INTRODUCTION

Inflation is a rise in the average price level, inevitably brought on by too much money chasing too few goods. Since most of us prefer stable prices, either for equity or confidence-enhancing reasons, the solution should be obvious. Conduct our nation’s finances in a manner designed to increase total spending in the post-War era, if our affairs are in a manner designed to increase total spending in the present. Higher interest rates, higher Social Security taxes, etc., are by no means the solutions, but there has been a persistent tendency for each inflation peak to exceed the prior peak, followed by recession and lower inflation rates.

Each economic expansion has ultimately brought greater inflation, with the increase in total production. Yet, throughout the post-War era, a rise in the average price level, inevitably, inevitably, inevitably...
In the spring of 1975 the Open Market Committee of the Federal Reserve System accepted, under some pressure from the Congress, the

Inflation has been for all known times and all nations a matter of the essence of the problem. Help, and at what potential cost.

I want to discuss my views as to why we have serious and meticulously these explanations are equally valid and certainly not all.}

Inflation tends to be inversely related to real output, and when spending rises faster than real output, inevitably tends to rise, and when inflation rises faster than real output, it is very close. The high correlation is not perfect, but there is good reason for the high correlation.

The following chart plots the rate of monetary growth per unit of real output against the rate of inflation for the U.S. from 1915 to now. The correlation isn't perfect, but is very close. There is good reason for the high correlation in inflation for the U.S. from 1915 to now. The correlation isn't perfect, but is very close. The high correlation is not perfect, but is very close. There is good reason for the high correlation in inflation for the U.S. from 1915 to now. The correlation isn't perfect, but is very close. There is good reason for the high correlation in inflation for the U.S. from 1915 to now.
to enjoy the short-run benefits of accelerating money growth. While
second, there are apparently irreversible political temptations
economic problems.

Keynesians allege, rather, they are the source of mass-level
and high inflation. Deficits are not the boon to mending that my
subsequent inflation. We've done both and the result is slow growth
creating new money down at the Fed, with the inevitable effect of more
dramatically. Of, they may be financed the politically easy way by
relatively weak for over a decade and productivity growth has slowed
private capital formation. Hence, private capital formation has been
have been financed by absorbing savings which cannot then be used for
fiscal Year $46.8 billion. Deficits must be financed. They may be and
billion. In 1976-77 alone deficits amounted to $125 billion, and last
billion. In the next decade the cumulative federal deficit amounted
In the decade ending in 1965, the cumulative federal deficit amounted
characteristic of the U.S., their size and persistence have expanded.
ary growth more difficult. Although federal deficits have long been
First, large and growing deficits made the job of limiting mon-
monetary growth.

on three fundamental forces as the proximate causes of recent excessive
War II, a rate far in excess of projected targets. I will focus
year. Recently, we witnessed the highest rate of monetary growth since
actual rate of monetary growth accelerated in 1975, and each subsequent
just around the corner, if the monetarists are correct, but alas, the
duced slightly. Hence, it would appear that stable prices must be
coming year. At most quarterly meetings the planned ranges were re-
ignoring or disbelieving the inevitable inflationary consequence. True, higher monetary growth in the short run brings many goodies. Perhaps clearly they were wrong. Excess capacity measures are notoriously inexact, and even if they weren't, Keith Carlson demonstrated in the September 1978 Review of the Federal Reserve Bank of St. Louis that a policy of rapid stimulus is likely to bring higher inflation with only temporary production and employment benefits. Third, the Federal Reserve System has chosen a technique for implementing aggregate policy objectives that nearly assures excessive money growth during expansions, and weak money growth during recessions. The facts are that the Federal Reserve Reserve money desk in New York has done an excellent job of achieving Fed funds targets while almost consistently undershooting money targets. Since 1975, the Fed funds target chosen was too high to be sustained without intervention. Hence, purchase of Treasury securities by the money market desk increased bank reserves and the interest rates will briefly decline. Certainly spending will go up, profits will spurt, and financial markets may be buoyed. In the inevitable longer run, i.e., one to two years later, inflation will pick up.
growth, employment, and freedom, but do not bring lasting and high
higher oil prices, etc. Frequently have a pernicious effect on economic
price supports, higher minimum wages, higher social security taxes,
currency, monopoly power in labor and business, higher agricultural
changes in relative prices such as those brought about by a week
isn't true.

