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Causes and Effects of Inflation

C. LOWELL HARRISS

Through the broad sweep of history, units of money have always lost purchasing power—not in every decade or generation, but eventually. In other words, *inflation* in the sense of a *rise in the general level of prices* has occurred time and again, all over the world. Inflation deals *not* with *particular* prices or the relations among prices but with the *general price level*, a drop in the purchasing power of the dollar. The general price level goes up when money demand rises more than the goods and services available for buying. Money demand goes up when the quantity of money rises or when velocity, the rate of turnover, rises—or some combination of the two.

Today's problems in this country are not something new. Yet there *are* new elements. Two of these must shock the thoughtful observer. One is the failure to learn from the past and to take preventive action. A second is an apparent resignation to additional inflation in the years ahead, perhaps indefinitely. Expectations of continuing inflation, as Professor Fabricant and other contributors to this volume can help one see, are not merely passive responses. They become causal forces. Members of the public—as savers and investors, as managers of businesses and leaders of labor unions, and as consumers—try to alter behavior on the basis of guesses about price-level changes.

Man makes inflation—and suffers from it. How does he make it? How does he, and how will his children, suffer? What are the varied effects? How might this country move from the current situation, which contrasts sharply with most of American history, to conditions that would

Tables 1–9 were prepared at the Tax Foundation, Inc., under the direction of Dr. Elsie Watters.

resemble those long considered normal? Questions such as these prompted this volume.

The Record of Price-Level Changes

To help set the stage, table 1 shows two measures of prices and of changes from 1930 to mid-1974. No single price index can be fully satisfactory.

TABLE 1
*Indexes of Prices and the Purchasing Power of the Dollar
for Selected Calendar Years, 1930-74*

<i>Year</i>	<i>Wholesale Prices (1967=100)</i>	<i>Consumer Prices (1967=100)</i>	<i>Purchasing Power of the Dollar (1967=\$1.00)</i>
1930	44.6	50.0	2.00
1935	41.3	41.1	2.43
1940	40.5	42.0	2.38
1945	54.6	53.9	1.86
1950	81.8	72.1	1.39
1955	87.8	80.2	1.25
1960	94.9	88.7	1.13
1965	96.6	94.5	1.06
1970	110.4	116.3	.86
1971	113.9	121.3	.82
1972	119.1	125.3	.80
1973	134.7	133.1	.75
1974 ^a	159.0	147.8	.68

Source: U.S. Department of Labor, Bureau of Labor Statistics.

^aEstimated; based on price changes for first six months.

Measurement of *the* price level presents formidable problems when each household buys hundreds or thousands of varied commodities and services in a year—and no two families use exactly the same “market basket.” All consumers alter their combinations of purchases from year to year, in part because of changes in relations among prices. Moreover, the characteristics and qualities of tangible goods and intangible services change; there are vast improvements in some and deterioration in others. Experts cannot be confident about the adequacy with which adjustments allow for quality changes in computing the price indexes.

The figures show that with 1967 as the base—100—consumer prices went from around 72 in 1950 (the Korean war) to 80 in the mid-1950s and to nearly 95 when Vietnam war expenditures began to become substantial in 1965. That ten-year increase seems small indeed compared

TABLE 2
*Indexes of Consumer Prices by Selected Expenditure Classes
 for Selected Calendar Years, 1929-73
 (1967=100)*

Period	All Items	Food	Rent	Home Ownership	Fuel/Oil and Coal	Gas and Electricity	Apparel and Upkeep	Transportation	Medical Care	Personal Care
1941	44.1	38.4	57.2	—	40.5	81.4	44.8	44.2	37.0	41.2
1945	53.9	50.7	58.8	—	48.0	79.6	61.5	47.8	42.1	55.1
1960	88.7	88.0	91.7	86.3	89.2	98.6	89.6	89.6	79.1	90.1
1965	94.5	94.4	96.9	92.7	94.6	99.4	93.7	95.9	89.5	95.2
1967	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1970	116.3	114.9	110.1	128.5	110.1	107.3	116.1	112.7	120.6	113.2
1972	125.3	123.5	119.2	140.1	118.5	120.5	122.3	119.9	132.5	119.8

Source: U.S. Department of Labor, Bureau of Labor Statistics.

with recent rates of rise. The 1973-74 estimated increase—in one year alone—is almost as great as the 15 points in ten years. The same data examined from the opposite point of view, not prices but what the dollar will buy, reveal that from 1967 to 1974 the dollar dropped almost one third, to 68 cents.

