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Inflation and Unemployment: The Great Debate

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On our cover: The Batsto Village restoration, located off U. S. Highway 30 in southern New Jersey, covers the period 1766 to 1850 when this part of the state was an active iron- and glass-producing center. With the mansion on the hill, the workers' houses across the Mullica River, and the industries in between (furnace, gristmill, sawmill, glassworks, brickyard), Batsto once was a thriving community of nearly a thousand people. (Photo courtesy of the New Jersey Department of Environmental Protection.)

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The Future Role of Interest Rates in Open Market Policy*

by David P. Eastburn, President
Federal Reserve Bank
of Philadelphia

There must be some significance in the wide disparity between the way economists and politicians view interest rates these days. Economists have become inclined to assign a diminishing role to interest rates in monetary policy. Politicians, reflecting, I believe, the man-in-the-street view, attribute considerable importance to interest rates and tend to distrust a monetary policy that promotes high rates.

Like most generalizations, this one has many exceptions. Yet it helps explain why the future role of interest rates in open market policy is a matter of some significance. Even though some economists may be inclined to write off that future as a dim one, policymakers cannot do this so readily.

The role of interest rates in our society has had a long and checkered history. Many social and political conflicts have revolved around interest rates as a symbol dividing the haves and the have-nots. The establishment of the Federal Reserve System, and particularly its form of organization, was influenced by attitudes toward interest rates and the control over them. To a considerable extent, the history of the Fed can be told in its changing attitudes toward interest rates.

In approaching the question of the future role of interest rates, therefore, let us sketch these shifting views in the Federal Open Market Committee since World War II. Although it might appear that the process has been one of fashionable surges and declines in the role of interest rates, this is not the case. The FOMC has changed its thinking in a logical progression of steps set in motion by an historical event—World War II—and two intellectual upheavals—

* An address given before the Southern Economic Association and Southern Finance Association, Washington Hilton Hotel, Washington, D. C., November 10, 1972.

the Keynesian and the monetarist revolutions.

CHANGING VIEWS OF RATE CONTROL IN POSTWAR AMERICA

During World War II and for several years afterward, the FOMC abandoned a countercyclical monetary policy for stability of Government bond prices. This era marked the peak of the Committee's concern for interest rates and still stands as an object lesson of the dangers of placing complete emphasis on stable interest rates.

So strong was this lesson, in fact, that not long after the 1951 accord between the Treasury and the Fed, the FOMC moved to a "bills only" policy which, in its extreme form, denied that monetary policy should attempt to influence the level or pattern of interest rates.

At about the same time, forces within the Fed spearheaded an early counterattack on the Keynesian view that monetary policy was relatively ineffective in countering cyclical swings in economic activity. The argument went this way. Even if it were true, as the Keynesians said, that aggregate demand is insulated from the effects of rising and falling interest rates, aggregate expenditures can be influenced by changing credit availability.

As time moved on, not only were there opportunities to observe some of the shortcomings of fiscal policy as a countercyclical tool, but there were opportunities to study the extreme Keynesian view that monetary policy was ineffective. Econometric evidence began to accumulate that aggregate demand is not impervious to credit market conditions in general and interest rates in particular.

Through the early 1960s a modified Keynesian view began to emerge in the FOMC that monetary policy could work to reduce business cycles and that this goal could best be achieved by influencing interest rates and other money market conditions. Moreover, during the period some of the early bad taste of pegging interest rates began to fade. By about the mid-sixties, a concern for interest rates and money market conditions was again dominating the Committee's thought process.

Just at this time, however, the monetarist response to Keynesian economics was gaining respectability and monetarism was beginning to have an impact on FOMC policy. The monetarist view, of course, represented a challenge both to Keynesian economics and to interest rate policies. In the monetarist counterattack lay the seeds for the second postwar decline in the prestige of interest-rate control. This time, however, the decline has been neither as rapid nor as complete as the one we saw in the fifties.

Views in the FOMC have gradually shifted away from a countercyclical policy based on interest rates toward one based on control of the aggregates. The rapid growth in credit and monetary aggregates of early 1966 precipitated the so-called proviso clause in the Committee's directive to the Open Market Desk. By this device, the Committee, for the first time, instructed the manager of the System's Open Market Account to keep an eye on monetary aggregates as well as money market conditions.

In March 1970, the Maisel committee[1] on ways to improve the operations of the Open Market Committee completed its report. This report leaned to a further move in favor of an aggregate policy. Although it has not been adopted, the FOMC, earlier this year, agreed on a reserve target designed to help achieve greater control over

[1] This committee under the chairmanship of Governor Sherman Maisel had been appointed by Chairman William McChesney Martin in the spring of 1969. The committee's concern was not so much with technical aspects of open market operations as with improving the performance regarding the FOMC's ability to accomplish its goals.

the monetary aggregates. The precise measure selected was reserves available to support private deposits, or RPDs. The experiment with RPDs calls for the manager of the desk to seek tighter control over that aggregate and by implication allows for somewhat more fluctuation in interest rates.

But it still leaves considerable scope for concern with interest rates. To a large extent the current dilemma of the FOMC is to determine the precise role of interest rates in a world which recognizes the importance of monetary aggregates.

