INFLATION: A GLOBAL ENIGMA

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Inflation is describable in different ways:

A Dictionary Meaning

"Inflation is an increase in the volume of money and credit relative to available goods resulting in a substantial and continuing rise in the general price level — contrasted with deflation."[1]

Economics Parlance

The currently accepted descriptions in economics parlance fall into two categories: (1) demand-pull inflation, which connotes that too much money is chasing too few goods, or (2) cost-push inflation, which connotes that an increase of costs results in an increase in prices.

An Analytic View

A leading economics adviser offers an explanation:

> There is some average of the prices of all relevant goods and services, what is often referred to as the 'price level.' If that average is increasing through time, then there is 'inflation,' and more or less depending on how much the average is increasing per unit of time. If the average is decreasing, then there is 'deflation.' And if it is not changing, or is constant over time, then there is 'price stability.'
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> So the words 'inflation' and 'deflation' and the phrase 'price stability' are all descriptive of the behavior of an average of prices, not of any particular prices. Thus, price stability can obtain when all prices are changing, as they will or should be when demands and/or supplies are changing. Inflation can obtain when some prices are decreasing and deflation when some prices are increasing.[2]

The variety of definitions suggests the complexity of the problem. Inherent in the problem are many interrelated factors which prompted a member of the Board of Governors of the Federal Re-

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1. WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 1159 (1963).

2. Kareken, *Inflation: An Extreme View*, 2 FED. RES. BANK OF MINNEAPOLIS Q. REV. 7 (Winter 1978).

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serve System to state: "in this struggle against inflation, we shall have to use all available options."[3] To analyze inflation solely in terms of balancing the budget and prudent monetary control is too broad-brushed an analysis of a many-faceted problem. Similarly, to point to the manifold increase of the price of oil since the 1973 Arab embargo as a significant cause of a spiraling inflation, although true, loses sight of many other key contributing factors.

I. CURRENT VIEWS ON INFLATION

A wide range of economic events affects the steady rise in inflation. From the start of his Chairmanship of the Federal Reserve Board, G. William Miller has asserted that the challenge of inflation requires a cooperative effort among numerous constituencies: the administration, Congress, the financial world, international bankers, and the public. In numerous talks to the financial sectors of the business world, labor, the public, and in reports to the media, Miller has expressed his views and indicated his positions on the various aspects of inflation.

Miller's approach does not vary in marked degree from the thinking of his predecessor, Arthur Burns. Without attempting a lengthy catalog of his position statements to date, a brief survey of his major concerns will underscore the goals he seeks to attain. Miller urges a balanced budget by 1982; he advocates a reduction in federal expenditures over the next five years to 20% of the nation's output of goods and services from the current 22%, a position which has provoked political reactions nationwide; he envisions an annual reduction in the inflation rate of 0.50% to 0.75% — a hopeful result from the totality of his recommendations; he encourages an increase in business investment — new machinery, plant, and equipment — over the next five years from the current 9% to 12% of the gross national product, coupled with an increase in the investment tax credit; he favors a stimulus to increase housing starts by 75,000 to 100,000 units over five years; in this vein, Miller endorses higher interest rates payable by savings banks as a means to discourage the shift of savings to higher yielding fixed-income security investments, thereby maintaining an acceptable mortgage interest rate; he recommends tax reductions for business and individuals, and encourages efforts to ease the drag of federal regulations on economic activity; he encourages an increase in exports from 7% to

3. Henry C. Wallich, Moving In For a Soft Landing, George C. Eccles Lecture Series, Utah State University (Feb. 9, 1978).