Table 2 shows more details of consumer prices for a few selected years. Obviously, some elements have risen much more than others. Table 3

TABLE 3
*Implicit Price Deflators for Gross National Product
and Selected Components*
Selected Calendar Years, 1929-73
(index numbers for 1958 = 100)

Year	Gross National Product	Personal Consumption Expenditures	Gross Private Domestic Investment		Government Purchases of Goods and Services
			Nonresidential Structures and Producers' Goods	Residential Structures	
1930	49.3	53.6	38.1	37.1	37.9
1935	42.6	44.4	35.9	29.8	37.0
1940	43.9	45.5	40.0	36.9	38.5
1945	59.7	65.4	51.0	54.9	52.6
1950	80.2	82.9	74.4	82.5	71.8
1955	90.9	92.8	86.7	92.9	87.1
1960	103.3	102.9	102.9	104.5	105.0
1965	110.9	108.8	107.5	114.2	119.4
1970	135.2	129.3	130.2	140.2	157.6
1971	141.4	134.4	136.3	147.4	168.1
1972	146.1	138.2	139.6	157.4	178.6
1973	154.3	145.9	144.9	174.0	191.5

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

enables one to compare some of the major elements of the gross national product. (In this case, 1958 is the base year of 100.) The prices paid by businesses for factory and other buildings and machinery have gone up at about the same rate as consumer items. But prices paid for new housing and for government have risen by considerably larger amounts.

The effects of such changes are distorting, disrupting, and pervasive, far more so than is generally recognized. No one mind can possibly know much about more than a rather small fraction of the total effects of double-digit inflation, 10 percent a year or more. Four essays in this volume deal with the effects. Professor Peterson shows some of the many ways in which business operations are influenced. The reader can get some conception of the difficulties added to the management of com-

panies on which Americans depend for most of their income, the goods and services they consume, and the taxes to pay for government. The full costs in loss of efficiency cannot possibly be measured, but they burden everyone regardless of his awareness.

By failing to adjust taxes for inflation, the tax system hurts business in ways never intended. The laws tax "phantom profits" as if they were real—quite generally at rates around 50 percent (and higher where state taxes are above average). The government still requires the use of original cost in figuring the amounts deductible as depreciation expense. Obviously, however, recovering the same number of dollars as invested in the past will not replace the productive capacity.

It is not only in the supermarket that the dollar has lost buying power. The machinery and equipment element of the wholesale price index in the summer of 1974 was 55 percent above that of 1964 and 35 percent above 1969. For structures, the rise was 77 percent.

Although Congress has never said, "Let us tax some of the return of capital as if it were net earnings," the laws do so. Business practice itself, as well as principles still acceptable to the accounting profession, condone the use of obsolete cost figures for nontax purposes. Such failures do not bind government. *It* controls tax policy, and it can make reforms. In times of inflation what the tax law defines as "income" is not limited to the true *earnings* of capital. Some of the *capital itself* gets taken by the tax net. "We" have been forced to send to government, in the form of tax on earnings, funds that in a basic economic sense are costs. In government spending, Americans consume capital without realizing the fact.

Two essays deal at somewhat greater length with particular industries, each highly important to everyone. Dr. O'Leary from his experiences at the very center of national finances paints a starkly realistic and highly disturbing picture. The effects of large inflation profoundly threaten the working of financial markets as they have been developed over the decades. The typical American has little opportunity to learn the importance of capital markets. Yet they affect, not only his ability to finance a house, automobile, or other purchases on reasonable terms. The world of finance also affects the modernization and expansion of production facilities for jobs, the introduction of new and improved goods and services, and local and state government capital projects.

