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THE SOCIAL AND POLITICAL CHALLENGE OF INFLATION: AN ECONOMIST'S VIEW

Harold T. Shapiro*

There is a new and unusual concern in contemporary America. For the first time since the Great Depression, there is a growing lack of confidence in the capacity of our economic system to deal effectively with its multiple responsibilities.

This Special Issue of the *Journal of Law Reform* has been nourished, at least in an emotional sense, by this same concern. The editors of the *Journal* apparently share the widespread frustration regarding what seem to increasing numbers of citizens as the largely intractable nature of the country's current economic ills. There is a certain apprehension that we may not be able to develop solutions to our lagging productivity, to our continuing inflation and unemployment, to our energy "problem," or to a host of other "economic" issues currently outstanding on the national agenda: unemployment of young people and minorities, environmental decay, economic security, trade policy, and the role of government in guiding our economic destiny.

Our current uneasiness regarding the economy may be part of a broad current in contemporary social thought that calls into question the whole idea of economic progress, an idea that has been one of the foundations of our economic self-consciousness since the founding of the republic. Our growing anxiety about economic matters may also reflect an uneasiness arising from the decline of the United States dominance in world economic affairs. This latter development has important political and social, as well as economic impacts. It implies, for example, that if we wish to maintain our "dominance" in world political and economic affairs we will have to devote an increasing proportion of our output to non-consumption uses.

Of the various challenges before us, the public's attention seems focused primarily on our continuing inflation. We would all agree that the law reflects, if somewhat imperfectly, impor-

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tant dimensions of our cultural and political life. But what relevance does it have for the study and analysis of the continuing inflation we have experienced over the last decade or so? Certainly antitrust statutes, minimum wage legislation, and other legal constraints restrict the freedom of business enterprises to organize production as they see fit, and thus add to the firms' cost of production. In this sense, such statutes, reflecting social as well as economic values, may make prices higher than they would otherwise be. However, unless there are a continuously increasing number of such restrictions, they cannot be blamed for a *continuing* inflation. Similarly, a continuing inflation cannot be fully blamed on OPEC oil prices, harvest failures, domestic oil cartels, labor unions, or new developments in the international monetary system. These factors have their impact to be sure, but their effect is, by and large, relatively short-lived, and they cannot serve as an adequate explanation for a sustained inflation covering a half-decade or longer.

I believe that a *continuing* inflation can only be understood when considering society in its broadest context and not in the narrow confines of economics. Inflation is, at its heart, not simply an economic problem, but a political and social problem. Inflation relates more directly to our political system's response to a changing social agenda than to any unresolved deficiency in our economic system. It is my judgement that our persistent inflation rests primarily on a changing social agenda and a political system which may be somewhat "out of sync," not on any fundamentally new characteristic of the economic system itself.

To understand the basic underlying causes of inflation, we must ask ourselves why our government has persisted, through Democratic and Republican administrations alike, in making the *political choice* of running large budgetary deficits and financing these, in part, by increasing the supply of money. To put the matter more directly, economic policies are forged in the furnace of national politics. The goals of governmental economic policy are selected within a political process where the economic, social, and political interests of different constituencies are balanced against each other.

It is my thesis that inflationary policies are not thrust upon society by an unknowing government, or by a Federal Reserve Board that is somehow inadequate. Rather, these policies represent the government's response to political pressure from constituents who want ever-increasing benefits from the federal government, but who are unwilling to tolerate commensurate increases in taxes. These policies also represent the desire of legis-

lators and other officials to avoid the short-run dislocation costs of increased unemployment and decreased output that might stem from a less inflationary policy.

At the political level, our capacity to select and act on national priorities has become greatly impaired. We stall each other's initiatives and seem to have lost much of our essential capacity for meaningful compromise. It is not that we cannot identify solutions to certain national problems. The problem is that we have lost our capacity to adopt any solutions that may impose a sacrifice on some particular group.

