INFLATION -- BURDEN ON THE YOUNG

Remarks of
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I'm glad to be in Boise once again, and delighted to see an audience that's much younger and better looking than those I usually speak to. Of course, I'm not sure that all of you are vitally interested in economic affairs. But I would guess, to take an obvious case, that most of you care very much about the prices you must pay for your textbooks and cafeteria food -- and about the chances you have of landing a job when you leave this campus. It's these two questions -- employment and (especially) inflation -- that I'd like to discuss today.

Employment Problems

Many of you who are seniors will be out on the job market next spring. Others have somewhat more time to spend with the books before you make your entry into the world of work. What is it going to be like? Well, that of course depends upon your area of specialization, but I can tell you that in general it will not be as good as it was for those who got their degrees some 10 to 15 years ago. That was a sort of golden age for the college graduate, with employers scouring the campuses in search of graduates of all types. Today, in contrast, you hear stories on every hand of history majors driving cabs and English majors working as short-order cooks.

A part of this lies in the difficulty of high-school seniors (or anybody else) making predictions about the future. You may have noticed that the market for engineers (to take one example) has been very strong recently. Will that market be just as fantastic four years
from now? Well, that depends upon future business requirements for engineers -- and also upon today's students' decisions about what business demand will be. In other words, if every third person entering college last month decided that engineering was where the action was, then four years from now there would be a lot of engineers driving cabs along with those history majors.

Now, the type of job problems which we have been discussing are extremely important, but are outside the realm in which we in the Federal Reserve System have any direct influence. In other words, we cannot tell students which fields will be characterized by good or bad job markets several years from now. What we can do is to work to achieve a healthy and growing economy that can, on average, provide jobs for all of the new entrants to the market each year.

Over the past decade, the national economy created new jobs for roughly 19 million people -- an unprecedented 24-percent increase for the decade. This increase included not only new high-school and college graduates, but also a large number of women who decided to re-enter the labor force after a period of homemaking and child rearing. Of course it's impossible to keep up that sort of pace indefinitely -- and indeed the number of jobs has dropped by about a million during the current recession. Despite recent signs of an improvement in the economy, we can't be sure how strong the job market will be in the period ahead. We can be sure, however, that an even worse recession will strike if we don't bring under control the severe inflation that's been undermining our economy for so long.
Inflation Problems

Well, what about the fact that the prices you pay for tuition, for books, for food, and for everything else have been rising at what seems an unmanageable pace? There's no doubt that inflation has replaced famine and pestilence as one of the major scourges of modern civilization. No one is immune. Every year, the value of the dollar bills in your purses and wallets falls a little bit farther. Even though you get paid a little bit more for those summer and part-time jobs, generally you can consider yourself lucky if you just manage to keep your head above water.

After taxes and inflation, the average person in this country is about 10 percent better off than he or she was a half-decade ago. That represents considerably slower growth in living standards than we achieved in the preceding half-decade. And students may be in even worse shape, since the prices of the items which dominate your budgets -- things like food, tuition, books and rent -- have been rising even more rapidly than the overall rate of inflation. In fact, I know of only one place in the world where it is still comfortable to be a student. In Saudi Arabia, students get totally free tuition, plus free room and board and $200 a month for pocket money.

Of course, the Saudis have something that we do not -- a huge quantity of high-priced exportable oil, whose price has increased about 15-fold over the past decade. Among the beneficiaries of the surplus oil revenues have been Saudi students. We too have been blessed in the past by similar bountiful resources, and we have translated them into higher living standards through the productivity of our workers and
machines. But our living standards have lagged recently because of lagging productivity -- which suggests a strong need for us to overhaul our tax and other policies to stimulate productivity growth.

One policy area where we've gone astray in the past has had to do with the relation between jobs and prices. For some time, we believed that we had a choice between one of two evils -- inflation and unemployment. Specifically, faced with high unemployment, we thought all we had to do was to turn on the switch labeled deficit spending and easy money, which would create a little inflation and pull down the unemployment rate. The implicit judgment, of course, was that society was better off with full employment and a little inflation, than with high unemployment and no inflation.