The essay by Dr. Manus on the effects of inflation on public utilities tells another disturbing story. Suppliers of communications, electrical, and other services of utmost importance to consumers—and to business as producers—face new difficulties because inflation raises costs to utilities whose rates are regulated under procedures which have been built to operate on the implicit assumption of a stable dollar. Moreover, inflation raises the interest costs and complicates the problems of raising

the new capital that will be needed in huge amounts to supply a growing population which expects better levels of living.

Professor Bach draws upon his detailed study that has extended over many years to measure some of the effects of inflation. One of the most widely recognized conclusions about inflation is that not everyone is affected in roughly the same proportion or even the same direction. The recent work summarized here gives insights into how much the different sectors of the economy have been benefited or hurt.

Inflation increases the "tax take" of government, not only because "phantom profits" are taxed as if real, but also because graduated personal income tax rates take increasingly larger fractions of income as dollar incomes go up. Even though some of the rise in money income reflects merely an offset to loss of purchasing power of the dollar, progressive rates absorb larger, rather than stable, proportions. The personal exemption is fixed in the dollar amount, \$750 at present; the law, therefore, taxes all increases in income of persons subject to tax.

The speed with which dollars move into brackets subject to higher rates depends upon the width of brackets. In the income ranges where the vast majority of Americans experience changes in income, brackets are "narrow" rather than "wide"—four of \$500 each, then ten of \$2,000 each for single persons and twice as much for married couples.

Whereas a married couple with two children and a gross income of around \$12,000 would pay about 10 percent on average income, the rate on *increases* would be 19 percent. At \$20,000 taxable income, the marginal rate becomes 32 percent for a married couple and 38 percent for a single person. The Treasury is a one-third partner. The government gets appreciably more than enough to maintain its real buying power, i.e., an amount proportional to the rate of inflation.

Each increment of inflation *permanently* raises burdens. Even if inflation ends, the higher *real* burdens remain unless rates are reduced. Millions of families and single individuals, not merely a few with large incomes, now encounter the effects of progressive tax rates. Inflation adds to the *real* burden of the personal income tax. A 10 percent inflation would raise tax collections by 14.7 percent.¹ Imagine the outcry if a president or a member of Congress were to propose explicitly a rate boost of such size.

The process of inflation automatically enlarges the size of government. Progressive rates, inadequate depreciation, inventory profits taxed as earnings, illusory capital gains taxed as income (while real losses are incompletely deducted), combine to enlarge tax revenues faster than the true earnings of labor and capital. More resources shift to government.

¹ J. M. Buchanan and J. M. Dean, "Inflation and Real Rates of Income Tax" (Paper delivered at the 1974 annual conference of the National Tax Association—Tax Institute of America, mimeographed).

Political processes can thus determine the use of more and more of the product of our effort and capital. If explicit actions had been required, would not our lawmakers have been more cautious?

The cumulative effect in, say, four or five years can mark more than a slight change in society. The size of government increases without a deliberate analysis of the alternatives, without any reference to voters, without a reasoned conclusion that the quality of performance of government justifies such expansion.

Causes of Inflation

What causes inflation? War, rapid increases in money (silver from the Americas to Spain in the sixteenth century or new checkbook money in most countries today), government budget deficits, crop failures, wage rates rising faster than productivity, monopolies exerting increases in power, freeing the currency from ties to gold or silver—these and other forces have been said to cause inflation. Several are interrelated. Space limits required focus on “causes,” and “causes of causes,” of America’s current inflation.

Professor Poole summarizes monetary developments. He shows that increases in the stock of money have been in amounts that by widely (but not universally) accepted theory can account for the drop in the purchasing power of each dollar. In addition to the figures in his essay, the reader will find in table 4 three measures of the money supply. Although the magnitudes of increases have differed, each has gone up by more than would be consistent with preservation of the worth of the dollar.

