant. Fiscal forces are important insofar as they affect monetary expansion. The reactions I described would not necessarily create inflation if the effect of increasing the rate of monetary growth were felt immediately with equal rapidity on output and on prices. But that is not the fact. The fact is that if you increase the rate of monetary growth, it takes time before the increase has its effect on spending. When it does, its initial effect is on output, and its effect on prices is delayed still more.

The typical pattern when the rate of money creation increases is that, for a time, it seems to have no effect, which gives the monetary authorities an incentive to step too hard on the gas, to print too much money. Then, when faster monetary growth does take effect, it takes effect in the first instance on output, not on prices. Roughly six to nine months after an increase in the rate of growth of the quantity of money, there tends to be an increase in the rate of growth of output. But it's not until about a year and a half to two years after the increase in the rate of monetary growth that it tends to have an effect on prices.

So the typical postwar pattern has been to react to recession by printing money. This tends to produce expansion. At a still later date it tends to produce inflation. You then get people exercised about inflation. The monetary authorities step on the brake and slow down the rate of monetary creation. After a lag this tends to produce a recession without producing much of a slowdown in prices because of the long delay in the effect of the monetary expansion. This in turn produces political pressure to do something about it. You have a shift in policy. Monetary growth accelerates. This tends to produce an expansion in real output and employment at the same time that you are still feeling the anti-inflationary effect of the earlier monetary tightness. And so for a time in the early stages of expansion, you have a declining rate of inflation and rising output, and everybody says: "Ah, fine. We've got the problem licked." But then the delayed effect of the monetary expansion catches up with you and you're off again on the same path.

The important thing to notice is that this is a kind of ratchet process; each step starts at a higher level. Every time you have a recession, and you start to expand, people at first do not expect whatever rate of inflation you have, and thus a low rate of inflation is expansionary. But as people get adjusted to the rate of inflation and come to expect it, it takes a higher and higher rate to be expansionary. Thus, the process is one of intermittent inflation produced by overreaction to the recessions that punctuate the inflation.

Q. For example?

A. Recent experience offers an ideal example that illustrates this about as beautifully as you could want. In the fall of 1966 the Fed stepped very hard on the monetary brakes and we had what everybody recognized as a credit crunch. The rate of growth of the quantity of money was brought to a negative value in the last part of 1966. That didn't have any effect in 1966, but in the early part of 1967 it started to produce a recession. We had what was called a mini-recession in which the rate of unemployment went up and the rate of expansion of real output sharply declined. The Fed got very much exercised and was placed under great political pressure to do something about it, so it started to expand the money supply at a rapid rate. The expansion of the money supply had no effect for about six months, as is typically the case, and we continued to have the mini-recession. But after six months the monetary expansion brought about a very sharp recovery from the mini-recession; we had renewed economic expansion, but not a particularly rapid rise in prices. Then in 1968 we had the delayed effect of this monetary expansion on prices, and inflation started to accelerate. But not until early 1969—after the failure of the tax surcharge imposed in mid-1968—was there enough reaction against the inflationary pressure to cause the Fed to do something. Once again it stepped on the monetary brake. Again this had little effect in 1969 as output and prices continued to go up. But by the end of 1969 the slowdown in the rate of monetary growth which had started in early 1969 began to take effect, culminating in the recession of 1970. However, as usual, the effect on prices was delayed. The cost of living continued rising at around 6 percent throughout 1970. So we had an inflationary recession—an increase in unemployment and, simultaneously, rapid inflation.

This in turn caused great pressure on the Fed to do something. Both the Republicans and the Democrats made a big issue of unemployment. And of course unemployment did rise to 6 percent by the end of 1970. The result was a reversal of monetary policy early in 1970 to a more rapid rate of monetary growth. Once again, this had little effect for six or nine months; but by the end of 1970, it was starting to have its effect, and so there was a turnaround in the cycle. The recession came to an end and expansion started. But as usual, the effect on prices was delayed. So in early 1971, when the monetary expansion of 1970 was starting to affect real output, the economy was still feeling the deflationary effect of the monetary contraction of 1969. And the rate of price inflation started to come down. While it started to come down, it never came down as low as it had been before because it started from a much higher level. It came down until about the middle of 1972; then, in the middle of 1972, the effect of the monetary expansion which had begun in 1970 started to be felt. Inflation began to take off again, and in the first six months of this year it really took off.

