

A Monetary Problem

Learning—and forgetting—the lessons of inflation.

BY IRWIN M. STELZER

When the teaching of economics involved a bit more common sense and a lot less mathematics, we told our students that inflation occurred when there was too much money chasing too few goods. As always, Milton Friedman said it better: "Inflation is always and everywhere a monetary phenomenon."

To Robert J. Samuelson, the distinguished and always sensible *Washington Post* and *Newsweek* columnist, it is some-

**The Great Inflation
and Its Aftermath**
*The Past and Future
of American Affluence*
by Robert J. Samuelson
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thing more than that. The economy, he argues, "is a social, political and psychological process . . . changes in ideas, institutions, values and beliefs can alter the economy just as much—and sometimes more than—new technologies, changes in prices or shifts in interest rates."

A bit mushy for the taste of most economists, especially those who would capture the working of our economy in an economic model. But an idea worth considering.

As is Samuelson's argument that the great inflation that began in the mid-1960s—and that Ronald Reagan finally squashed, not without inflicting considerable but temporary pain on workers who lost their jobs—

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profoundly affected “how Americans felt about themselves and their society; how they voted and the nature of their politics; how businesses operated and treated their workers; and how the American economy was connected with the rest of the world. . . . Stable prices provide a sense of security. . . . They are like safe streets.”

This is not the place to recite Samuelson’s carefully drawn history of that inflation. The book is accessible enough for any interested lay reader, and of great relevance to the situation in which we find ourselves today. Samuelson reviews the variety of measures politicians adopted to fight inflation: Richard Nixon’s wage and price controls, Lyndon Johnson’s jawboning of steelmakers and imposition of restrictions on exports of hides to keep leather and shoe prices down, and Jimmy Carter’s appointment of an “inflation czar.” All of these moves made matters worse by obscuring the essential nature of inflation.

Nor was the Federal Reserve much help: “Through its history, the Fed has made many small errors but only two major blunders. The first was permitting the Great Depression; the second was fostering the Great Inflation.” Both of those blunders “stemmed from mistaken ideas that informed the political and intellectual climate” of their day. Among them were the views that it is possible to concede only a bit more inflation to get faster economic growth (the Phillips Curve); that monetary policy has severe limits as an inflation-fighting tool; that we had to grow faster lest the Soviet Union leave us in its wake; that full employment and economic perfection was ours for the taking if only we got policy right; and that there is “an administrative solution to inflation.”

Which brings us back to Milton Friedman. These misapprehensions, and political pressure to keep the economy red hot, lured successive Fed chairmen into keeping monetary policy looser than it should have been, resulting in too much money chasing too few goods. Inflation, it seems, is indeed a monetary phenomenon.

Fast forward to today, and an environment in which deflation tops infla-

tion as policymakers’ principal concern. This book was completed before the credit crisis, the massive government response, and a renewed acceptance of the idea that monetary policy is too weak a tool to rely on when the economy is in distress. But it has important lessons for us.

A “central lesson” that Samuelson would have us learn from the Great Inflation and the policy responses to it is “that ambitious efforts to remedy obvious economic shortcomings can actually make matters worse—that happened then, and it could happen now. The law of unintended consequences went into overdrive and might again.”

Even more relevant, and far scarier in light of President-elect Obama’s rallying of the best and the brightest of the economic profession, is this warning, one that should cause Barack Obama to wake up in the middle of the night in a cold sweat:

What is relevant for our era is that these [failed] policies were not undertaken on ignorant whim. Rather, they embodied the thinking of the nation’s top economists, reflecting a broad consensus among their peers. It was the scholarly respectability of these ideas . . . that recommended them to political leaders and made them easier to sell to the public. . . . A plethora of new taxes, spending programs and regulations, each of which may seem justifiable or involve small cost, could coalesce into a larger burden. The economy’s growth could suffer death by a thousand cuts when no individual cut might matter much.

Now we have entrusted policymaking to a group so loaded with Ivy Leaguers that David Brooks has warned that a terrorist attack on the Harvard-Yale game might bring the government to a halt. Let’s hope that Obama, himself a university-bred intellectual, is aware that the Great Inflation’s “intellectual godfathers were without exception men of impressive intelligence. They were credentialed by some of the nation’s outstanding universities. . . . Academic

pedigree alone is no guarantor of useful knowledge and wisdom. Skepticism ought to qualify and restrain our reformist impulses.”

And yet reform is needed—reform of our entitlements program, our immigration policy, our environmental and energy policies, to mention just a few that weigh on Samuelson’s mind. And reform of regulation of financial institutions, one that weighs on mine.

Rahm Emmanuel has said that the current crisis is an opportunity. If he means an opportunity to launch New Deal Mach II, we are in for some trouble. But if he means an opportunity for

his supercool, intellectual boss to sift through the crisis-fighting ideas that will be thrown at him by his lineup of academic superstars, selecting those that will provide immediate help but eventually reduce the role of government in economic life—leave government a strengthened referee but a less important player—we might, just might, avoid some of the policy errors



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that Samuelson so vividly describes.

If Samuelson errs, it is in attaching too much importance to policymaking. There is a great big economy in the real world beyond Washington. Entrepreneurs have taken, and will take again, risks; venture capitalists will find money to enable them to pursue their dreams; Americans like to work, and work hard; the economy has, in the end, survived the errors of the Washington-centric policy types who have never met a payroll (an oldie but goodie) and will never sell what Charles Krauthammer calls a Schumermobile, which is Sen. Charles Schumer’s price for a GM bailout.

With all of Samuelson’s worries, and most are worth losing some sleep over, we have moved from economic triumph to economic triumph, stumbling at times but making the needed adjustments along the way. We have our problems, and some will not be solved. But capitalism still deserves the two cheers Irving Kristol bestowed on it three decades ago. ♦