The quantity of money increases when the banking system expands demand (checking) deposits to meet loan requests of business, the government, and consumers. The banking system can, and will, create new deposits when the Federal Reserve System makes legal reserves available. Why does it create such reserves—and lending capacity for banks—in amounts that will be inflationary? One reason is that human beings like to borrow “easily”; they like interest rates lower than would prevail if the only supply of funds to meet demand for loans were from saving. By creating new deposits for borrowers, banks can give them funds that did not exist. “Something for nothing”—or so it seems. The country does not lack politicians and businessmen and consumers who support such policies and who condemn the opponent of money creation as heartless and stagnationist.

Not only the quantity of money but also the rate of use—velocity—influences total money demand and the level of prices. Table 5 reveals one measure of the rate of use of money—the turnover of demand deposits (essentially transactions velocity). In 233 Standard Metropolitan Statistical Areas (including New York City) the average number of times a dollar in a checking account was used went up from 45 (less than once

TABLE 4
Measures of the Money Supply,
December Averages for Selected Years, 1947-74
(in billions of dollars)

<i>Year^a</i>	<i>M₁</i> <i>(currency plus</i> <i>demand deposits^b)</i>	<i>M₂</i> <i>(M₁ plus time</i> <i>deposits in</i> <i>commercial banks^c)</i>	<i>M₃</i> <i>(M₂ plus</i> <i>nonbank thrift</i> <i>institutions^d)</i>
1947	\$113	—	—
1950	116	—	—
1955	135	—	—
1960	144	\$217	\$314
1965	171	301	463
1967	187	350	533
1968	202	382	577
1969	209	392	594
1970	221	425	641
1971	235	473	727
1972	256	526	822
1973	271	572	895
1974 ^e	281	597	931

Source: Board of Governors of Federal Reserve System.

^aAverages of daily figures, seasonally adjusted. 1974 figures are for June. Data for the M₂ and M₃ series have been compiled only for 1960 and subsequent years.

^bIncludes currency in circulation, demand deposits at all commercial banks other than deposits by domestic commercial banks and the United States government, and foreign demand balances at Federal Reserve Banks.

^cExcludes time deposits of the United States government and of domestic commercial banks. Includes certificates of deposit (CDs) other than negotiable CDs in denominations of \$100,000 or more.

^dDeposits with mutual savings banks and shares of savings and loan associations.

^ePreliminary.

TABLE 5
Annual Averages of Demand Deposit Turnover Rates for
Selected Calendar Years, 1964-74

<i>Year</i>	<i>Total 233 SMSAs</i>	<i>New York SMSA</i>
1964	45	90
1965	48	100
1967	57	122
1970	73	155
1971	81	188
1972	86	207
1973	103	248
1974 ^a	117	281

Source: Board of Governors of Federal Reserve System.

^aFirst seven months.

a week) in 1964 to 117 (more than twice a week) in the first half of 1974. In New York City, average turnover more than tripled from 1964 to 1974, when it reached a rate of more than one use each business day.

More than one writer in this volume, and untold numbers elsewhere, attribute inflation to the government. The alleged and the actual causal relations differ. Government, or an agency of government (the central bank, in this country the Federal Reserve), controls monetary policy. And the national government's own finances can be a cause of inflation—in time of peace as well as war. Table 6 presents figures for receipts, outlays, and surplus or deficit of the federal government for selected years to 1960 and for the entire period since.

TABLE 6
Budget Receipts and Outlays for Selected Fiscal Years, 1930–75^a
(in billions of dollars)

<i>Fiscal Year</i>	<i>Receipts</i>	<i>Outlays</i>	<i>Surplus (+) or Deficit (-)</i>
1930	\$ 4.1	\$ 3.3	\$ +.7
1935	3.7	6.5	-2.8
1940	6.9	9.6	-2.7
1945	50.2	95.2	-45.0
1950	40.9	43.1	-2.2
1955	65.5	68.5	-3.0
1960	92.5	92.2	+3
1965	116.8	118.4	-1.6
1970	193.7	196.6	-2.8 ^b
1971	188.4	211.4	-23.0
1972	208.6	231.9	-23.2
1973	232.2	246.5	-14.3
1974 ^c	264.8	268.3	-3.5
1975 ^d	294.0	305.4	-11.4

Source: Office of Management and Budget.