FUTURE ROLE OF INTEREST RATE POLICIES

As the Committee gropes for an answer to this dilemma, it may find a variety of reasons for giving interest rates a prominent place in its deliberations, including:

1. Interest rates can potentially be used to help control the monetary aggregates.
2. Interest rates can be used as a stepping stone to countercyclical goals.
3. Interest-rate control can be used to stabilize credit markets.
4. Interest rates can, from time to time, enter directly as a goal of economic policy.

How the FOMC comes out on these issues will determine the role and direction of interest-rate policy in the future.

Interest Rates and Control of the Aggregates. Control of monetary aggregates such as M_1 and M_2 is not a trivial problem.[2] As a practical matter, the Open Market Committee has direct short-term control only over its own portfolio (or some closely related aggregate such as reserves) and interest rates. Its influence on the money stock must therefore proceed indirectly through the size and mix of the System Open Market's portfolio, through interest rates, or through some combination of the two.

From a purely theoretical standpoint, therefore, interest rates might be a useful bridge to the money supply. The FOMC has discussed this possibility, but I think most members now believe that they can influence the broad monetary aggregates more successfully by targeting narrow aggregates such as RPDs.

This view rests to some extent on tentative evidence accumulated by staff economists in the System, but mostly it is based on the Committee's experience in recent years. On several occasions, some members of the Committee have felt, in retrospect, that they lost control of the aggregates because of excessive concentration on interest rates. Looking into the future, therefore, my guess is that the Committee will continue to try to influence the aggregates more through reserves than through interest rates.

Interest Rate Control and Countercyclical Monetary Policy. The future role of interest rates will depend, secondly, on where the Federal Open Market Committee comes out on the question of rates *versus* aggregates in achieving its countercyclical goal. As I have said, the FOMC has switched from a strategy that relied almost exclusively on money market conditions to a strategy that recognizes value in both the aggregates and money market conditions.

The Committee has adopted an essentially eclectic position for two reasons. First, as a group it does not believe that the state of the economic arts allows a clear choice between the two. Some members tend to lean in one direction, some in the other, but few are entirely convinced of either view. Second, there is a general belief among Committee members that the economy and the policy problem are too com-

[2] M_1, or total money narrowly-defined, includes coin, currency, and demand deposits. M_2, or total of money broadly-defined, includes coin, currency, demand deposits, and most time deposits at commercial banks.

plex to yield to simple either/or choices made once and for all. The Committee would rather keep its options open.

As I look ahead, I see that the inroads made by the monetary aggregates into countercyclical policy will be permanent. In fact, I would guess that the Committee might well push control of the aggregates further if the current experiment with RPDs turns out to be successful. But I have difficulty seeing the FOMC going all the way to make the aggregates the sole guide to countercyclical policy.

Interest Rates and Credit Market Stability. The role of interest rates in the future will depend, thirdly, on the importance of a long-standing goal of policy: stability of the credit market.

This is one of the most controversial goals of the central bank. On the one hand, it has been attacked as an unnecessary subsidy to dealers in the credit market at best, and a cause of economic instability at worst. On the other, it has been supported as the first line of defense against financial panics, essential for the maintenance of efficient credit markets, and a crucial contributor to smooth Government debt operations.

The validity of each of these points has been debated widely, and time does not allow a review of them in detail here. I believe the FOMC would agree that it has an important obligation to preserve some degree of stability in credit markets. Certainly, it sees as one of its responsibilities the avoidance of cumulative financial distress such as that threatened at the time of the Penn Central bankruptcy. Whether it would see stabilization of the credit markets as always consistent with its other goals is more difficult to say.

On a day-in-day-out basis, fostering stability in credit markets generally means providing smooth and orderly movements in interest rates. It is possible, of course, to minimize very rapid day-to-day swings in interest rates while providing sufficient month-to-month movement to achieve other goals, especially those involving the monetary aggregates. A tradeoff between interest rates and aggregates develops only when interest-rate stabilization extends over long periods of time. The danger is that a policy aimed essentially at smoothing day-to-day rate movements will tend to drag on into weeks and perhaps even months at the expense of other objectives. The danger is compounded by the fact that policy is ordinarily made by a series of fairly short-run decisions. Unless longer-run goals are constantly in mind, stabilization of interest rates can get in the way of other countercyclical objectives.

Interest Rates as an Ultimate Goal of Policy. A fourth determinant of the role of interest rates in monetary policy will be how they enter directly into society's or the Government's utility function. A special case today is the relationship between interest rates and direct controls. A legitimate case can be made on equity grounds that when some income receivers are restricted, earners of interest income should not be allowed off the "control hook." This argument, taken by itself, leads many to believe that increases in interest rates—as well as wages, prices, and dividends—should somehow be limited.

The problem, of course, is twofold. If the attempt is to restrict increases in interest rates in general by an expansive monetary policy, the result can not only be inflationary but also self-defeating as inflation premiums themselves push up interest rates. If the attempt is to limit increases in specific kinds of interest rates, the result can be a misallocation of resources among various uses of credit.

The Committee on Interest and Dividends has recognized both of these dangers. In an early statement of policy, its chairman stressed the need for flexibility of interest rates for countercyclical purposes.

> Arbitrary attempts to control interest rates, either in selected areas or for the economy as a whole, must be rejected as inefficient, inequitable and, in the end, unworkable for all concerned.[3]

The Committee also has made clear that its efforts to hold down specific kinds of rates are directed toward making the credit markets more flexible and effective as an allocator of funds and resources.