10% of the gross national product.[4]

Additionally, Miller initially proposed a two-year deferral of the next scheduled minimum wage increase from the current rate of $2.65 an hour to $2.90 an hour, coupled with lower minimum wages for teenagers. He would defer the proposed tax cut from October 1, 1978 to January 1, 1979 which would result in an additional $8-9 billion gain in revenues. He would implement his recommendations to encourage the installation of new machinery, plant, and equipment with a schedule of accelerated depreciation lives to encourage business to invest. This plan calls for five years for depreciating business equipment, ten years for depreciating plants, and twenty years for depreciating office buildings — his primary concern being to encourage investment and to diminish consumption.[5] All this, of course, would require legislation.[6] Most importantly, he leans against the potential swelling of the money supply. His primary purpose in setting moderate ranges for increases of the money supply is to effect reasonable price stability. Overall, he is very aware that the Federal Reserve Board cannot cure the inflation problem by unilateral action. Nevertheless, Miller periodically makes recommendations that affect the business community in the hope that the recommendations of the Federal Reserve Board will serve as a curative catalytic agent.

The concerned corps of informed advisors — economists, analysts, business chieftains, and others involved in the search for the causes and cures of inflation — would readily agree that there is no quick *panacea*. An attempt to arrange an order of priority by pinpointing the causes and formulating the cures would be an ideal approach. However, because of the urgency of the problem which confronts not only the United States but the rest of the world, there is a compelling need to place all relevant factors on the analysis board. Such a *modus operandi* might result in a fruitful mix of ef-

4. Levine, *Independent Force: Fed Chairman Miller Wins Power by Seizing on Inflation Issue*, Wall St. J., June 21, 1978, at 1, col. 6. *See also* Henry C. Wallich, Honest Money, Commencement Address to the Fordham Graduate School of Business (June 28, 1978). Secretary of Commerce Juanita Kreps has been the Carter administration's spokesperson encouraging United States manufacturers to sell abroad. She has spoken frequently before many groups in furtherance of improving the United States trade deficit by significantly increasing exports. U.S. DEPT. COMMERCE NEWS (Apr. 13, 1978); *Id.* (May 25, 1978); *Id.* (June 14, 1978); *Id.* (July 26, 1978).

5. *Fed. Chairman Urges Congress to Delay Minimum Wage Increase*, Wall St. J., June 30, 1978, at 6, col. 4.

6. *Miller Confirms Credit Was Tightened, Pledges 'Restraint' in Monetary Policy,* Wall St. J., Apr. 26, 1978, at 3, col. 2.

forts which could help to solve the inflation problem. Chairman Miller has dramatically posed the challenge to the administration and Congress for a faster depreciation of plant and equipment in language readily understood by those engaged in running a business. He stated that this technique would get "the biggest bang for the buck."[7] The result would be to create employment without inflation. Legislation would be required for this purpose, a crucial fact which highlights the need for Congressional action and cooperation.

Even more ambitious than Miller is George Soros, a writer on economic subjects. Mr. Soros recommends a depreciation schedule that would start with 150% of the cost of new investment and gradually return to the present 100% over a period of years.[8] One of the effects of such a program would be to reduce or eliminate the originally proposed $25 billion tax cut. Without such a new incentive, a recession looms as the undesirable alternative to bring relief from inflation; it is generally anticipated, absent available, workable options, that a recession is likely to start in the first half of 1979.[9] Ironically, it is predicted that when the recession comes the dollar will strengthen, price pressures will abate, interest rates will drop, and the stock market will go through the roof. The gist of Mr. Soros' idea is to couple a stimulation of the economy with a cut in the budget deficit. Since a higher level of economic activity would contribute to tax revenue, investment and consumption will be enhanced. The stimulus to the economy by an accelerated depreciation schedule as compared with a tax cut may be viewed in the following manner: a tax cut in the originally planned and now reduced amount spread over a population exceeding 200 million is like sprinkling artifical rain to nurture crops which need prolonged and bountiful rainfall.

An increase in the tax investment credit is often mentioned as a supplemental aid directed toward encouraging capital investment by business. The prevalent opinion among economists and tax specialists is that although the increased tax credit initially reduces the amount of collectible revenue, the resultant business expansion and

7. Miller, *Urging a Balanced Budget, Backs Tighter Fiscal, Relaxed Monetary Policy*, Wall St. J., May 12, 1978, at 2, col. 3.