^aData for 1930 and 1935 are for the administrative budget, 1940–50 on the consolidated cash basis, and 1955–75 for the unified budget.

^bTotal deficits for 1961–70 inclusive, \$55.1 billion net. The only year without a deficit was 1969, which had a surplus of \$3.2 billion.

^cPreliminary.

^dEstimated.

Federal deficits are widely assumed to be a source, perhaps the chief source, of inflation. Such a conclusion is not necessarily accurate. The Federal Reserve faces no legal or economic compulsion to provide the banking system with extra reserves so that banks can create money (deposits) to buy the additions to federal debt. The Treasury may go into the capital markets and by borrowing there reduce the amounts

available for utilities, housing, manufacturing, and other borrowers. "Tight money" and "high" interest rates may appear as a result of the added Treasury demand for limited supplies of funds for lending.

Human beings, however, like to get things easily. Acting as groups—governments—they see attractive possibilities. One is to vote expenditures to be paid for by taxes on others. Another possibility is to create money to pay for government spending. The printing presses and, even more so, the banking system permit money creation without effort, work, thrift, or sacrifice.

If the economy has much unutilized productive capacity, money creation may finance benefits from government spending without loss of either other output or price-level increases. Economists have preached this sermon long and fervently, attributing it to Keynes's writings of the 1930s when inflation presented no serious problem. "Modern economics can free mankind from bondage to balance as a criterion of wise fiscal policy." And the figures for most years have shown what seem to be disturbing numbers of unemployed persons and wasteful underutilization of plant and equipment. Therefore, many economists in high places and throughout academe have supported "what comes easily" to many on Capitol Hill, in the executive branch, and throughout the land—federal expenditures (and loan programs) not paid for by taxes.

The resulting budget deficits have done more than finance new output from otherwise unutilized productive capacity. One might ask whether these deficits have not been a major cause of inflation. Nevertheless, the economy faces no inherent necessity for creating money to accommodate the Treasury or other borrowers. But how much easier it is to let banks have more reserves and expand their loans than to require borrowers to compete for limited savings!

When a new dollar has been injected into the income-expenditure stream, it will continue to circulate after the original use. One respect in which money differs from other things is that when a dollar is used it is not used up. The person or company or government getting it will then use it. The process of purchase and payment will continue. The effect of one month's or one year's money creation, for the Treasury or for business, is an enlargement of the money stock that is available for continuing use. The faster the money is used (velocity of turnover), the more effect each added dollar will have in supporting money demand and increases in the price level.

The role of federal government finances has become increasingly complex. Professor Weidenbaum, in a presentation that warrants special attention because of the new developments it interprets, emphasizes the growing size of federal spending. More and more financial activities influenced by the federal government are outside the budget. The desire to use the power of government to escape some of the discipline of

competitive markets creates pressure for indirect as well as direct utilization of federal government power to borrow—and to employ the money-creating mechanism.

Inflation extends over the world. Spokesmen in many countries feel that at least part of their inflation has been imported. The causal relations cited are complex; they differ from one country to another. At the conference Professor Robert Mundell of Columbia University emphasized the points noted here. The press of other work prevented him from submitting a written paper for this volume.

Few Americans have been aware of an enormous increase in liquidity over the world. The expansion of Eurodollars, for example, has greatly enlarged a relatively new form of liquid asset. The figures of changes in international monetary reserves since August 15, 1971, stagger the imagination. Advocates of retaining ties of money to gold have argued that without the discipline exerted by such restraint, governments would create, or tolerate the creation of, money on a scale that would be inflationary. Consistent with this view, certainly, is an "explosion" in the quantity of money since the United States finally ended the dollar's fixed tie to gold. In any case, governments over the world have been expanding money at a rapid, though of course not uniform, rate.