Unfortunately, we have found lately that life isn't that simple. Indeed, most recent studies seem to show that rapid money growth and inflation actually create unemployment. I won't go into the technical details, but I'll give you an example which may help. During the 1973-75 period, this country went through the deepest and longest recession since the Great Depression of the 1930's. There was a time when that sort of event would be accompanied by an actual decline in prices. Not so this time -- in fact, prices rose more rapidly during that period than at any other time since the price surge following World War II. Our experience has been comparable during the current (1980) recession. This record of high unemployment plus double-digit inflation has destroyed whatever faith we may have had in a strict trade-off between inflation and unemployment.
But suppose the earlier belief was true, that we could obtain some improvement in jobs at the expense of constantly rising prices. Could we live with the resultant inflation? Let's look at the historical record, and what may lie in store for us. Needless to say, we've experienced inflationary episodes before in our history, but most were associated with major wars. But now prices have continued their unrelenting ascent for several decades, in wartime and peacetime alike, and it has gotten worse with each decade. During the 1950's, consumer prices rose at a modest 2.1-percent annual rate. The rate began accelerating in the mid-1960's -- and then in the 1970's, prices rose at a 7.9-percent average annual rate.

Let me put this in concrete terms. Suppose that each of you seniors gets a job next June paying $13,000 -- an average income for a new graduate. Now suppose that your boss, being a kindly person, promises to increase your salary each year by the rate of inflation (which we conservatively assume to be 7.9 percent) in order to preserve the purchasing power you had when you began work. With such an arrangement, in 20 years you'd be making roughly $59,000 -- though this income would buy no more food, clothing, shelter or anything else than $13,000 did back in 1980. Worse still, after taxes you would be buying considerably less than you did 20 years earlier, because you would then be up in those income-tax brackets which we think only apply to fat cats. Within 20 years you would be paying more than 40 percent of your income to Uncle Sam, compared to roughly 20 percent today. So, unless we alter
our system of taxation, or get rid of inflation, you all may become
victims of the silent squeeze.

Now let's consider a situation where inflation blatantly discriminates
against the younger generation -- the housing market. Inflation has
helped many people in my generation to build up substantial equity values
in their homes in recent decades -- by some estimates, this inflation-
bloated equity now exceeds one trillion dollars. But first-time
homebuyers in the younger generation are not so lucky. Because of high
housing prices, which average $100,000 or more in some sections of my
state, first-time homebuyers find it all but impossible to accumulate
the downpayment for a new home. Because of inflation-bloated mortgage-
interest rates, those would-be purchasers can't meet the monthly payments,
even if they can somehow scrape together the downpayment. Their elders
can move from home to home, utilizing the inflation-boosted equity
amassed in earlier decades, but most young people are effectively frozen
out of the home-buying market.

Causes of Inflation

Judging from all the election-year opinion polls, the public has
come to recognize that inflation is a severe disease that could undermine
our entire economy. But how did we get into this fix? Part of the
problem lies with "shocks" to the economy. We're now suffering from our
second major oil-price shock, represented by the doubling of OPEC
crude-oil prices last year. Moreover, despite the current glut, a rising
trend of energy prices can be expected over the longer term, with the
gradual depletion of the world's low-cost oil reserves. Food prices are likely to rise sharply in the period immediately ahead, as a result of the severe weather problems affecting food production worldwide. By some estimates, food prices could rise at a 15-percent annual rate over the next year -- double the increase of the past year.

We may not be able to do too much about the shocks affecting food and energy prices. But we can do much more to limit the underlying inflation rate which affects the other three-fourths of our household budgets. Throughout much of the past decade, the underlying or core rate of inflation was below 6 percent; over the past year, it approached 9 percent. That price upsurge reflected two factors. One was the excessive money growth of past years, when monetary policy was pushed off course by the excess credit demands created by Federal deficit financing and other forces. The price rise also reflected an upsurge in unit labor costs, because of sharp gains in labor compensation in the face of declining productivity.

