Panel 2 - Addressing Inflation: Historical Experiences and Lessons for Today

In the first presentation, Carola Binder, an associate professor of economics at Haverford, discussed the history of price stabilization in American democracy. This is the topic of her forthcoming book, *Purchasing Power: Prices and Inflation in American Democracy* which covers more than two centuries of debate over how to manage prices and inflation. The primary themes of her presentation were the contentious nature of this debate and the difficulties of solving inflation. Any government effort to manage and stabilize prices will pit different interest groups against each other, blur or shift the balance of power between the branches of government, and spark debate over what is legitimate and effective for a democracy to do.

Today, the Federal Reserve is in charge of price stability and uses monetary policy to keep inflation near its 2% long-run target. The path to this point, however, was long and fraught. In fact, the United States saw many busts and booms from the colonial era to present day. After the Revolutionary War, state and local governments had massive war debts, but little means to pay. This caused the money supply to shrink and prices to fall, which hit farmers the hardest. Farmers rebelled, most famously at Shay's Rebellion, which led the young United States to scrap the Articles of Confederation and write a new constitution. At the Constitutional Convention, the Founders sought to design institutions that avoided price fluctuations and social unrest. The Founders were also concerned that inflation violated an important right–the right to contract–since inflation could reduce the value of debts. For example, if a lender was owed $200 during an inflationary period, they might only be able to buy $150 worth of goods once repaid. The Founders accordingly decided to prohibit states from printing their own currency, and gave Congress vague monetary powers that neither explicitly allowed or denied the federal government to print money.

Between the ratification of the Constitution and the Civil War, the nation wrestled with the question of a national bank and tariffs. President Andrew Jackson opposed the bank, as the paper currency it printed could lose its value, and he promoted a return to "hard money" such as gold coins. In 1832, he vetoed a bill that would recharter the bank, and soon after, pulled all federal funds from the bank. Without a national bank, state banks recklessly caused price fluctuations. At this time, southern plantation states argued with middle and western farming states over tariffs. The latter sought protectionist policies for their crops, while the south feared such policies would result in retaliatory tariffs being placed on their own internationally traded goods. This debate, in conjunction with the ongoing price fluctuations caused by Jackson's attacks on the national bank, contributed to regional tensions that culminated in the Civil War.

After the Civil War, the federal government assumed a larger role in controlling prices and inflation. This occurred particularly during the Progressive Era, with the establishment of a national banking system under the Federal Reserve Board and authority for food price-controls, through the Food & Drug Administration. Through World War I, the Great Depression, and World War II, policy-makers debated how the Federal Reserve ought to act. By 2012, the Fed adopted a publicly-announced target of 2% annual inflation.

Through this history of debate about the causes and solutions of inflation, Binder showed that this debate has had commonalities throughout American history. There has been resistance to using monetary policy to reduce current inflation as part of a larger, ongoing debate regarding the Fed's role in the economy. How democratic should policy-making for price stabilization be? Officials from the Federal Reserve are unelected, and can greatly impact Americans' lives — for better or worse — with monetary policy. By raising interest rates, for example, the Federal Reserve may reduce inflation, but doing so can put people out of work.

John Roberts, a recently retired Federal Reserve official, gave his presentation on inflation expectations. He compared the U.S.'s current inflation to that of the early 1980s, which was the last time inflation was this high. Roberts (concurring with earlier speakers) showed that the situation now is quite different from that of the 1980s. According to a recent survey of professional forecasters, a substantial decline in inflation is expected, with only a modest increase in unemployment. In contrast, in the 1980s, as inflation declined, unemployment rose. Roberts argued that this difference is due to longer-run inflation expectations, meaning that the public's long-run expectations for inflation are different now compared to the early 1980s. This is because the Federal Reserve has been much clearer and more public about its objectives in recent years, and its transparency has a positive impact on the economic future.

Expectations, Roberts explained, are important because they influence how people act. Current prices and wages reflect businesses' expectations about the future. For example, if firms expect low unemployment in the future, they may anticipate rising wages and prices and set their prices accordingly. Since the Federal Reserve ultimately controls inflation by controlling the money supply, the expectations of businesses are tied to their expectations of how the Federal Reserve will act. Since 2012, the Federal Reserve has explicitly laid out a long-run goal of 2% annual inflation. If the Fed is doing a good job of communicating, and the public has confidence in the Fed, then the public's expectations of inflation should match the Fed's expectations and inflation will be low.

To test whether the expectations of the Fed and the public match, Roberts examined a survey of professional forecasters, financial markets, and the University of Michigan household survey. The survey of professional forecasters and financial markets showed these groups' expectations matched the Fed at 2%. The household survey was only slightly higher than 2%, but

also showed that the public's expectations of inflation were not far from the Fed's. In short, the public's expectations for inflation have remained stable, despite the chaos of the pandemic economy and the highest inflation in decades. This is likely due to the Fed's transparency and its explicit inflation target, which the Fed of the 1980s lacked, making it harder for the public to figure out where they expected inflation to go. In sum, Roberts showed that good governance and, in particular, governmental transparency can have a positive impact on our expectations of inflation, and therefore, on inflation itself.

During Q&A, a question that appeared throughout several panel events about changing the inflation target was asked. Binder stated that if the Fed changes the target because they are unable to match the lower expectation, the Fed could lose credibility amongst the public and business. She supports utilization of Nominal Gross Domestic Product (NGDP) as a target goal, instead of the current method of setting inflation targets. (For more on the NGDP, see the report on Panel 3.)

Given Roberts' many years of experience at the Fed, several questions were directed at him about how inflation models were forecast. Roberts responded that when he worked in the Fed during the 2008 financial crisis, the Fed produced worst-case projection models that would later become the baseline for future modeling. There were also questions of how to rein in inflation in high inflationary times. For example, Argentina, during the early 1990s, had a 200% inflation rate where prices would change by the end of the day. How does one deal with that? Do we let technocrats in independent bodies deal with the issue? While college-educated elites tend to be more supportive of letting technocrats make these decisions, Binder expressed some concern with the idea of technocrats doing everything behind closed doors, just because the Fed already does things well. Giving unelected technocrats additional responsibilities just because

they “get things done” is problematic (This point emerged again in Hogan’s presentation in Panel 3.). The talk ended with an emphasis on the importance of democratic principles and the ability of the people to make important decisions.

Rapporteurs: CSAD Student Associates Garrett Culbertson ‘23 and Margaux Harrington ‘24, and CSAD Senior Associate George Novotny ‘23.