Employment Aspects

Inflation and attempts to end it involve employment. The total of aggregate demand, say \$1.2 trillion, will finance full employment—at some average wage rate. If the average wage rate goes up, however, more dollars will be needed. The injections of new money in the form of increases in bank loans—made possible by the Federal Reserve to finance either government spending or private business or consumers—can stimulate the demand for labor. In the short run, aggregate demand, including the demand for man-hours of work, can be increased easily. Employment and wage rates will rise.

Rising prices and wage rates, however, may induce increases in employment costs that will price some labor out of the work, e.g., short work weeks, layoffs, or incomplete hiring of new entrants to the labor market. If employees and their unions expect inflation, or a higher rate of inflation, the expectation can lead to insistence on wage increases that assure future unemployment—unless the monetary authorities "validate" the higher level of injections of additional money. Is this not one of the worst dangers of inflation? If wage rates are "sticky," or completely inflexible, downward, then the only way the employment of a growing labor force can rise to a reasonably satisfactory level will be through an "adequate" rise in productivity (output per hour), a squeeze on the shares of output for the suppliers of nonlabor factors of production, or the injection of more money.

Contributors to this volume express concern about current unemployment. A further drop in business as a result of efforts to reduce inflation will reduce employment. Some of the drop in jobs will be temporary as companies adjust inventories; some will be more stubborn because wage rates are too high relative to what consumers will pay for the output of each hour's work. The term *stagflation* appears many times. Employment suffers from elements of stagnation (inadequate expansion of output) while the price level continues to rise.

The short- and the long-run effects of inflation on employment are complex. Dr. Fiedler, for example, notes that much of the 1974 difficulty in housing construction resulted directly from inflation. The drop in housing starts was due, not merely to the rise in prices of materials and labor but also, and quite obviously, to the rise in interest rates and the diversion of loan funds to other parts of the economy. Business demands for loans soared, in part because more dollars were needed to finance operations at higher prices and in part because taxes do not recognize inflation in computing depreciation.

Table 7 presents data also not fully appreciated—the growth of em-

TABLE 7
*Labor Force by Employment Status,
Annual Averages for Selected Calendar Years, 1929–73^a
(in millions)*

Year	Total	Armed Forces	Civilian Labor Force		Unemployment as a Percentage of Civilian Labor Force
			Employed	Unem- ployed	
<i>14 Years of Age and Over</i>					
1929	49.4	.3	47.6	1.6	3.2
1933	51.8	.3	38.8	2.8	24.9
1939	55.6	.4	45.8	9.5	17.2
1946	61.0	3.5	55.3	2.3	3.9
<i>16 Years of Age and Over</i>					
1949	62.9	1.6	57.6	3.7	5.9
1950	63.9	1.7	58.9	3.3	5.3
1955	68.1	3.0	62.2	2.9	4.4
1960	72.1	2.5	65.8	3.9	5.5
1965	77.2	2.7	71.1	3.4	4.5
1970	85.9	3.2	78.6	4.1	4.9
1971	86.9	2.8	79.1	5.0	5.9
1972 ^b	89.0	2.4	81.7	4.8	5.6
1973 ^c	91.0	2.3	84.4	4.3	4.9
1974 ^{b,c}	94.7	2.2	87.6	4.9	5.4

Source: U.S. Department of Labor, Bureau of Labor Statistics.

^aBeginning in 1960, data include Alaska and Hawaii.

^bNot strictly comparable with previous data because of population adjustments.

^cData as of August.

ployment. Selecting different sets of years for comparison permits various observations. One might note that unemployment rose by 1.2 million from 1949 to mid-1974 while employment went up 30.0 million—yes, a rise of 30 million. In less than a decade, 1965 to mid-1974, actual employment rose 16.5 million. And the new jobs were generally good jobs. Did inflation help? Or would the employment rise have been greater if the price level had been more nearly stable? Unemployment as a percentage of the labor force rose during this period. The causal relations are not clear.