Nevertheless, the strong political and social overtones implicit in the public's attitude toward interest rates place the FOMC in a potentially difficult position in a period of direct controls. On the one hand, the FOMC must take into account these considerations in deciding on the most appropriate policy to follow with respect to interest rates. But, on the other hand, the FOMC has to avoid the temptation of seeing every period as somehow special and somehow worthy of abandoning long-run goals of economic policy. To adopt such an attitude uncritically could lead to abandonment of the responsibilities of a central bank as one "special" period blends into the next.

[3] Testimony by Arthur F. Burns before Committee on Banking and Currency, House of Representatives, November 1, 1971.

CONCLUSION

So, in conclusion, what is the likely future role of interest rates in monetary policy?

In recent years the FOMC has tended to concentrate its actions more heavily on the monetary aggregates. It has not, however, been willing to move to the extreme of abandoning interest-rate policies entirely, nor is it likely to do so.

The aggregates seem to be firmly entrenched as a tool of countercyclical policy and may make further inroads. Countercyclical policy, however, is not the Fed's only goal. Two other important ones are credit market stability and, from time to time, interest rates themselves.

Speaking for myself, I continue to see countercyclical goals as the Fed's primary responsibility over the long haul. I would not, however, be willing to reject other important goals of policy. The problem will be in choosing when and for how long to yield temporarily on countercyclical targets in favor of other legitimate goals. ■

the nation's liquid assets: a shrinking share for money

by hsiung tarasanar

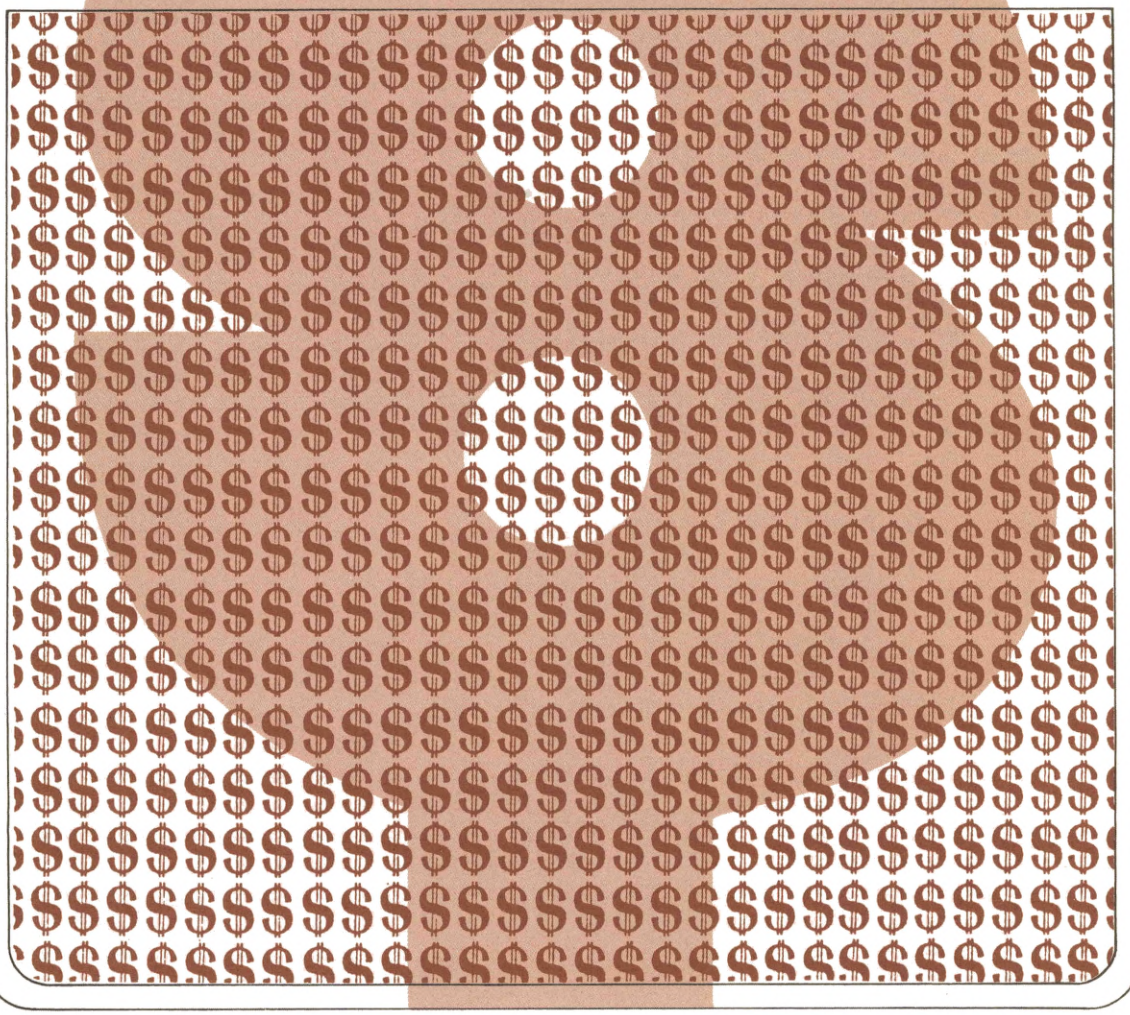
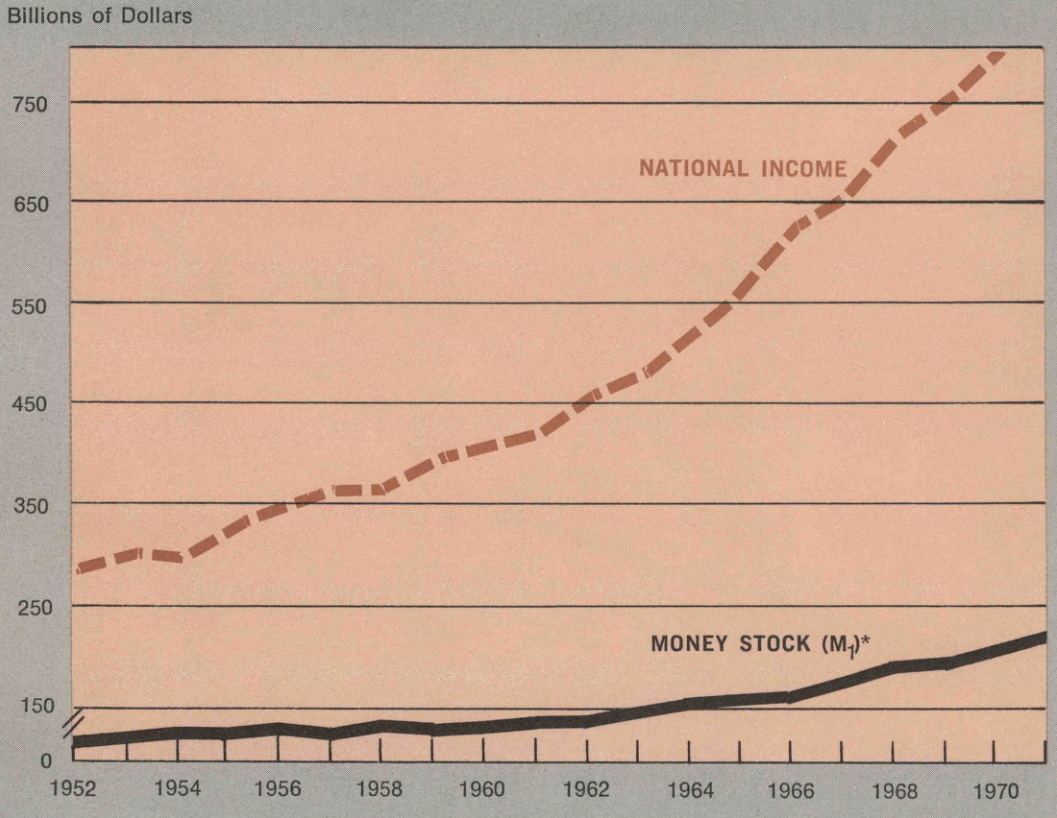