The Federal Reserve, recognizing that price stability requires a progressive reduction in money-supply growth, moved aggressively last fall to enforce its anti-inflation policy decisions. To that end, the Fed began to place more emphasis on controlling money-supply growth, and less emphasis on minimizing short-term fluctuations in interest rates. The policy has been broadly successful, despite major fluctuations around the growth trend. In the six-month period prior to last fall's policy shift, the M-1B money supply (currency plus check-type deposits) increased at more than a 10-percent annual rate; since that time, however, the money supply has increased at only about a 6-percent rate.
The historical record suggests that any prolonged reduction of money growth will be followed, with a lag of two years or so, by a reduction in the underlying inflation rate. The past year's deceleration in money growth thus should have favorable results for prices, especially if the Fed is successful with its announced policy of bringing about further deceleration in coming years. But a period of sustained price stability cannot be assured until we control those forces which have led to the past record of excessive money creation -- primarily such factors as excessive Federal-deficit spending.

Fiscal Policy and Inflation

No one can deny the close connection between the doubling of prices and the upsurge of deficit financing over the past decade. The combined Federal deficits of the 1970's reached $315 billion -- about the same as the total of all deficits recorded in the nation's entire earlier history. The Federal government continued to run huge deficits, instead of surpluses as it should, throughout the 1975-79 period -- one of the longest business expansions of the past generation. In the fiscal year just ended, the recession led to a near-record deficit of about $61 billion. And in the new fiscal year, despite all the earlier talk of a surplus, we may expect at least a $30-billion deficit -- even if no tax cut is enacted.

Of course, tax-cut proposals are popular today, and not simply because this is an election year. Indeed, without a tax cut, the tax burden on most people would rise significantly in 1981, by more than $50 billion if present laws remain unchanged. A combination of inflation
and a "progressive" income-tax structure could generate an extra $20 billion in tax revenues. Another $17 billion is expected from higher social-security taxes, because of the need to pay benefits that rise constantly as a result of being indexed to inflation. And yet another $15 billion or so is likely to result from the "windfall" profits tax on oil companies.

A good case can be made for tax reductions, first to reduce the tax burden on the nation's people, and secondly to stimulate job-creating and productivity-enhancing business investment. However, I would give equal importance to sharp spending cutbacks, which are essential if we hope to reduce the government sector's excessive demands on the nation's resources. The task won't be easy, especially in view of the bipartisan support for a 25-percent increase in defense spending (in real terms) over the next half-decade. But prudent reductions across a wide range of nondefense programs are both possible and necessary. In this connection, the Congressional Budget Office last spring provided a list of 58 areas which could yield perhaps $233 billion in budget cutbacks over a five-year period. For example, changes in indexing requirements for social-security benefits and other programs alone could yield $70 billion in savings.

Concluding Remarks

Finally, what can you personally, as one of the most informed segments of our electorate, do about inflation? Well, some of you will become economists and financial analysts, and spend much time studying
the problem of inflation. Others will become journalists and TV commentators, occasionally dealing with inflation and other economic phenomena. To these people, I would urge that you spend several days in the coming year just trying to sort out for yourselves the causes and cures of inflation. I would urge you to read several good articles or books on the subject -- if your professors haven't already given you a bibliography, we'll be happy to send you some Federal Reserve materials on the subject. In any event, you owe it both to yourselves and to your future public to develop a solid understanding of this problem.

Now for the rest of you -- you chemists, geologists, ranchers, historians and the like. Even though you may seldom come across the word inflation (which now seems increasingly unlikely), you will be affected by inflation no matter where you work or live. You can, however, do something about it. First, I would urge you also to make a brief intensive study of inflation, since it is important that you develop a basic understanding of the problem. Then, I would urge you to write those people you're sending to Congress and express your concern about inflation. As it stands, most letters to Congress simply ask Senators and Representatives to spend more money for this or that pet project, which of course only means votes for more inflation. What they need are some votes for less inflation. But above all, remember that inflation is not an act of God; it is a man-made problem with man-made solutions. With a little bit of work devoted to understanding and acting on the problem, you -- all of you -- can be part of the solution.

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