Inflation –

A Monetary or a Fiscal Problem?

by GILBERT W. FITZHUGH

To a non-economist businessman who likes to think of himself as a realist, the debate on this question is becoming tiresome — and is really beside the point. For once, the answer is basically simple: "Both — and more besides."

Another catch phrase is the alleged trade-off between inflation and unemployment. Here again, the basic answer is also simple: "There *is* no trade-off." In the long run, we must have *both* a stable currency *and* high employment, or we'll have neither. And in the short run, there is also no trade-off in actual operation. In fact, to assume that there is one can easily produce results directly opposite from well-meaning intentions. Fancy charts purporting to demonstrate some inverse correlation between inflation and unemployment are just that — fancy charts, which are substantially dependent on how one chooses base periods.

Wouldn't it keep us closer on target if we would just keep forever etched in our minds the incontestable facts that the unemployment of the thirties *followed* the inflation generated by World War I and the rampant private speculation and other excesses of the late twenties, and that the current unemployment *followed* the inflation caused by the government-generated excesses of the late sixties and early seventies? To argue otherwise is like saying that wet pavements cause rain. If we do keep these facts in mind, perhaps we can reduce the looming havoc of further inflation and subsequent bust.

Therefore, let's review the bidding and see how we got where we are today.

The United States economy is in a bind today that has no parallel in our previous history. The financial problems of World War I proved relatively manageable in retrospect — we fought the war and eventually paid the financial cost through means which unfortunately included climbing a few rungs up the inflation ladder. In the early 1930s we paid the piper for this inflation and the subsequent credit binge of the 1920s. The house of cards eventually collapsed, as it always does. The Great Depression was a pretty hard way to regain our senses and work our way out of past excesses. Nowadays, we seem to be trying to prove the observation that those who don't study history must relive its mistakes.

World War II was fought and eventually paid for by another leg up on the inflation ladder, and so, too, the Korean conflict. In spite of the devastation that prevailed through all these troubled periods in our history, there always seemed to be some way out.

One might say that we were just unlucky after the Vietnam conflict — an action financed almost entirely by inflation and propped up by the slogan of "guns and butter." Before we had a chance to pull ourselves together, we were hit from all directions. Boom conditions throughout the industrialized world raised demand here and abroad, and, in addition, poor crops in some countries raised the demand-supply ratio so high that our domestic food prices exploded in 1973. Supplies of other raw materials also proved unequal to demand, and imbalances in the international monetary system resulted in two dollar devaluations, which aggravated our own inflation problem.

The crowning blow was, of course, the skyrocketing crude oil prices that followed the embargo, which was in itself a totally new experience for the 20th-century United States. I would not venture to guess why Providence saw fit to cap this scenario with heavy rains in the spring of 1974, a drought throughout the summer, and an early frost — which all combined to destroy the hopes for relief from food price inflation. In any event, we faced 1975 in the economic doldrums, with high unemployment, a high rate of inflation, a housing industry in deep recession, and tremendous capital needs with seriously insufficient saving and investment in sight.

But it was not all just bad luck — it was mostly bad management. In the early part of the period, we deluded ourselves that a "little" inflation is a good way to stimulate the economy. No one listened when a few people warned that a little inflation is like being a little bit pregnant. It tends to become a lot of inflation, and sometimes very quickly. The result is inevitable, and should have surprised no one.

The common thread running through all these successions of boom and bust was an almost continual run of expenditures exceeding income — either public or private or both, and occurring in both "good times" and "bad times." In

E&S readers had plenty to say to us about Professor Alan Sweezy's article on "Keynesian Economics and Inflation," which appeared in our February-March 1975 issue, but it remained for trustee Gilbert Fitzhugh, in responding to Dr. Sweezy's remarks, to produce a full-fledged article of his own - which we present herewith.

simple language, we were (and are) living beyond our means. Theories to the contrary notwithstanding, "now" never seems to be the time to pay off a debt — better mañana.

The monetarists are correct in theory. You can't have inflation without an increased supply of money. But if large deficits are incurred, especially by the Federal Government, the only alternative to increasing the money supply is public or private bankruptcy — or both.

To blame inflation solely on the increase in the money supply is to wear blinders to blot out the fiscal mismanagement that leads to a monetary "bailing out" operation through the printing press.