The reason the picture is so complicated is because of the interaction of monetary expansion and contraction and the different timing of their effects on output and prices. A further reason is that the enormous concern about unemployment causes a bias in monetary policy. It tends on the average to be more and more expansionary rather than less so.

Let me put this in another way. I think it was a great mistake for the Fed to have gone in for rapid monetary expansion in 1970 and to an even greater extent in 1971. There's no way to cure an inflation that does not involve a period of economic slowdown or recession. It's not that I like recession or unemployment. But just as there's no way to cure an alcoholic that doesn't involve a period of drying out, there is no way whatsoever to cure an inflation that we have ever discovered that doesn't involve going through a period of economic slowdown. In 1970 we started on a cure. We got halfway through it. Having gotten halfway through it, we threw away the cure and said: "Oh boy! We're not going to stick to it; we can't stand the pain." Having gotten halfway through the cure, we started stepping on the accelerator, rapidly increasing monetary expansion. We offset the recession, but at the cost of inserting an inflationary stimulus that's now set us off on a still higher level of inflation.

This is not the first time. It's the third time in the last fifteen years that we have started on a cure, nearly completed it, and thrown it away. Indeed, we once completed the cure and then threw it away.

If you go back to the period of the late 1950s and early 1960s, we completed the cure. Inflation was beaten, and it was beaten by accepting a four- or five-year period of relatively high unemployment. We completed the cure. We got the economy in a position where the inflation was eliminated. Then what happened? We had expansion from 1961 to about 1963 or 1964 at a fairly slow rate with no substantial inflation. But then came political pressure, first from Mr. Kennedy then from Mr. Johnson, to try to get rapid growth. You will remember that Mr. Kennedy's slogan in 1960 was to get the economy moving again. The whole emphasis at that time was on the importance of growth, and damn the costs. And so we had a very expansionary monetary policy, a very expansionary fiscal policy, reinforced by the Vietnam war and the unwillingness on the part of President Johnson to cut civilian expenditures. All this led to large deficits, which again produced pressure for monetary expansion. We threw away the noninflationary position we had obtained.

In 1966-67 we started on a cure and threw it away when it was half completed. We paid a price in the form of a mini-recession, but got very little for it. In 1969 we started on a cure; we paid the price of a year of recession in 1970; but before we had completed the cure, we threw it away again. Really, what we're doing now is throwing away the benefits we got from the 1970 recession. Right now, if I interpret things right, we're starting off on another cure. But we're not going to have the political will to stick with it. We're going to throw away the cure when we're half through. And we will be launched on another and still higher round of inflation. This will continue until the public at large gets so fed up with inflation that it is willing to pay the price of several years of slow economic growth and of relatively high unemployment in order to break the back of the inflation, to reestablish a climate of noninflationary expectations which will enable us to have high employment with stable prices.

How soon that will happen, I don't know. We don't seem to be ready for it now. Each time the costs get higher. It would have been simple to have cured inflation in 1967 by sticking with the relatively tighter monetary policy. It would have been fairly inexpensive and simple in 1970 to have stuck with it. If we had stuck with a fairly slow rate of monetary growth throughout 1971 and 1972, we would by now be on the way to having cured the inflation. But the longer we postpone it, the more difficult it is to stop it. Because each time you're revving up the inflation to a higher level and therefore it takes a more severe slowdown in order to brake it.

Q. Do I understand you to mean that the inevitable cost of stopping inflation is a higher rate of unemployment and, I might say, a higher rate than people are at present willing to accept?