Certainly, one of the key factors that relates employment and prices to each other—and changes in total employment to changes in the price level—is productivity. If output per man-hour improves by more than the rise in compensation per man-hour, then (unless capital costs go up by more) prices can trend downward. But if the employer finds that costs of employment rise by more than output per man-hour, prices must go up or employment must go down or returns to capital must drop.²

Table 8 gives figures, admittedly not perfect but the best available, on wages and man-hour productivity. Output per man-hour has increased—for example, (with 1967 as 100) from 104 in 1970 to 116 in 1973. But man-hour compensation rose by even more, from 125 to 154. As a result, average unit labor cost in the total private economy went up from 119 to 132. Would one not inevitably expect a rise in consumer prices and sluggishness in labor markets?

Efforts to Reduce Inflation

One type of effort to slow the growth of labor cost (the excess of rise in compensation over increase in output per man-hour) was represented by the three-month freeze beginning in August 1971 and then by the controls of Phase II. Professor Mitchell's essay draws upon his intimate involvement in this program as well as his study of other efforts to implement policies of restraint. He examines the problems and the results.

Another approach to restraining labor cost relies heavily upon employee understanding. Mr. Jennings has found that when employees are informed accurately and fully about the company's affairs, they are generally willing to conclude wage agreements which do not force costs up so as to erode profit prospects, threaten jobs, and raise prices. More impressive perhaps has been the experience of certain companies with profit sharing with employees. Dramatic successes are cited. Money and real incomes can rise. Here, it would appear, is one promising method of im-

² Since labor's share is about three times as large as that going to suppliers of capital, a "large" decline in the net amount going to suppliers of capital is needed to "finance" a decline in labor productivity per wage dollar.

TABLE 8
Output, Compensation, and Unit Labor Costs in the Private Sector
for Selected Calendar Years, 1950-73
(index numbers, 1967=100)

	1950	1960	1970	1973 ^a
Output per man-hour, total private	60	78	104	116
Nonfarm industries, total	65	80	103	116
Manufacturing	64	80	108	128
Nonmanufacturing	65	81	102	110
Compensation per man-hour, total private ^b	43	72	125	154
Nonfarm industries, total	45	74	123	152
Manufacturing	45	77	122	150
Nonmanufacturing	46	73	124	153
Unit labor cost, total private	72	92	119	132
Nonfarm industries, total	70	92	119	131
Manufacturing	69	96	113	118
Nonmanufacturing	70	90	123	139

Source: Department of Labor, Bureau of Labor Statistics.

Note: Figures rounded to nearest whole number.

^aPreliminary.

^bWages and salaries plus employers' contributions for social insurance and private plans.

proving the economic well-being of both employees and suppliers of capital without adding to the cost-push aspects of inflation.

Professor Fabricant has studied and written on various aspects of inflation over many years. He integrates this material with work he has done on other economic topics such as the role of government and productivity. He takes a broad view of the current situation and outlook and shows why returning to price-level stability must be slow and painful. His paper examines, among other things, the role of expectations about inflation and the part that they may play in developing policies for the future.

Experience, however, does show that an inflationary trend can be reversed. The program of the late 1950s described by Professor Saulnier deserves far more attention than it has received. He tells a success story of fiscal and monetary policy plus other elements. It was not without its pains. But understanding these, along with what actually worked, can help prepare the nation to deal with their counterparts.

To prevent inflation, government should keep the growth of the supply of money at a rate consistent with price-level stability, but that is easier to say than to do. One difficulty is to say "no" to those who want still more money created. They may argue that more is needed to finance a budget deficit or to provide financing for worthy projects for which funds from private saving seem to be inadequate at current prices.

Among economists, raising federal taxes has become a standard prescription for curbing inflation. Governments by taxation take from families and business some of their income or some of their capital. The dollars thus taken are not available to pay for consumption; nor can they be saved and then used for the private purchase of investment goods.

The tax funds withdrawn from the income stream are no longer available to finance private demand for goods and services. Some of the effect of lower money demand will be prices lower than otherwise; some will be a reduction of physical quantities and hence fewer man- and machine-hours of work.

A second prescription for reducing inflation is to cut the increase in federal expenditures. In periods of inflation the orthodox fiscal program would presumably be a federal budget surplus. If revenues exceed spending, then federal finances can reduce the income flow, taking out more than is put back and thus acting to limit or offset "demand pull." Such is a "tight" fiscal policy.