It would be helpful if our decision-makers learned early that inflation is neither inevitable nor desirable, but that it is intolerable, wrong, unhealthy, and immoral, and simply must not be permitted to continue.

Those who have called it stealing are not exaggerating. Some have said it helps borrowers because it makes it easier to repay loans. How many borrowers would really want someone to lend them $100 and then one year later pay back $90 principal and, say, $7 or $8 interest? Would they think it was fair for the lender not even to get his bait back? (And would they ever expect the lender to lend them money again?) Would they understand the injustice any better if the lender had loaned them 100 bales of hay instead of 100 dollars? Either way, the effect is the same as if someone put his hand in everyone's pocket and took out $10. Is it surprising that inflation leads directly to higher interest rates — particularly when the government considers the $7 or $8 interest as income and taxes it, but does not recognize the $10 drop in principal as a tax loss?

It would also be helpful beyond measure if our decision-makers learned that increasing productivity is not an economists's whimsy, or a devious way in which an employer can extract blood, sweat, and tears from his work force, but rather is the only means of improving and spreading both the high standard and the quality of living enjoyed in the United States.

Unfortunately, instead of bending every effort to control inflation and increase productivity, successive governments, in attempts to ward off the inevitable day of reckoning, pulled one rabbit after another out of the hat. *Anything* rather than face the unpopular truth that we were living beyond our means. Our leaders kept telling us that various palliatives were needed to "buy time" to cure the root causes. Try to recall all the temporary and often detrimental measures adopted under the guise of "buying time" in order to get at the fundamental causes of our balance of payments problems. Was anything constructive done with the time so bought? The sorry routine in dealing with that and other problems was to sit back and wait for the next crisis, and then pull another rabbit out of the hat. It may be true that it is hard to get this country to act without a crisis, but we're running out of rabbits. To use my actuarial jargon, we used up our contingency reserve, and when the going got real tough we had no cushion left.

Certainly, inflation is not confined to the United States. It's a worldwide disease, and each country compounds the problems of the others. However, it is no comfort in looking at United States price rises to say that the situation is worse in some other countries. With this country's vast natural resources, huge market, industrial development, and productive workers, we *should* have the best record of price stability. We like to consider ourselves a leader. Let's be a leader in the battle to protect the value of the dollar. Remember the expression "Sound as a dollar"?

There is no doubt that we will get through these trying times — the point is, how, and when? It might even turn out that the present situation is such that we find ourselves with no alternative but to return to the use of common sense — that most uncommon virtue — hopefully before we are forced through another economic wringer. Perhaps we're ready to rid ourselves of some of the nonsense that has been allowed to gain so much headway, and begin again to rely on hard work, integrity, and thrift — in other words, that old-time religion brought up to date, despite the ridicule often heaped upon it, even from those who should know better.

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Just what are our problems? It seems to me that our fundamental economic problems are not basically economic at all, but rather social and political. People generally have expectations or appetites that are larger than our capacity to produce, and these expectations are constantly rising. This in itself is not necessarily bad — within reason, it can be good. What is bad is that we have come to the point where we think we can have everything we want, and all at the same time, and immediately.

Whether because of rapid communications by radio, TV, and satellite, or because of political promises that have not been, and probably cannot be, fulfilled, or because of unrealizable desires fanned into supposed needs by advertisements, or the competition of labor union leaders for position, or the impractical evaluations of present conditions and the solutions proposed, therefore, by some academicians, or a combination of these — or for whatever reason one chooses to put forward — the hard fact is that too many people want instant gratification.

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Not having learned the most important lesson of economics — that there is no such thing as a free lunch — they too often expect their desires to be provided by others, usually government, rather than through the old-fashioned route of hard work and thrift. They don't just think it would be *nice* to have "everything." They demand it as their *right* — practically guaranteed by the Constitution, if not even higher authority.

And what is the result? When they find that collectively we can't get a quart out of a pint bottle they first become disappointed, then disenchanted, and then alienated. They want to somehow strike back at government, big business, the establishment, or anyone or anything except themselves. This is popularly called a "general malaise."

So we continue our spending spree. In the private sector, the "Buy Now, Pay Later" syndrome has infected the whole country. We are deluged with messages not to wait until we have *earned* money, but to borrow it on the "easy" payment plan and enjoy instant gratification. Buy a fur coat; take a trip to Europe; do anything your little heart desires — you're entitled to it. And don't worry about paying for it. Perish the thought!

