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Why we chose to have stagflation

Wages and prices are not set by the market but determined by political considerations that reflect power and values

For years economists have been chastised for their inability to find a way out of stagflation, the miserable combination of high unemployment and high inflation that has afflicted the U.S. in the 1970s. Economic theory suggests that it should be possible to trade some of one for the other; that is, use the unemployed to drive down the cost, and hence the price, of products, or stimulate the economy to operate in a higher gear, reducing unemployment while putting upward pressure on prices.

For years, however, inflation has exceeded 6% and unemployment 7%. (A 4% rate is considered full employment, although in Western Europe it is often lower.) Economists have viewed stagflation the way a physicist would view an object suspended in midair in violation of the laws of gravity—as a scientific obscenity. And being unable to understand stagflation, they have, of course, encountered difficulties in trying to find ways to deal with it.

The role of politics. The secret lies not in some magic hokum but in the fact that, to a great and growing extent, wages and prices are not determined by the market and subject to its laws but are "managed," i.e., formed deliberately by political considerations stemming from power and values, not from the intersection of the forces of supply and demand. Thus, within a few months late in 1977, the legal minimum wage was increased substantially for the next three years, from $2.30 per hour to $3.35 by Jan. 1, 1981. This will increase unemployment in the sector in which youth is most concentrated. The decision was not made between employers and employees. Indeed, the youth—who is the one most often drawing the minimum wage—is hardly in the position to bargain for it. Nor was it made by unions pressuring management. Unions put pressure on the Democratic President and Congress, which, having just turned down several of their other requests, found it politically necessary to respond to this one.

Similarly, the payroll taxes that finance Social Security were substantially increased, adding to the costs of labor, and hence of products, not as a result of new fringe benefits awarded by employers to employees but through government action.

While the political vector behind these decisions was largely labor unions, senior citizens' associations, and liberals, the pressure to increase the cost of other products came from farmers and various industrialists, from producers of shoes to steel to domestic oil and gas. To reiterate: all this within a few months.

Beyond this, prices of many other products (such as gas, electricity, telephone services, and rail, bus, and airline travel) are directly regulated by the government and therefore are subject to political pressures. Still other prices are pushed up by huge government subsidies—above all, those of health services. All other prices are significantly affected by tax policies, import limitations, foreign policy (for example, limiting trade with Cuba), pollution laws, affirmative action programs, occupational safety laws, and scores of others.

This is not to suggest that the market has no role, but that political normative forces are certainly strong enough to account for inflation and unemployment levels being a few points higher than they would be otherwise.

To put it differently, we understand stagflation. It represents the intrusion of politics and political values into economic processes and decision-making.

While the dynamics of politics and value systems may well elude econometrics, this does not mean that they are not subject to systematic research and comprehension. Moreover, the understanding of the polity and socio-ethics suggests to us where we need to turn to deal with stagflation, although it does not necessarily imply that these "impurities" must be removed to allow the market to act more freely and correspond to economic theory.

The question is basically one of what we collectively desire—lower prices or lower unemployment on the one hand, or a humane, just society concerned with the quality of life on the other. What the persistence of stagflation indicates is that we *chose* to put up with 6% inflation and 7% unemployment, at least in the last few years, to make social progress (from fighting pollution to increasing worker protection) as well as social peace. We may now choose to correct the balance somewhat through deregulation—that is to say, make an industry such as the airlines more subject to the marketplace. And we can choose to go slowly on new social costs and even roll some back—for example, delaying the introduction of air bags in passenger cars. These decisions will have to be made through the political process, via mechanisms that are quite well understood and not at all mysterious.

Taking a broader view. In short, stagflation is not a reflection of our ineptitude but of our commitments to social values, of the relative political strength of these values compared to our concern with a "sound dollar," and of our willingness to rely more heavily on the government than on the marketplace.

Whether this is a desirable development or one that must be reversed is a matter of value judgment. But to suggest that stagflation is a mystery merely indicates that one has elected to view the world through narrow econometric lenses rather than more widely through social and political as well as economic ones. There is a problem here, but if there is a mystery, it is in the eye of the beholder, not in the real world. ■

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