By lowering the growth of spending (including "off-budget" financing), or by raising tax collections, Congress can produce fiscal action that will alter the flows of income in ways that reduce total demand. Here, it would seem, is an obvious means of preventing inflation if the public really wants to do so.

The obstacles are formidable. A variety of forces operate to increase federal spending. Some result from earlier inflation. Some of recent years represent the costs of undertakings of the Great Society. Some spending programs are newer still. Nevertheless, does it not seem that the *increases*—\$400 per capita (adjusted to the estimated fiscal 1975 worth of the dollar) more in fiscal 1974 than a decade ago—must have done enough to call for a change of pace? And new congressional procedures intended to slow the rise of expenditures have just been approved.³

Indexing gets increasing attention as one method for meeting some of the problems of inflation. One argument of advocates is that indexing would reduce uncertainties of expectations as a source of pressure for policies that in fact make things worse. Professor Kuhn explains the indexing proposals in general and analyzes the probable effects.

Foreign Experience

The fact that inflation today is worldwide made an examination of the experiences of some other countries appropriate. Table 9 shows how purchasing power has eroded over the world. But the experiences differed

³ Good reasons of efficiency in resource allocation will in themselves, regardless of inflation, support determined efforts to control spending, i.e., to be as certain as possible that benefits to the public will be worth the cost to taxpayers.

TABLE 9
Erosion of Value of Money in Selected Countries, 1963-74

	Indexes of Value of Money (1963=100) 1973	Annual Rate of Depreciation of Money		
		1963-68 ^a	1968-73 ^a	1974 ^b
<i>Industrialized Countries</i>				
New Zealand	58	3.8%	6.9%	5.6%
West Germany	71	2.4	4.4	6.4
Netherlands	57	4.5	6.4	7.9
Norway	58	4.1	6.4	8.1
Sweden	61	4.1	5.7	8.3
South Africa	65	3.0	5.5	8.9
Switzerland	64	3.4	5.3	9.0
Belgium	66	3.5	4.6	9.1
United States	69	2.5	4.8	9.3
Canada	68	3.0	4.4	9.4
France	64	3.1	5.8	11.1
Australia	66	2.2	5.3	12.0
United Kingdom	58	3.7	7.0	12.1
Denmark	54	6.0	6.0	12.2
Italy	64	3.4	5.4	12.7
Spain	49	7.0	6.6	13.3
Yugoslavia	25	13.6	12.2	15.4
Japan	55	4.9	6.6	18.2
Greece	69	2.1	5.3	24.6
Median rates		3.7	5.7	11.1
<i>Less-developed Countries</i>				
Venezuela	80	1.4	3.0	4.7
Iraq	75	1.1	4.5	5.9
Guatemala	82	0.4	3.4	10.4
Iran	72	1.5	4.9	11.6
Peru	39	11.6	6.5	13.6
South Korea	31	13.0	9.0	15.8
Thailand	72	2.5	3.9	17.6
Mexico	64	3.0	5.8	18.3
Brazil	6	32.7	15.8	18.7
Turkey	41	6.2	7.9	18.9
Colombia	33	9.8	11.1	20.5
India	46	9.0	6.1	21.0
Argentina	8	20.3	25.0	23.1
Zaire ^c	21	20.8	8.1	24.4
Philippines	48	4.7	9.4	25.1
Indonesia	1	70.7	12.3	31.8
China (Taiwan)	68	2.2	5.5	35.6
South Vietnam	8	22.5	22.3	39.3
Median rates		3.6	6.0	18.7

Source: First National City Bank.

^aCompounded annually.

^bBased on average monthly data available for 1974 compared with corresponding period of 1973.

^cFormerly the Congo.

tremendously over the 1963-73 decade and in the first part of 1974.

Because of space limits only three countries are discussed. The essays by Professors Robock, Glade, and Schmolders on Brazil, Mexico, and Germany respectively reveal a variety of experiences and policies within each country in the periods covered.