8. Soros, *150% Depreciation Could Do It All*, N.Y. Times, May 7, 1978, at 14F, col. 3.

9. *But see U.S. Not Heading For Recession*, Int'l Herald Tribune, Sept. 15, 1978, at 9, col. 6 (Treasury Secretary Michael Blumenthal recently told a group of business and government leaders that there is no chance the United States will slide into another recession during the remainder of President Carter's first term, a view with obvious political overtones).

technological improvement ultimately bring about higher employment and increased productivity.

The urgency of solving the inflation problem head on has evoked other frontal attacks. These assaults are leveled at aspects of the economy which bear on curbing the rising rate of inflation. For example, the now abandoned notion of wage-price controls tried during the Nixon administration has yielded to the acronym TIP, which stands for Tax-Based Incomes Policy. This policy relies on tax incentives and disincentives. Senator William Proxmire, Democrat of Wisconsin, said in a news conference that despite the shortcomings of TIP, the policy "is the only game in town." Although TIP has many variants, it would operate as follows: the government would announce wage increase guideposts for the next calendar year and publish a tax incentive plan schedule. At the end of the year, companies would pay a tax according to the schedule if wage increases exceeded the government's guideposts. By contrast, they would receive a subsidy — a negative tax — if the wage increases were below the guideposts. It would act directly only on wage inflation. Opponents of TIP emphasize the fact that it constitutes an excise tax on labor, that the resultant reduction in employment would lead to fewer goods being offered on the market, and that higher prices would be charged.

An outspoken critic of TIP is Preston Miller, Associate Director of Research for the Federal Reserve Bank of Minneapolis. However, the compelling challenge of rising inflation should welcome even criticizable efforts on a trial basis in line with Senator Proxmire's desperate exhortation that "it is the only game in town." The concept of a tax incentive-disincentive incomes policy exemplified by TIP has received strong support from Professor James Tobin of Yale. Tobin claims that one of the President's biggest mistakes was to abandon an incomes policy to allay business and labor's suspicions of a new Democratic administration. In fact, Tobin considers an incomes policy as one of only three effective alternatives to extricate the economy from the morass of inflation — the other two being the risk of feeding an increased inflation and the slowing of the economy by the administration and the Federal Reserve Board.[10] Another ardent supporter of TIP is Kathleen M. Cooper, Chief Economist of the United Banks of Colorado, who believes in the Arthur M. Okun plan to provide tax incentives to

10. Silk, *Why Carter Holds Firm on Tax-Cut Package*, N.Y. Times, May 2, 1978, at 51, col. 1.

California Western International Law Journal, Vol. 9, No. 2 [1979], Art. 3

hold down wages and price increases. Cooper prefers wage rather than price guidelines because of the difficulty of administering price guidelines due to the numerous elements that feed into the pricing structure. Her opinion is that if wages slow down, prices will slow down.[11] TIP, however, has been somewhat overtaken by wage-price guidelines.[12]

Perhaps the most direct anti-inflation remedy is a tax reduction. In this vein, the Kemp-Roth Bill[13] was introduced in the Congress. It was argued that the bill would have permitted the taxpayer to avoid the "double whammy" created by inflation and a progressive income tax. In support of the Bill it was argued that a substantial tax cut — a 33% cut for individuals over the next three years — would be conducive to economic growth, and that the government's revenues would eventually increase to such an extent as to make the budgetary deficit of negligible concern. Irving Kristol, a New York University Professor who supported the tax reduction approach, describes the notion as a "[p]opulist remedy for populist abuses."[14] Professor Kristol's view was that the Kemp-Roth Bill was a companion to California's Proposition 13, which dramatized the start of the tax cut movement. A program of tax reduction to slow the rise of the inflationary spiral is finding widespread support and includes among its supporters Juanita Kreps, Secretary of Commerce.[15]

The contemplated annual reduction of the budget requires the elimination of many expenditures, following a thorough study of budgetary items that can be reduced or eliminated. A reduced budget is attended by difficulties. The obvious obstacles are the built-in allocations absolutely needed for a highly industrialized society, the expected resistance of members of Congress who are fearful of stormy reactions from their respective constituencies, and the constitutional mandate that the federal government is charged with responsibility for the national defense. The federal outlays for de-

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11. Mullaney, *Economic Scene: The Evolution of an Economist*, N.Y. Times, July 14, 1978, at D2, col. 1.