CHART 1

DURING THE PAST TWENTY YEARS GROWTH IN THE NATION'S MONEY STOCK HAS NOT KEPT PACE WITH GAINS IN NATIONAL INCOME



*Coins, currency, and demand deposits

Source: Board of Governors Federal Reserve System

CHART 2

YET, TOTAL LIQUID ASSETS HAVE BEEN KEEPING UP . . .

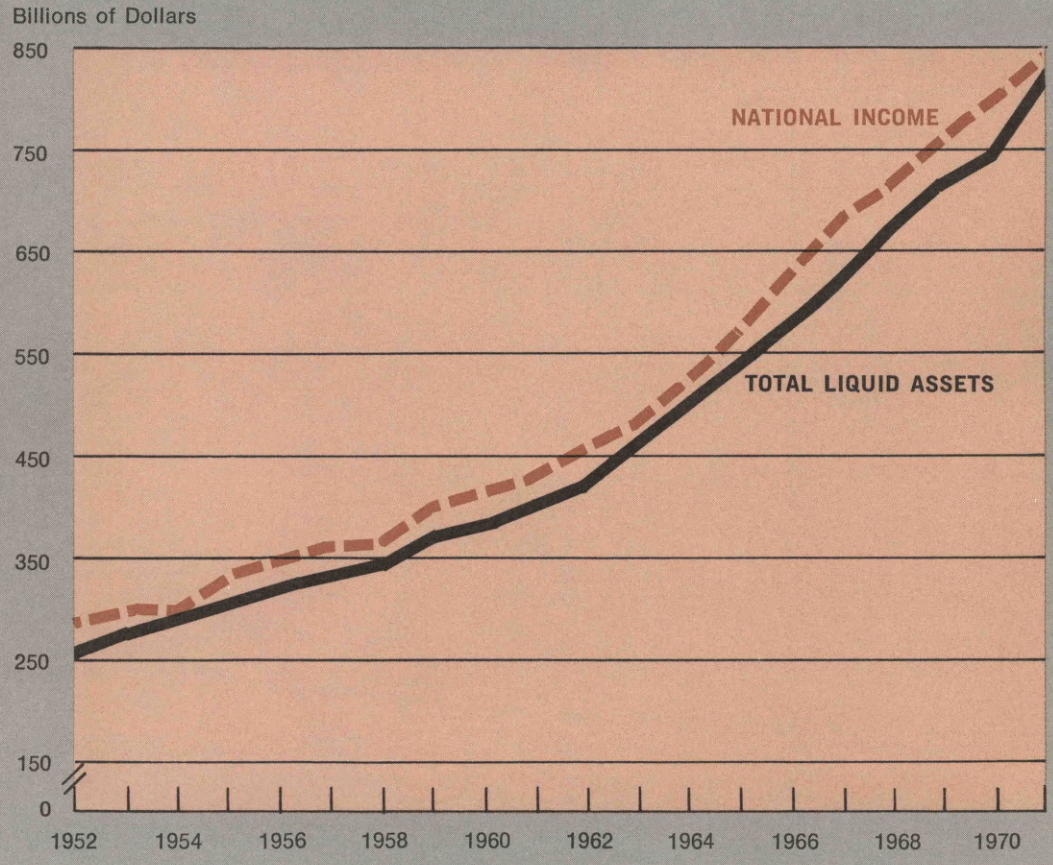


CHART 3

THANKS TO HEFTY INCREASES IN TIME AND SAVINGS DEPOSITS

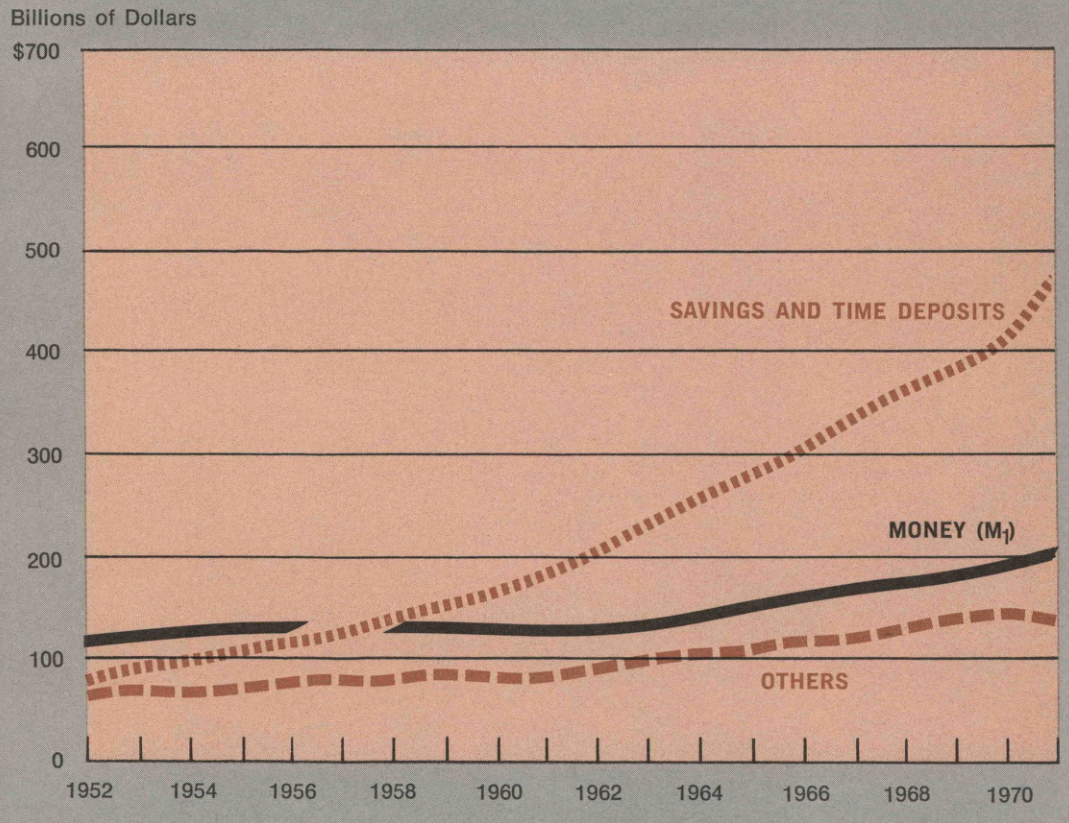
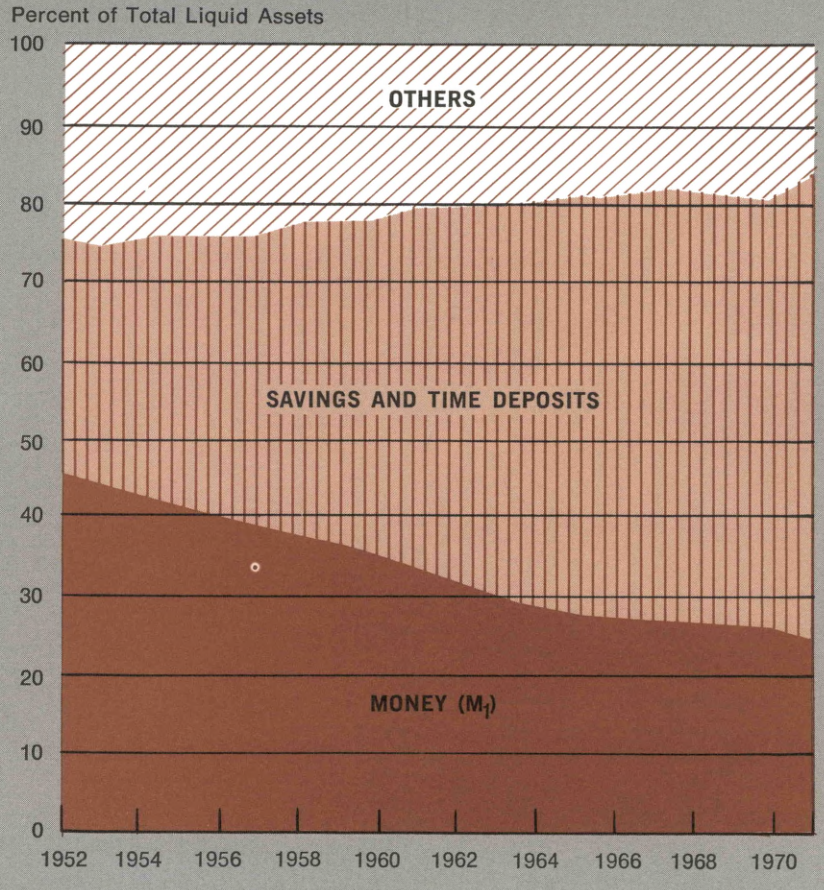