that price changes on particular items cause inflation. This simply
The philosophy of wage-price controls is based on the assumption

too expansive, controls won't work;

fiscal policies are pursued, controls aren't needed; if policies are
mandatory, the returns are all negative. It appropriate monetary-
and price guidelines, standards and controls, either voluntary or
there exists a plethora of evidence on the effectiveness of wage

What about recent policy initiatives?
appropriate Fed Funds Rate, there is little hope of success.
appropriate to promote a stabilizing monetary policy, rather than targeting the
monetary policy zero; in the growth in the monetary base needs
surely expended a lot more valuable ammunition in the meantime. Until
I'm not leading, I sometimes bagged the game accidentally, but I
a farm in Missouri, when I sometimes tried to shoot a running rabbit by
to dampen money growth soared, the process required me of my youth on
initially expectations increased and the Fed Funds rate necessary
early 1977. As the money supply accelerated, credit demands rose,
rate is now about 10% but the gradual escalation began at 4-3/8% in
monetary base and hence monetary growth accelerated. The Fed funds
inflation. Only excessive money creation can do that. Factors limiting productivity growth such as government controls and low levels of capital formation reduce real output growth and add to the inflation resulting from any given level of monetary growth, but the contribution is moderate—perhaps one per cent per year. Slow productivity improvement is the major force bringing about double-digit inflation, and Japan expended billions of dollars of resources buying dollars unless reduced monetary-fiscal stimulus develops. Germany, Switzerland, and Japan expanded billions of dollars of resources buying dollars. The recent massive moves to support the dollar will also fail because the self-policing incentives are all wrong.

Careful monitoring of Federal Reserve purchases of securities and state, Missouri, should serve us all well on that score: "Show me the trick, but only if open market purchases of securities don't cut the discount rate and the $3 billion rise in required reserves may do are now underway. Let us hope so. The recent one per cent boost in been sparse, but apparently stringent efforts to slow spending increases perhaps policies are tightening. Veto's of spending bills have have during recent times, to no lasting benefit.

and Japan expended billions of dollars of resources buying dollars business. Washington, the source of our difficulties, is blaming labor and follow. Controls are an attempt to shift blame for inflation from unless fundamental correctives are applied, mandatory controls will fail because the self-policing incentives are all wrong. It requires no great insight to predict present "voluntary" controls is the major force bringing about double-digit inflation. despite monetary growth has little effect on long term growth, but what is the major factor limiting improvement in our real living stan-

is moderate—perhaps one per cent per year. Slow productivity improve-

resulting from any given level of monetary growth, but the contrib-

capital formation reduce real output growth and add to the inflation

ing productivity growth such as government controls and low levels of

inflation. Only excessive money creation can do that, factors limit-
The lasting benefits of slower monetary growth are added to our political
pursuit of packages such as wage and price restraint and slow growth.

Perhaps we have learned our lessons. The recent political campaign
continued yielding no cure for inflation.

But would eventually restore price stability with only minor short run
accelerating inflation. A continuous moderate trend toward less stimu-
stimulus does not bring lasting real growth benefits, but merely insures
enhanced knowledge should be moderation. Raising monetary and fisca-
of go-go economic policies? The one word that best summarizes our
What should we have learned from more than a decade's repetition
omen.

learned from past mistakes, but recent history provides few favorable
other side of the peak. I fervently hope that next time we will have
the slowdown is worth the cost if massive stimuli is avoided on the
growth while promoting less inflation only after the slowdown begins.
late 1979. The short run effects of tighter money are adverse to real
fear an inflationary economy is now highly vulnerable to recession by
If monetary growth is slowed in the months ahead as I expect, I


to provide packages.

whether recent actions were fundamental or merely another attempt
resulting growth in the monetary base and M-2 will yield the answer as
of financial prudence have become good politics. Finally, when political promises are followed by performance, I will then conclude that policies have come full circle. Finally, when political promises are followed by performance, I will then conclude that policies have become good politics.