A. There is one and only one way to stop inflation. That is, to slow down the rate of monetary creation. We do not know any other way. Suppose you were to slow the rate of monetary growth from 10 percent to 5 percent. In about five or six months the rate of growth of spending would slow down from 10 percent to something like 5 percent, maybe 6 percent, maybe 4 percent —there's no perfectly precise relationship here, rather, an order of magnitude. But the rate of price inflation would not slow down. Most prices are being set for some time in the future. There's a built-in rigidity in prices: people are printing price catalogues, employment contracts are being made for two or three years in advance, and so on. Consequently, spending would slow down, but prices would continue to rise at something like 7 percent a year, and this means that the spending slowdown would show up in a slowdown in physical output and in an increase in unemployment. Only as the rate of growth of physical output slows down, as unemployment increases, would there tend to be pressure to slow down the rate of growth of prices, to slow down inflation. That's why the first impact is on physical output and why it takes another year or year and a half before you really have a significant price slowdown. That's why the cure of inflation via a slower rate of monetary growth involves, as a side effect, a lower rate of employment and a period of economic slowdown. Because the public at large is not willing to pay the price of that side effect, because politicians and others claim there's some way of avoiding it, we go off into another round of inflation at a higher rate. Unfortunately, there is no way to avoid paying the price sooner or later.

It's tempting to think that maybe we can just stop at a 7 percent inflation. But exactly the same forces that produce the 7 percent inflation will produce an 8 percent or 9 percent inflation. Because what will happen at the 7 percent inflation is that sooner or later there will be a recession, a slowdown, some increase in unemployment, for a variety of reasons. And then, in order to get rid of the unemployment, a still higher rate of monetary growth will be necessary, one that will produce 8 percent or 9 percent inflation. If you want to see the process at work you can see it even more sharply in Great Britain than here. We are about two or three years behind Great Britain. At the outset, the Edward Heath government was determined to stop inflation. It imposed a tight money policy, and unemployment started to increase. When it hit a million, the political pressures, as Heath saw them, became intolerable, and he reversed his policy 180 degrees. He went from a policy of slowing down the economy, in order to slow down the inflation, to a policy of stimulating it. And after the usual lag, he induced another round of inflation. Now you have prices in Britain rising at a rate of something over 10 percent a year.

Q. Do we have to choose between a higher rate of unemployment and inflation? Is there no third possibility?
A. From a long-run point of view there is no need to choose. From a long-run point of view, we can have both high employment and no inflation. But once having started on an inflationary course, there is no way of getting off it without going through an interim period of high unemployment. We don't even have the choice you've suggested; all we can choose is when we're going to have the unemployment. Is it a long-run solution to say we're going to go from 7 to 8 to 10 to 15 to 20 to 30 to 40 percent inflation? That's the South American solution. They're not very happy with it, and they haven't been able to avoid unemployment either. The only choice is, when do we take the medicine? The sooner we take the medicine, the less costly it will be. What we do by accepting inflation in the short run is simply to postpone the cost, but we also make it much greater.

Q. Increased unemployment entails some serious social problems, because the first ones to be unemployed are minorities, blacks, women, young people. What do we do about that?
A. Increased inflation imposes social costs too. What do we do about that?

Q. If our only choice is between a slowdown with unemployment such as happened in the late 1950s under Eisenhower, or an expansion with rising prices, higher employment and higher output as happened between 1961 and 1965, or more recently from 1971 to the present, then most people would prefer the cost of the inflation to the cost of the recession.
A. You're setting up a false issue. If by accepting inflation we could indefinitely have a higher level of employment and output, we would buy something for the inflation. But you're making a false comparison because that's only a temporary possibility. In order to buy higher employment, we have to go to higher and higher rates of inflation. You mentioned the late 1950s and the 1960s. I wonder if you realize that the average level of unemployment during the eight years of Mr. Eisenhower's regime was almost to the last decimal identical with the average rate of unemployment during the eight years of Mr. Kennedy and Mr. Johnson?