CHART 4

THUS, TODAY, MONEY ACCOUNTS FOR A SMALLER PORTION OF OUR TOTAL LIQUID ASSETS THAN IT DID TWO DECADES AGO



Inflation and Unemployment: The Great Debate

by James M. O'Brien

At long last the economic engine is getting up a full head of steam. Production is moving ahead at a rapid pace and unemployment is coming down from the high levels of '71. But Government decision-makers will have little time to rest as they now must begin to set the tone for Uncle Sam's fiscal and monetary policies over the longer haul. A major issue will be how to weigh holding the line on inflation versus achieving further declines in the unemployment rate.

Until recently most economists believed that the New Economics clearly spelled out the choices for policymakers. Monetary and fiscal (or demand management) policies are used by the Government to influence the total volume of spending in the economy. According to the New Economics, when total spending is kept at a brisk pace, the nation's production and, consequently, employment can be maintained at high levels. With a high rate of spending, prices will be rising and profit-minded businessmen will have an incentive to keep production lines humming. Thus, the New Economics hangs its hat on a "tradeoff" between inflation and unemployment. If, on the one hand, policymakers are willing to put the economy on a high inflation turnpike, they can buy a low unemployment rate.[1] If, on the other hand, they want to travel a low inflation road, they can do so but only at a cost of longer jobless lines.

While the New Economics is now part of the conventional wisdom, something of a retreat to the "old" or classical economics has begun to gather momentum in professional ranks. According to an increasing

[1] Government policymakers would not, of course, *directly* aim their policies at creating inflation but both economic thinking and historical experience indicate that if the rate of change in total spending is increased to a higher level, inflation will be greater than it otherwise would have been.

minority, the experience of the late 1960s bared the Achilles heel of the New Economics and the notion of a tradeoff between inflation and unemployment. While lower unemployment accompanied the higher inflation of the mid-'60s, unemployment refused to budge as inflation accelerated in the closing years of the decade. This group of economists argues that this resulted because inflation can lower unemployment only temporarily. Attempting to preserve the "low" unemployment level will lead to *accelerating* rates of inflation which cannot be tolerated for long. Those subscribing to this view have been dubbed Accelerationists. In effect, they are reiterating the doctrine of an earlier era and are contending that stable prices (or a stable inflation rate) is the only achievable goal within the reach of monetary and fiscal policymakers. The demand managers shouldn't be concerned about unemployment because they can't do much about it for long.

Put under the gun, supporters of the New Economics have mounted a counterattack. They still uphold the importance of a high employment goal for monetary and fiscal policymakers. The Accelerationists' conclusion, they charge, is too much out of the textbook and doesn't accurately reflect the real world.[2]

THE ACCELERATIONIST ATTACK

The Accelerationists draw their intellectual ammunition from the "old" or classical economics. Before the advent of the New Economics, professors often taught their students that the economic world could be split into two levels. At the nitty-gritty level are the "real," or fundamental, factors of the economic structure—labor and other resource supplies, technology, entrepreneurship, and consumer preferences. The interaction of these "real" factors dictates a nation's production of goods and services and, hence, the level of employment. It also establishes the rate at which each commodity can be exchanged on the market for every other one. At one level removed from real factors is the money economy where items for sale and resources for hire have *dollar* price tags attached. Except for short periods of time, it is only at this level that monetary policies can have their say. Government can shower its citizens with more green paper, but the result eventually will be higher price tags rather than changes in output and employment. In short, jobs and production cannot be increased merely by running the Government's printing press at a faster clip.

Suppose, for example, the economy has been chugging along for some time with stable prices but with the unemployment rate at 5 percent. And suppose that even though this is the unemployment rate determined by interaction of the economy's "real" factors, it is deemed too high by Government officials. If, say, the shoemaker is to be coaxed into increasing the number of his assistants, he will have to find it profitable to produce more shoes. At first glance, expansionary Government policies,

[2] Focal points for the two sides of this debate can be found in Milton Friedman's presidential address delivered at the Eightieth Annual Meeting of the American Economic Association, 1967; and in James Tobin's presidential address at the Eighty-Fourth Meeting, 1971. In his address, Tobin counters the arguments of Friedman and other Accelerationists.