12. The wage-price guidelines concept and program are discussed *infra* pp. 373-76.

13. H.R. 8333, 95th Cong., 1st Sess., 123 CONG. REC. H 7171 (1977).

14. Kristol, *Populist Remedy for Populist Abuses*, Wall St. J., Aug. 10, 1978, at 20, col. 4. *See also* Miller, *Tax-Cut Plan Gives GOP a New Issue—And a New Face*, Wall St. J., Sept. 19, 1978, at 1, col. 4; *Senate Panel Rejects GOP Bid for 33% Tax Cut*, Wall St. J., Sept. 19, 1978, at 2, col. 2.

15. *'Real' GNP Slid in First Quarter on Strike, Snow*, Wall St. J., Apr. 20, 1978, at 3, col. 1.

fense will total $111.7 billion next year, estimated to be approximately 5% of the gross national product for 1979.[16] With the need for increased technological advances in military equipment, this item of the budget necessarily will increase with the years. Of significance in this connection is that United States defense expenditures have declined in ten years from 9% of the GNP to slightly less than 5%.[17] However, the lingering reminder remains: Chairman Miller emphasizes the need to balance the budget by 1982 as a necessary condition for fighting inflation. Additionally, he is joining the frontal attack brigade and has made various suggestions along these lines. For example, he has urged the administration to consider an "anti-inflation" tax on excess profits as part of a "second stage" of the battle against inflation. He has advised, in a drastic change from his previously stated position, that tax cuts for individuals in 1979 be abandoned in favor of a deferral of the social security tax increase scheduled for next January. Miller has also advanced other measures which have been the subject of study and recommendations by the host of writers and spokesmen who have joined the fight against inflation. An examination of some basic proposals made by economists and analysts is worthy of closer consideration.

II. BASIC PROPOSALS

A. *Productivity*

Productivity, which is defined as the average output per hour of labor, is a major part of the inflation problem. Through the 1950's and most of the 1960's, productivity rose at the rate of nearly 3% a year. In the years after 1968, the trend dropped to half that rate. Since late 1976 it has been almost flat.[18] A corollary to the drop in productivity is the twin phenomena of inflation and lowered unemployment. The nation's output over the past year was increased by putting more people on the payroll rather than by improving each person's capacity to produce. The explanation for diminishing productivity is varied. Some say they do not know why it has stopped rising. Others claim that it is attributable to the low rates at which business has been investing new capital, a fact which

16. Malabre, *Tracking a Trend: Military Outlays Play Smaller Economic Role but Turnaround, Fueling Inflation, Is Likely*, Wall St. J., Aug. 20, 1978, at 38, col. 1.
17. *Id.*
18. *Productivity in the U.S.*, Int'l Herald Tribune, Aug. 1, 1978, at 6, col. 1.

may be the result of low profits and the uncertainty of the business climate. Still another view is that the cost of new environmental and safety regulations, which requires industry to invest heavily in equipment to control air and water pollution, has imposed heavy burdens on business which, in turn, affects its capacity to improve productivity performance.