Q. Kennedy inherited a high rate of unemployment.
A. The unemployment was relatively high at the end of Mr. Eisenhower's period and low at the beginning. It was relatively low at the end of Mr. Kennedy's and Mr. Johnson's period and high at the beginning. What I'm trying to make clear is that the low unemployment at the end of the period was the reward for the relatively high unemployment at the beginning of the Kennedy-Johnson term. It was the slowdown that Mr. Eisenhower was willing to accept at the end of the 1950s that made possible a relatively high rate of growth of output during the 1960s, with relatively low inflation through much of it. The other way around, we have paid the price in the past few years of the expansionary policies of the Kennedy-Johnson Administration. By having highly expansionary policies, they left us with a heritage of inflation. If we now say: "O.K., let's

go on to more inflation," we can go to higher and higher levels of inflation, we can keep postponing the evil day for a while.

It is important to keep the transitional costs of getting from the present high level of inflation to a lower level of inflation as small as possible. The way to reduce those costs is to improve our welfare system and eliminate obstacles to the employment of low-income people. If you really want to do something to help the low-income people you're speaking about, the way to help them is not to promote inflation; many of them are the most extreme sufferers from inflation. The most important things you can do to promote their well-being is to eliminate the minimum wage laws, which deny them jobs; reduce the strength of trade unions, which deny them jobs; and abolish the Davis-Bacon and Walsh-Healey Acts, which deny them jobs. There is a considerable number of other structural changes of that kind which would improve the markets for the relatively disadvantaged. And the ideal combination of policies would be simultaneously to remove those obstacles and also to slow down the economy.

Q. Don't you have to make a distinction between the policies of the Kennedy Administration—the monetary, fiscal and guidepost policies that terminated the recession that occurred under the Eisenhower Administration—and the method of financing the Vietnam war that began in 1965, which many people argue laid the basis for the current inflation?

A. Not at all. First of all the guidepost policy was, in my opinion, utterly ineffective. It was window dressing, just as the more rigid price- and wage-control policies under Mr. Nixon are, in my opinion, attacks on symptoms and not causes. The only reason for having price and wage control now, just as the only reason for having guideposts before, is because of an unwillingness to do anything about inflation combined with a desire to give the public the impression that something is being done. The fact is that the acceleration of inflation had already been getting under way before the Vietnam war started. I think in retrospect the Vietnam war has been a source of apologetics for the failure of economic policy. In my opinion the policies of the Johnson Administration were a straight continuation of the policies of the Kennedy Administration. Growth at all costs, rapid expansion in government spending, encouragement of a relatively low level of interest rates, which meant trying to encourage the Federal Reserve to follow an expansionary monetary policy.

The one break in that policy came in 1966. The Federal Reserve did step sharply on the monetary brakes. And when it stepped sharply on the monetary brakes, despite the fact that the Vietnam war was accelerating, you did have a mini-recession, and you did have some slowdown in the rate of inflation. When it stepped again sharply on the monetary gas pedal, started increasing the rate of growth of the quantity of money rapidly, you had a reversal of the mini-recession and a speeding-up of inflation.

Don't misunderstand me. The Vietnam war was a catastrophe. It had enormously adverse social and political consequences for the United States that almost tore this country apart. But I do not believe it was of any great importance from an economic point of view. At no time were the expenditures on the Vietnam war more than about 2 percent of national income. At no time did the expenditures on the Vietnam war account for the major part of the increase in federal spending. If you take the increase in governmental spending from 1964 to 1968, during Johnson's second term, you will find that more than half of the increase in federal spending came through civilian programs, not through the Vietnam war.

Q. You touched on the question of offering greater compensation to those who are unemployed in a recession. Would you be willing to have public service employment if these people want jobs?