Students of contemporary economics often use the term New Economics to refer to the economic doctrines of John Maynard Keynes and his "followers," the "Keynesians." The term classical economics usually refers to the economic doctrines which Keynes and the Keynesians attacked and which dominated economic thinking in the first third of the twentieth century. However, a recent article finds that the doctrines of the New Economics may not be so new and the current debate by no means historically unprecedented (see J. H. Wood, "Money and Output: Keynes and Friedman in Historical Perspective," *Business Review* of the Federal Reserve Bank of Philadelphia, September 1972, pp. 3-12).

which put more money in people's pockets would appear to do the trick. With more customers knocking on his door, the shoemaker's wares will command higher prices. In this profitable situation, he will want to supply more shoes. At current wage levels more assistants will be demanded. Since a sudden spurt in prices will at first be viewed by workers as a temporary aberration, they will have little incentive to push for more favorable wage contracts. Hence more assistants will be put on the payroll, thereby reducing the out-of-work tally.

However, the Accelerationists predict that attempting to maintain the employment gains would set the economy on an inflationary treadmill that is self-defeating. Eventually with rising prices continuing, assistant shoemakers will come to regard inflation as a way of life. Since their concern will be with the purchasing power of their wages *(real wages),* they will want inflation accounted for in wage agreements. If an hour's work earned them a steak yesterday they will not settle with hamburger for an hour's work today. As wages move into line with prices, profit margins will be squeezed, cost cutting will occur, and employment will be cut back. Another injection of money into the economy and a further step-up in inflation will be needed to put the extra assistants back on the payroll. But pretty soon wage demands will again include offsets for the new higher inflation and employment will again retreat. And another round will have to begin. . . .

Thus, these renovated classical economists conclude that in the long run the Government is fighting a losing battle if, through an inflationary policy, it tries to pin the unemployment rate beneath that ground out by the economic "fundamentals." Although the Accelerationists are not certain what this "natural" rate of unemployment might be, current bets range from 4 to 6 percent for the United States.

THE COUNTERATTACK

Supporters of the New Economics direct their counterattack against an *untested* acceptance of the Accelerationist conclusion that attempts to maintain a "low" unemployment rate will result in accelerating rates of inflation. They note the importance of the concept that the worker be concerned with his *real* wage to the Accelerationist conclusion. Most New Economists would agree that the real wage principle is sound. But they ask, how long would it be before higher inflation is fully anticipated and fully adjusted to by *most* workers in their wage demands? If it takes generations for adjustments to be completed, then a lot of employment gains might be bought before accelerating inflation becomes a problem.[3]

The New Economists point out that historical and social settings can play an important role in determining a worker's wage. For example, the mill operator with seniority, a mortgaged home, and several kids may not find it worthwhile to present his boss with an ultimatum if his wage (other things equal) doesn't keep pace with the price of steak. Or the assistant shoemaker may not find it desirous to pull up stakes as higher wages beckon him elsewhere. And if the younger generations find it difficult to break childhood ties, for some localities and some industries wage demands may lag a higher inflation pace for quite awhile. Thus, higher inflation could coax employers into maintaining a greater work force for many years.[4]

[3] Another argument by some New Economists is that our economics is not yet so polished that we can confidently predict what will result even in the "long run."

[4] Employment expansion would also spread beyond the industries where wage demands failed to reflect fully the higher inflation. For example, as textile manufacturers increase their employment and supply more material to customers in the apparel business, more workers will also be needed to produce more clothing.

For nearly 15 years the New Economists have been examining the facts to see if higher inflation could really help the unemployment picture. Starting in the late 1950s they began putting various countries under the economic microscope. They found as a country moved up on the inflation scale it usually moved down on the unemployment scale.[5] The inflation experiences of the various countries tended to be of the stop-and-go variety. As a result, wage earners probably did not have enough time to anticipate fully the movements to higher (lower) rates of inflation. These early studies help to confirm the view that increasing inflation, when it is not fully expected, can reduce unemployment. But there still remained the important issue of whether higher inflation could bring the unemployment rate down *when the inflation is fully expected by workers.*

The experts have recently set out to build statistical mousetraps that could catch the elusive effects of fully expected, or long term, inflation. These newer models give some ground to the Accelerationist thesis but, more important, fail to go to the full distance. It appears to be true that as the worker comes to expect higher inflation, paychecks will move ahead at a faster pace and previous employment gains will take some lumps. But these recent experiments indicate that when higher inflation is completely expected, average wage demands still don't fully compensate for it. Thus, according to the evidence, even when the faster pace in inflation is taking nobody by surprise, some employment gains will remain.[6] Although for how long is still uncertain (see Box).

The New Economists do not deny the economic principles behind the Accelerationists' attack. Instead, they claim, the practical importance of these principles on any particular issue can only be determined by studying the facts. The facts, they contend, indicate that the notion of buying less unemployment with inflation should not be rejected by policymakers.

A POLICY FOR ALL PERSUASIONS?

The Accelerationists have enunciated the objections of modern classical economists to employment goals which depend on money and spending policies. They direly predict that accelerating rates of inflation will face any economy whose policymakers continually shoot for a "low" unemployment target with monetary and fiscal policy. The only suitable goal for these policy tools is the achieving of price (or inflation) stability, they argue. The New Economists, in turn, claim that the everyday world is full of "frictions" which can easily prevent the Accelerationists' conclusion from occurring. Employment *is* a legitimate goal of monetary and fiscal policy. It is foolish, they conclude, to settle for high unemployment and reduced production today because of concern over an uncertain inflation prob-

[5] These findings of an inverse relation between historical inflation rates and historical unemployment rates were given the name Phillips curves after the Australian economist, A. W. Phillips who, in 1958, published a study showing the relation between (wage) inflation and unemployment for the British economy. The relationship was later shown to exist for numerous other countries including the United States.