Among some of the major industrial powers, increases in productivity in manufacturing for the decade of 1967-77 are revealing: United States — 27%; France — 72%; West Germany — 70%; Italy — 62%; Japan — 107%; Canada — 43%; and Great Britain — 27%.[19] It is apparent that the United States and Great Britain are on the lowest rung of the productivity ladder. Barry Bosworth, Director of the Council on Wage and Price Stability (CWPS), concedes that the administration is not certain why productive growth has been so slow.[20] It is often stated among administration officials that the major drawbacks on productivity are the increasing regulatory burdens on business, particularly on the environmental level for new plants. When productivity grows slowly or declines, inflation worries are heightened. With wages rising while output per hour falls, the cost of production increases, putting pressure on prices. Most recent surveys indicate that businessmen, conscious of uncertainties caused by inflation, are conservative in their capital spending plans.[21]

Inflation itself may work to retard gains in productivity because it may discourage long-term investment, which is the type of capital spending needed to enhance productivity research and improve technology. The higher the rate of inflation, the higher the rate of insecurity and hence the less technology a dollar will buy. In short, inflation distorts investment incentives. It is said that productivity figures usually follow the economic curve: in recessions, productivity lags because production falls faster than workers are laid off; in recovery, productivity climbs fast because output picks up before the work force builds. Professor Dale Jorgenson of Harvard University relates the soaring cost of energy to a winding down of the economy, effectively slowing the substitution of productivity-increasing capital for labor.[22] That is the reason the

19. *Id.*

20. *Productivity Mightn't Increase in 1978, Adding Price Pressure, Carter Aide Says*, Wall St. J., July 21, 1978, at 2, col. 3.

21. *Id.*

22. Flint, *Inflation-Productivity Puzzle: Capital Outlays May Be Hurt*, N.Y. Times, May 27, 1978, at 25, col. 3.

return on capital formation is so slow and employment is growing so rapidly. According to Professor Jorgenson there is no reversing this trend for the next decade.

Professor Klein of the Wharton School recommends accelerated depreciation and the investment tax credit to increase productivity, observing that a tax cut will result in additional productivity by lowering the pressure for higher wages.[23] The alternative is that, if there is no tax cut and inflation continues to rise, a recession is inevitable by early 1979. Kathleen M. Cooper, chief economist of the United Banks of Colorado, has said: "until we pull down the differential between high compensation and low productivity, we'll never beat inflation."[24] The academic economists generally, although respectful of Chairman Miller's views and actions to date, believe that he is oversimplifying the analysis of the problem by giving high priority to lower federal spending and a smaller budget deficit as the basic approach to reduce inflation. More recently, Miller joined with Treasury Secretary Blumenthal to formulate and spearhead an all-out effort to combat inflation.[25]

The word "stagflation" has been in vogue for some time. It is sometimes defined as a mixture of economic stagnation and inflation, which is tantamount to a coupling of a drop in productivity and inflation.[26] To date, management finds it difficult to offset rising wages and other costs with more efficient production. The only course for management to take has been to switch from "cost offsetting" to "cost pass-along" strategy in order to maintain profits. Thus, management has opted for cost-push inflation. Such management strategy really invites labor to demand wage increases.

The productivity problem is not peculiar to the United States. It has prompted British economists to note that unless British industry can produce and sell the goods required to meet the demand, the demand will be met by imports which will set inflation going again; that is, it will create jobs in other countries rather than in Britain.

Thus, the attack on the dragon of inflation must command the resourceful efforts of all to approach the problem from different

23. Mullaney, *Economic Scene: Wharton's Call: Fight Inflation*, N.Y. Times, June 16, 1978, at D2, col. 1.

24. Mullaney, *supra* note 11.

25. This new effort is discussed *infra* pp. 366-68.

26. Silk, *Economic Scene: The Origins of 'Stagflation'*, N.Y. Times, June 20, 1978, at D2, col. 1.

directions. We are indeed fortunate to have among our academicians, economists, analysts, and congressional leaders, people who continue to come forward with fresh ideas in the hope that a combination of remedies will ultimately result in a cure.