A. I touched on helping avert indigence; I did not mention higher payment to people who are unemployed. People who are unemployed and have resources for their support should not be helped. Public service employment is a very bad idea. I am thoroughly opposed to it because it is a bad way to provide relief for people who are indigent. If you look at the history of public service employment you find that it generally has involved creating jobs for the people who least needed help. It has not been an effective device. I had a great deal of sympathy for the kind of

WPA or PWA jobs that were created during the 1930s during a major depression, a catastrophe of a structural kind of a wholly different order of magnitude than anything you're speaking of now. What I had in mind was something very different. I had in mind replacing our present ragbag of welfare programs by a sensibly structured, rational negative income tax, which would assure real assistance in the form of cash to those people who needed assistance.

As to public service employment, have past programs been a success, have they eliminated unemployment among the people in real need? Not at all. The fascinating thing is that most proponents of governmental intervention completely agree that all past programs have been failures. Apparently, people cannot learn from experience. Over and over again we make the same mistakes. The most dramatic case at the moment is price and wage control. There have been dozens of historical examples of price and wage control. There is not a single example of a success. They've all been failures from the time of Diocletian 2,000 years ago to the present. Another example is the social welfare programs of the last forty years. Almost all of them have been failures. Agricultural adjustment assistance, farm price supports—who has a good word to say about them? Public housing, urban renewal, the war on poverty—you name it, and you have a catalogue of disasters and failures. But somehow or other, hope springs eternal that the next governmental program will be a success. The idea of public service employment is precisely in that category.

Q. You're several answers ahead of my questions. If a recession with increased unemployment is the price of the cure for inflation, you're asking a lot of people to pay the price through unemployment.

A. Excuse me, but you are again refusing to face the issue. You're stating a false proposition. It is not that unemployment is a price for stopping inflation; it is that there is no way once you have started on an inflation to avoid a period of unemployment. It's only a question of when. You're assuming that there's some alternative. Would you tell me what alternative there is which will permanently avoid the unemployment?

Q. If a lot of people are going to be unemployed at some time and for whatever the reason, isn't there some obligation to offer them public service employment? If not, is there some measure or set of measures that you would propose to alleviate the burden of unemployment?

A. Please, how is public service employment to be financed?

Q. The two possibilities are by taxes or by deficits.

A. If by taxes, then what you do is arrange that some people pay higher taxes and some other people get jobs, right? How have you increased the total amount of employment? Aren't you going to reduce employment on the one hand just as much as you increased it on the other? If I impose higher taxes on you, you have less to spend, don't you? Therefore, your demand for goods and services is less; that reduces employment. I take the taxes from you and I pay them over to people whom I hire in public service. Well then, I have people hired in public service instead of hired in some other way. I haven't increased total employment at all. I've just made different people unemployed. I've just shifted the problem of unemployment. I haven't reduced it. When you talk about increasing employment by public service employment, it makes economic sense only if you're going to finance it by printing money. But then you're not going to stop inflation. You're back again in exactly the same dilemma you started from. Public service employment is no solution to avoiding distress while halting inflation.

Q. Dilemma is the right word, because if you say that inflation is unacceptable and the public says that increased unemployment is unacceptable, then you are really at an impasse, aren't you?

A. Oh no, you're not at an impasse at all. If someone wants a stream to run uphill and it won't, is that an impasse? The stream just won't run uphill. In the same way people may say that they want neither inflation nor unemployment, but what will happen is that they will end up having both. Because of their unwillingness to bite the bullet and pay the price now, they will have both more inflation and more unemployment than they otherwise would.

Q. Let's approach the problem from a different angle. Is the distinction between demand-pull and cost-push inflation valid?

A. Yes, and no. There is a valid distinction, but the distinction people make is not valid. What is called cost-push inflation is almost always the delayed effect of demand-pull inflation. What happens, as happened, let's say, in recent experience, is that we had what is generally called demand-pull inflation, that is, increased spending which pulled up prices. From 1965 to 1969 the prices of final products went up more rapidly than wages and costs. That's why corporate profits went up very rapidly during that period. But as this became apparent, it was understandable that there would be a tendency for wages to catch up. In the case of union contracts which had been made for a three-year period, the effect of the inflation was that the real wages being paid at the end of that three-year period were less than either the employer or the employees had expected them to be. Consequently, you then had a tendency for wages to rise rapidly in order to catch up. Thus, in 1969-70, you had a continuation of inflation because wages were rising in order to make up for their previous lag. It is valid to say that in 1970 you had cost-push inflation. What you were having was a delayed adjustment to the earlier demand-pull inflation.