When the federal government is unable to mediate the various demands on the national treasury, it has a short-run, often short-sighted alternative—monetary expansion. When the Congress has finally expended all tax revenue and is unwilling or unable to expand the national debt, it can continue to “satisfy” constituents' demands, at least in the short-run, by printing money. Thus, while no group in society explicitly demands more inflation *per se*, pressures for the government to pursue a more inflationary policy arise from the fact that there are always groups—those who are next in line for federal support—who benefit from such a policy. That is, at any particular moment in time there are groups who believe that financing certain government programs by “printing money” will work very much more to their advantage than either foregoing federal support or being held responsible for tax increases. These groups may be defense contractors, college students, welfare recipients, industries that have just granted large wage increases, farmers—the list is almost endless.

It is a long tradition and an unfortunate failing of the economics profession that little of our effort is spent on analyzing the relationship between the political process and economic policy. The general outlook of economists is that the persistent application of “inappropriate” or inefficient policies (*e.g.*, tariffs) is explained by the personal failings of those in charge of public policy. The possibility that these policies may very well be serving vital interests, or that these policies may represent a rational strategy in an environment of scarcity, is scarcely given a second reading. Inflation, especially continuing inflation, is a policy. It does serve the perceived interests, at least in the short-run, of some groups. It is only by recognizing this aspect of the issue that we can come to a better understanding of its source and its cure.

At any moment in time, the government must balance the pressures for an inflationary budget policy against the benefit of

a less inflationary economic policy. That is, our representatives must try to find the appropriate balance or trade-off between the short-run political and economic dislocation costs of an anti-inflationary policy and the adverse effects of a policy leading to a sustained inflation.

A major underlying conflict, however, concerns the claims of different groups in society as to what they believe to be their fair share of the national income. Unfortunately, if we add up all these "fair shares," it more than exhausts the total available. We must somehow come to grips with the mediation of society's expectations regarding appropriate efforts, rewards, and sacrifices. This relates not only to the distribution of economic efforts and rewards among the current work force, but how we wish to provide for ourselves versus future generations.

A lot is at stake. It relates not simply to narrow economic issues, but to the nature of the future society we jointly wish to sustain. I will take the liberty of quoting from an article I wrote over a half decade ago:

Efforts to explain inflation exclusively in economic terms are not only less than fully satisfying, but work to obscure the nature of the underlying causes. National and international institutions, traditions, politics, and social objectives all play a role in a phenomenon, so intricately embedded in our economic system. Economic analysis *must be supplemented by a theory of public policy that explains those factors that induce a government to select a certain set of policies.*¹

The law, like economic institutions, simultaneously reflects certain basic cultural values of our society and provides actual mechanisms for achieving certain important societal objectives.² At any moment in time, therefore, an analysis of the law may yield useful insights into the nature of our society. A similar statement may be made with respect to economics. However, with respect to inflation, when we concentrate our attention exclusively on economic issues, we are often sidetracked into lengthy discussions on federal deficits, harvest failures, alternative definitions of the money supply, *etc.* These excursions have often prevented us from addressing the underlying issues: the structure of economic institutions and the alternative claims of

¹ Shapiro, *Inflation in the United States*, in *WORLDWIDE INFLATION: THEORY AND RECENT EXPERIENCE*, 270-94 (L. Krause & W. Salant, eds. 1977) (emphasis added).

² F. ALLEN, *LAW, INTELLECT, AND EDUCATION* (1979).

various interest groups.

I predict that our national despair on economic issues will soon give way to a healthy optimism. The next decade should be one of opportunity for the United States economy. For example, we will have an unprecedented proportion of our population in the prime working age range (25-55), and this labor force is better educated than ever. In addition, we seem to be repositioning national economic policy on a number of fronts in a very helpful way. Many examples are available, but we might especially note the areas of energy, government regulation, and investment. National economic policy will have a major impact on our capacity to deal with the challenges ahead, but the demonstrated resilience of the United States economy makes me optimistic indeed.