Instant gratification is often short-lived, and soon superseded by the "misery" perceived so long ago by Charles Dickens's Mr. Micawber: Annual income twenty pounds, annual expenditure nineteen pounds, nineteen and sixpence. Result: happiness. Annual income twenty pounds, annual expenditure twenty pounds, no shillings and sixpence. Result: misery.

In the public sector, we also spend more than we take in, leading to government deficits and directly to inflation. People complain about inflation, but when demands cannot be met from current income we go into debt as individuals and governments and rely, consciously or unconsciously, on inflation to bail us out. Almost everyone is against inflation until stopping it begins to hurt *them*. Meanwhile, they look for ways to protect themselves against the effects of inflation. Collectively, it can't be done. (Some people thought the stock market was a hedge. Was it? How successful was it for people who needed the money *now*, and couldn't afford to wait for a hoped-for upturn?) The only way to hedge against inflation is to stop it in its tracks!

But, just as we never seem to learn from past mistakes, so do we continue to try the old nostrums — wage and price controls, strangulating government regulations, taxation policies that result in disincentives for increased productivity — and we tolerate a continuance of make-work featherbedding rules and wage and price rigidities imposed by unions and employers.

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Of particular relevance to the subject at hand, we allowed ourselves to be led down the garden path of the "new economics," a prime example of a catchy slogan prevailing over reason. This philosophy called for deliberate deficit financing, even in periods of relatively high economic activity, in an endeavor to expand such activity further and faster. Discretionary fiscal actions were accorded a major role in attaining and sustaining "full employment." Such concepts as "full employment budget" and "fiscal drag" were supposed to justify the view that a Treasury surplus prior to "full employment" would be equivalent to economic disaster.

Certainly, new ways of analyzing the impact of federal fiscal operations can always be helpful. Right today, a clarification of the impact which might be expected from the huge federal deficit now in view for fiscal 1976 alone would be most welcome. However, I think it can be said without risk of contradiction that the new economics fell far short of the claims of its proponents, and in fact could actually be blamed for a substantial portion of the inflation problem. When policies of stimulation have outlived their usefulness, the very newest of economic approaches doesn't result in "right now" ever being the acceptable time to apply restraint. Politically, it is so much easier and more pleasant to apply stimulus than to slow down an economy and return it to noninflationary bounds.

It seems to me that we should seriously question the basic premises of the thesis that government planners can tune the economy so as to assure steady growth in employment and productivity, while at the same time maintaining a sound dollar. These premises seem to be:

1. Economists now have sufficiently accurate information to predict whether the government should be pursuing expansionary or restraining policies;
2. This information is available in time to be of practical use;
3. The fallible human beings who make the decisions for the government based on these data will make the right economic decision rather than the politically expedient one; and
4. These decisions will be made promptly at the right time.

Does recent history give us confidence that any of these four premises, much less all of them, will be met in this practical world of ours? On the contrary, is there not some reason to feel that governmental actions in recent decades have been more unstabilizing than stabilizing? In fact, it might be concluded that no government planning is better than wrong government planning. We must keep trying to solve our problems, but I would hope that less dependence could be put on single national planning and decision and more on individual planning and decision, thus giving ourselves a better opportunity to achieve a viable and flexible balance. The result *might* not be as good as a single *brilliant* government decision, but far better than a government blooper.

Where the problem of unemployment is concerned, I yield to no one in recognizing the tragic human consequences involved when people who are able and willing to work cannot find jobs. But I see no trade-off between inflation and unemployment. In the long run, we must have *neither* or we'll have both — as is being demonstrated at the present time. Surely, an unemployment rate in the area of 9 percent, and a recent inflation rate more than double the rates prevailing just prior to the 1973-74 price explosion, tell the story all too clearly.