Q. If that's the case, then why wouldn't wage and price controls be useful to control this cost-push inflation?

A. Because, if you froze the wages at where they ended relative to prices, you would be freezing real wages at the wrong level. The conditions of demand and supply did require that wages rise relative to prices. In the second place, what you've got is a price system in which you have many relative prices. If you try to eliminate inflation by freezing prices and wages, you freeze all particular prices and wages. The result of that is that you prevent those adjustments in relative wages that are necessary for the efficient operation of the economy. That's why we're having shortages in things that were under control. A far better way to eliminate the frictional effects we're speaking of would be to have universal escalator clauses.

Q. One last question. What economic policy do you recommend for the current situation and for the long run?

A. Exactly the same policy that I have been recommending for twenty years. No different. I recommend for the short run and for the long run that the Federal Reserve adopt a policy of increasing the quantity of money at a steady rate year in, year out, month in, month out. What that rate should be depends on which definition of money you use. If you use the narrow definition of currency and demand deposits, M_1, the rate of growth of the quantity of money should be somewhere around 3 percent a year. Maybe a little less or a little more; it doesn't matter too much. If you use a broader definition including time deposits, so-called M_2, the rate of growth of the quantity of money should be about 5 percent per year. We should start on that right away.

Simultaneously, we should abolish all wage and price controls and eliminate the whole apparatus of intervention, which does only harm and no good. We should also move in the direction of reducing the level of government spending. That ought to be our policy today; it ought to be our policy next year; it ought to be our policy ten years from now. And if we followed that policy, then we would for the next several years go through a slowdown; there's no doubt about it. We've got to do it sooner or later, and the sooner we get it over with the better. We would go through a slowdown; we would come out of that slowdown in about two years with the inflation stopped, with prices either stable or rising at 1 or 2 percent per year—you can't tell the difference between those magnitudes, given the imperfection of our index numbers. Unemployment would, after a couple of years, start declining; and we would gradually shift up to a relatively high level of employment and a low level of unemployment. We would not have perfect stability. There will still be other factors that will produce ups and downs. But we would avoid the kind of stop-go-stop policy that we have followed for the past fifty years, ever since the Federal Reserve System came into existence.

Incidentally, these proposals must include a continued policy of floating exchange rates. One of the good things that has happened in the past few years is a move toward floating exchange rates, which enables the U.S. internal monetary policy to be conducted independently of what happens in the rest of the world.

Q. If the economy ran into trouble, would you prohibit intervention by the monetary and fiscal authorities?

A. That's not an easy question to answer. It depends on what you mean by trouble. Obviously, I think that if we followed the policy I'm describing, we would not run into serious trouble. If I were wrong, if we ran into something that approximated a major recession or a depression, I would have to say that I had been wrong, and I would have to do something different. I'm not trying to put something down in tablets of gold that shall never be changed for all time. I want us to learn from experience.

So, in a way, I can't really answer your question, because what you might call running into trouble, I might not call running into trouble. Would we be justified in dropping my policy if, for example, unemployment in the course of the first two years after you introduced it ran up to 6.5 to 7 percent? No, not at all. It may well be that there is no way of getting out of our present predicament without going through a process like that. On the other hand, after we had been following the policy for five or six years, and we started to have unemployment of 7 percent, I might feel very different. If you start on this program with the idea that you are going to drop it the moment you have the slightest sign of economic difficulties, there's no point in starting on it.

Q. Do you think that the economy cannot rest at an equilibrium much below the level of full employment, which then requires some act of intervention by the Administration?

A. Of course it cannot! That has been thoroughly discredited by both theoretical analysis and empirical studies. I don't believe there's any chance of that at all.