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ON ECONOMIC EDUCATION

The Great Inflation and Its Aftermath

By Robert J. Samuelson

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History is what we say it is. If you asked a group of scholars to name the most important landmarks in the American story of the past half century, they would list some or all of the following: the war in Vietnam; the civil rights movement; the assassinations of John Kennedy, Robert Kennedy and Martin Luther King, Jr; Watergate and President Nixon's resignation; the sexual revolution; the invention of the computer chip; Ronald Reagan's election in 1980; the end of the Cold War; the creation of the Internet; the emergence of AIDS; the terrorist attacks of Sept. 11, 2001; the two wars in Iraq (1991 and 2003). Looking

abroad, these scholars might include other developments: the rise of Japan as a major economic power in the 1970s and 1980s; the emergence of China in the 1980s from its self-imposed isolation; and the spread of nuclear weapons (to China, India, Pakistan and others). But missing from any list would be the rise and fall of double-digit U.S. inflation. This would be a huge oversight.

We have now arrived at the end of a roughly half-century economic cycle dominated by inflation, for good and ill. Its rise and fall constitute one of the great upheavals of our time, though one largely forgotten and misunder-

About the Author:

Samuelson began his journalism career as a reporter on The Washington Post's business desk in 1969. After four years he left the paper to free-lance. His articles were published by the Sunday Times of London, the Los Angeles Times, the Boston Globe, the New Republic and other publications. He joined the National Journal as an economics correspondent in 1976 and began writing its "Economic Focus" column. He started writing a column for The Washington Post in 1977. In 1984, Samuelson left the National Journal and joined Newsweek as a contributing editor.

Samuelson has won numerous journalism awards. The list includes: The National Headliner Award for consistently outstanding column on one subject in 1995, 1993, 1992 and 1987; a 1993 John Hancock Award for best business and financial columnist; The Gerald Loeb Award for best commentary in 1993, 1986 and 1983; a Clarion Award for best magazine editorial/opinion column from Women in Communications in 1994; and a 1981 National Magazine Award. In 1997, he was a finalist for the Gerald Loeb Awards for Distinguished Business and Financial Journalism for commentary, and the Washingtonian magazine named him among the top 50 journalists in the capital city.



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stood. From 1960 to 1979, annual U.S. inflation increased from a negligible 1.4 percent to 13.3 percent. By 2001, it had receded to 1.6 percent, almost exactly what it had been in 1960. For this entire period, inflation's climb and collapse exerted a dominant influence over the economy's successes and failures—and much more. Inflation and its fall shaped, either directly or indirectly, how Americans felt about themselves and their society; how businesses operated and treated their workers; and how the American economy was connected to the rest of the world. Although no one would claim that inflation's side effects were the only forces that influenced the nation over these decades, they counted for more than most people—including most historians, economists and journalists—think. It's impossible to decipher our era, or to think sensibly about the future, without understanding the Great Inflation and its aftermath.

Without double-digit inflation, Ronald Reagan would almost certainly not have been elected



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president in 1980—and the conservative political movement that he inspired would have emerged later or, conceivably, not at all. High inflation incontestably destabilized the economy, leading to four recessions (those of 1969-70, 1973-75, 1980 and 1981-82) of growing severity; monthly unemployment peaked at 10.8 percent in late 1982. High inflation stunted the increase of living standards through lower productivity growth. And high inflation caused the stock market to stagnate—the Dow Jones Industrial Average was no higher in 1982 than in 1965—and led to a series of debt crises that afflicted American farmers, the U.S. savings and loan industry and developing countries.

If inflation's legacy were nothing more, it would merit a sizable chapter in America's post-World War II narrative. But there is much more. Declining inflation—*disinflation*—led to lower interest rates, which led

to higher stock prices and much later, higher home prices. This disinflation promoted the past quarter century's prosperity. In the two decades after 1982, the business cycle moderated so that the country suffered only two relatively mild recessions (those of 1990-91 and 2001), lasting a total of sixteen months.

Monthly unemployment peaked at 7.8 percent in June 1992. As stock and home values rose, Americans felt wealthier and borrowed more or spent more of their current incomes. A great shopping spree ensued, and the savings rate declined. Trade deficits—stimulated by Americans' ravenous appetite for cars, computers, toys, shoes—ballooned. Paradoxically, this prolonged prosperity also helped spawn complacency and carelessness, which ultimately climaxed in a different sort of economic instability and financial turmoil that assaulted the economy in 2007 and 2008.

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The very belief in the permanence of economic growth undid economic growth. Initially triggered by falling inflation and interest rates, the upward march of first stock prices and then home values induced speculative dizziness. People began to believe that prices of stocks and homes could only rise. Once that intoxicating mindset took hold, prices rose to silly and perilous heights, leading to “bubbles” that burst in 2000 (for stocks) and 2007 (for homes). Home loans were extended to buyers with weak credit and with little or no requirement for down payment. The presumption that homes would always be worth more tomorrow than today provided a false sense of security to lenders and rationalized credit standards that, with hindsight, seemed self-evidently doomed. When these “subprime” mortgages began to default in large numbers, the homebuilding boom ended, housing prices fell, financial institutions—banks, investment banks—suffered large losses on securities backed by mortgages, and the economy tipped into (or teetered on the edge of) another recession. The significant point for our story is that the economy’s present problems are yet another unappreciated consequence of inflation and its subsequent decline.

Inflation is an example of how

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economics affects almost everything else, and the American story of the past half-century can’t be realistically portrayed without recognizing its central role. Much of what we take as normal and routine either originated in the inflationary experience or was decisively influenced by it. But we have now come to the end of this period. Just what the next great economic cycle will bring is an open question that, in some ways, will involve dealing with the sequels of many of the effects of the Great Inflation. The great shopping spree has ended. What will replace it? Can we maintain acceptable levels of economic growth and stability? Globalization seems threatening to many Americans, as does the resurgence of a rough-and-tumble capitalism that some perceive sacrifices worker security for shareholder profit.

Whatever happens, the Great Inflation holds an important lesson for the future: the need to temper and regulate our national enthusiasm for self-improvement. For double-digit inflation was not an act of nature or a random accident. It was the government’s greatest *domestic* policy blunder since World War II. It was the perverse consequence of well-meaning economic policies, promoted by some of the nation’s most eminent academic economists. These

policies promised to control the business cycle but ended up making it worse. The unending quest to better ourselves is a powerful American virtue but one that, from time to time, gets us into immense trouble. Skepticism in the face of seductive appeals of collective uplift is not always pessimism or conservatism. Sometimes, it is just prudent realism.

--This article is adapted from “The Great Inflation and Its Aftermath: The Past and Future of American Affluence” by Robert J. Samuelson, published by Random House, Nov. 2008.

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339 College of Business Administration
University of Nebraska - Lincoln
Lincoln, NE 68588-0404
Tel: 402-472-2333
Fax: 402-472-9700
web: www.nebraskacouncil.org

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