What could help reduce unemployment in one year is not necessarily the answer at another time. Even in the short run, it is very doubtful whether general expansionary policies could be effective in materially reducing any prospective unemployment which our economy might encounter. Specific measures would be more appropriate, such as training, relocation and, if necessary, even a soundly conceived and properly financed public employment program, supplemented where necessary with expanded unemployment benefits. None of these would be as harmful or nearly as expensive as overstimulation of the whole economy at every turn. Any future unemployment which might accompany the adoption of sound policies would not be the result of these policies, but would more likely be caused by the continuation of wage, price, and other rigidities. In any event, such temporary unemployment would be far less severe than the unemployment that would inevitably follow a continuation of our pattern of excesses over the years.*

As of the time this article is being written (and who knows what may happen by the time it appears in print) the economy seems to be in the process of turning upward. It is important to note — if it happens — that the upturn started *before* there could be any real impact from a prospective $70 billion deficit in the Federal budget. Of course, this won't stop the apologists for the New Economics from asserting that it was the fiscal stimulus that turned the economy around and reduced unemployment, while inflation was being reduced to "only" 7 percent. Some are already arguing that we must increase and continue the fiscal stimulus to avoid "aborting" the recovery. They piously say that we can worry about the inevitable inflation later — always later, never now.

Nor will these dreamers find any difficulty in ignoring the facts and ascribing the inflation and high interest rates that will inevitably result to some cause, however unlikely, other than that same "fiscal stimulus"! Some people never learn. Let's hope the huge deficit *already* contemplated doesn't set back a truly sustainable recovery by several years.

Here's one possible blueprint for a brighter future

Is the situation hopeless? No. There is yet time, though it's getting short. Here's one possible blueprint for a brighter future:

1. If we as a nation could remember basic principles and resist slogans, perhaps we could at last reduce unreasonable expectations of what government and others can do for us, and concentrate on the importance of earning our own way. We might even take the first steps down the road to recognizing that the essence of liberty is self-discipline. If we can't discipline ourselves, the only alternative to anarchy is for someone else to do our disciplining for us. I hope an appeal to the time-tested principles of hard work, thrift, and integrity will not fall entirely on deaf ears, especially now when we have witnessed so many recent examples of the sad results of neglecting these time-honored guideposts. If enough of us demand higher standards of integrity and competence all along the line — from government, business, education, and labor — we'll get them.

2. Let us come to grips with the necessity for business and labor to increase production, productivity, and savings, and to emphasize the use of credit for sensible and productive purposes. These are the only reliable sources for the capital needed for housing, business plant and equipment, and for the funds which make social security and other transfers possible.

3. We must mount a massive campaign to conserve our natural resources, especially energy, to find new sources of energy, and to become much less dependent on foreign oil.

4. It's long past time to do something about the restrictions on production imposed by union-fostered featherbedding rules, jurisdictional disputes, and attendant rigidities.

5. We need to follow sensible policies to reduce specific pockets of unemployment and relieve the human suffering caused by any remaining excessive joblessness, without aggravating the future problem of unemployment. As a starter, it would be a tremendous help to have reductions in excessive government regulations and union monopoly powers, and flexible pricing and wage policies responsive to changes in costs, demand, and other factors. Unless such flexibility is free to operate on the *down* side when appropriate, as well as on the *up* side, inflation is a foregone conclusion.

With particular reference to the housing recession, it would be helpful if government and others would wake up to the fact that builders, labor unions, and land speculators are pricing new homes — and thus themselves — out of the market, with a big assist from increasing real estate taxes. Additional government subsidies to transfer the higher interest rates caused by inflation from the home-buyer to the taxpayer merely weaken what restraints there are on rising costs, and thus aggravate inflation still further. The price of the house and land is the primary factor in the cost of a home — the higher it is, the higher the mortgage payments will be. Some flexibility on the down side in wages and prices in housing, together with amendments of obsolete building codes and higher productivity could soon change this picture completely around.

6. Finally, we must face the hard facts that as a nation we have no choice in the immediate future but to adjust to a somewhat lower standard of living, or at least to a reduced rate of increase in such a standard, although it is still higher than that of any other nation in the world by most measures.

Each individual American citizen has an important role to play, especially by his own prudent actions in the market place, by what kind of education he prefers and supports, by what kind of representative he votes for and supports at all levels of government, and by what he tells these representatives that he wants to see accomplished. We can't blame our representatives in government too much if we don't express our views and let them know where we stand on important issues. They do what they think we want them to do. They do listen. It's time for us ordinary people to get into the act.

There's no such thing as a free lunch. ☐

*To add a technical footnote, the only kind of inflation that can even temporarily reduce unemployment is a continually increasing rate of inflation. Merely to state the case proves its absurdity.