[6] These recent studies point up the weakness of the late 1960s as evidence supporting the Accelerationist conclusion. Both the Accelerationists and the New Economists agree that unexpected inflation can result in a lower unemployment rate than that resulting from expected inflation. The late 1960s offers some confirmation of this view. As inflation became expected by workers, it took more inflation to keep the same unemployment rate. The 1960s need not indicate anything on the point where the two sides differ—whether or not there are any employment gains from *expected* inflation.

A CLOSER LOOK AT THE TRADEOFF EVIDENCE

Estimated Inflation—Unemployment Tradeoff*

Unemployment Rate (Percent)	Inflation Rate (Percent)
3.0	7.3
4.0	5.1
5.0	3.3
6.0	1.9
7.0	0.6

The numbers in the table represent estimates from one of the recent studies of the current inflation-unemployment tradeoff *when inflation is fully anticipated by workers.* For example, to achieve a 5 percent rate of unemployment would require a 3.3 percent rate of inflation, given the structure of existing labor and product markets. A 6 percent rate of unemployment would correspondingly be associated with a 1.9 percent rate of inflation, and so on.

This and other recent studies have found that the current tradeoff between inflation and unemployment is somewhat worse than it was in the 1950s. The studies found that this could be statistically explained by structural changes in the labor force—the increasing proportion of young and female workers who have above average unemployment rates and the greater dispersion in unemployment rates among age-sex categories.

The crucial difference between the earlier and more recent studies is that the latter attempted to measure the effect of inflation on wage changes when this inflation is expected. These recent studies found that when workers fully expect an increase in the inflation pace, their wage increase demands rise less than proportionally to the anticipated price increases. Thus, even inflation that does not surprise workers enchances the producer's profit picture, inducing him to increase employment, the studies concluded.

However, a possibly important weakness in these studies is the need to use an estimated measure of workers' inflation expectations since their actual expectations are unknown. The most popular method has been to assume that the typical worker takes a weighted average of past inflation rates to project the future course of inflation. The criticism leveled at this measure concerns the assumption that the worker looks only at past inflationary experiences. For example, if the worker expects a reduction in price increases because the Government announced tighter economic policies, a

* The results in this table are from Robert J. Gordon, "Inflation in Recession and Recovery," *Brookings Papers on Economic Activity* 1 (1971): 105-158. The unemployment rate refers to the "official" unemployment rate as measured by the Bureau of Labor Statistics and the inflation rate refers to an implicit deflator nonfarm price index.

weighted average of past price hikes would overestimate the worker's inflation expectations. Generally, if the measure of expected inflation is subject to important error, the estimated relationship between wage hikes and expected price hikes will tend to be less than the true relationship.

A second method uses inflation forecasts of business economists gathered over the last quarter of a century. While this is a true measure of anticipated inflation, it may not represent the expectations of workers. Thus, this measure is also subject to error and, hence, the same bias as the use of past price hikes. Because of the possibly serious deficiency in the measures of expected inflation used, some economists have been reluctant to accept the conclusions of the more recent studies.

lem that might more properly belong to our children's children.

While economists debate, policymakers must act. One option midway between these two views worth considering would be to set a moderately high but *steady* inflation goal for demand management policies rather than an unemployment goal. If the New Economists are right, then higher inflation will keep a lot of people off the unemployment lines.[7] If the Accelerationists are right, then at least there won't be the prospect of accelerating inflation that would follow an attempt to push unemployment too low. Accompanying this form of action, could be attempts by the Government to reduce further the costs of inflation to individuals.[8]

Whether or not inflation continues to remain anathema to policymakers, there is an alternative approach to the unemployment problem. Both Accelerationists and New Economists alike have urged the Government to play a stronger role in reducing the frictions hampering the economic wheels of labor markets. It is suggested, for example, that Uncle Sam might make it easier for the worker to pick up his things and move when better job opportunities lie elsewhere. This would help relieve the unemployment problem when certain regions become economically depressed. Serving the same end would be a greater use of manpower or retraining programs which would ease the transition from old to new skills. Other changes that would most likely ease the unemployment picture are reductions in restrictive practices on hiring nonunion workers and relaxation of minimum wage laws. From the Accelerationists' view this would reduce the unemployment rate the economy must ultimately settle on. From the New Economists' position of vantage, this could reduce or eliminate the need for inflation to reach an acceptable employment level. ■

[7] The higher inflation policy might also cause an initial slowdown in some workers' real wages. However, the average standard of living of members in the *labor force* should rise as the number unemployed recedes.

[8] For example, in 1973 social security payments will be directly linked to the Consumer Price Index. Other possible areas into which "escalator" clauses could be introduced are private pensions and interest payments on securities. Although as some New Economists have suggested, tying income derived from wages to inflation "escalator clauses" would likely tend to reduce the employment gains generated by higher inflation.

FORECASTS FOR 1973 NOW AVAILABLE

The Department of Research has compiled and analyzed a number of predictions for 1973 made by businessmen, economists, and Government officials. This compilation includes a summary of forecasts for the economy as a whole as well as for particular sectors of the economy. The more important indicators are presented in chart form.

Copies of this release are available upon request from Public Services, Federal Reserve Bank of Philadelphia, Philadelphia, Pennsylvania 19101.

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