B. Competition

Professor Walter Adams, Professor of Economics and past President of Michigan State University, after reviewing many of the alternatives which have been proposed to halt spiraling inflation, concludes that the most attractive alternative is a vigorous competition policy.[27] He recommends a dismantling of government programs that artificially stifle market forces and protect concentrated industries from competition. He notes what the mere threat of deregulation and the aggressive promotion of competition by the Civil Aeronautics Board (*CAB*) has already done to airline rates without causing losses to the carriers. He emphasizes that stopping the drift of protectionism in international trade would have the same effect. Since Professor Adams expressed his views, *CAB* has put into effect a program permitting airlines to slash coach fares as much as 50% below existing levels on all flights and as much as 70% for off-hours flights. David M. Lilly, a member of the Board of Governors of the Federal Reserve System, recently remarked that steps must be taken to improve competition among businesses through increased emphasis on antitrust policy, changes in regulatory procedures, and an easing of barriers in international trade.

C. Bias Toward Inflation

The government has contributed indirectly to the inflationary trend in our economy in several important respects: (1) for many years the federal government has virtually regulated various forms of transportation, which has raised costs from 10% to 30%; (2) tariffs and import barriers, although benefiting certain industries, have served to increase prices of some commodities or to prevent a drop in others; (3) agricultural price supports, restrictive building codes, the market power of business and unions, pollution controls, safety regulations, pension costs, mandatory retirement, and minimum wage laws are all part of the economy's bias for inflation. For the current year, new payroll taxes (social security and unemploy-

27. Adams, *Economic Scene: Competition and Inflation*, N.Y. Times, Aug. 1, 1978, at D2, col. 1.

ment insurance), new minimum wages, and proposed energy taxes are calculated to cause a 1% increase in the rate of inflation; (4) index price increases are synonymous with costs of living adjustment formulae, and contract provisions containing such formulae frequently have been called fuel for inflation. Indexing is viewed by many as an unacceptable approach to inflation because it takes away the incentive to fight the inflation itself; that is, it is an admission of defeat. Also involved in the indexing technique is a "pass-along price-raising" way of life, a point which was made by Byung Yoo Hong in his doctoral thesis at Columbia University, as distinguished from "cost-offsetting," which is considered preferable because under such a program the worker gets higher real wage increases than under cost pass-along management;[28] and (5) inflation is one of the major causes of unemployment in the current environment. It leads to sluggish buying, although there are those who buy now in anticipation of higher prices later. Today's high unemployment rate is the legacy of inflation. With respect to the enumerated points mentioned above, ways must be found to reduce unemployment while avoiding a new wave of inflation.

Several steps to slow down a spiraling inflation have been suggested: (1) a prudent monetary and fiscal policy; (2) a realization that prudent monetary and fiscal policy is not all that is required. Inflation is more than an evil of the business cycle; it is a structural phenomenon as well. The efficiency and flexibility of markets must be improved, and structural changes in our economy will have to be made. For example, improved competition, economic incentives as substitutes for inefficient safety, and environmental regulations which have been imposed on certain industries should be studied in an effort to correlate their cost burdens with the reasonable needs of the involved problem; (3) job training programs should be strengthened to increase productiveness of workers, particularly minorities and teenagers; and (4) unemployment insurance laws which provide such generous benefits that the incentive to work is reduced, should be reviewed.

Chairman Miller, to his credit, has recently expanded his frontal attack to include most of the proposals made by the corps of economists, analysts, academicians, and congressional leaders. The inflationary bias of our economy should be scrutinized and measures taken to moderate its effect on a constantly increasing inflation.

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28. Silk, *supra* note 26.

Just as an environmental impact statement is required as a condition precedent to the siting and erection of a nuclear power plant, we should require "inflation impact statements" to be signed by a governmental agency relative to changes in the minimum wage, import restrictions, and other practices and regulations that predispose our economy to an inflationary bent. In this way, the public would be awakened to the costs involved when new legislation is adopted and new procedures are instituted. An informed and aroused citizenry could support some of the corrective measures to diminish inflation, which has become an insidious ingredient of our economic life.

D. The Money Supply

The virus of inflation is attributable to many factors. Noteworthy is the fact that the rate of inflation is highest in a country with the highest rate of growth of the money supply. Japan, by slowing the growth rate of the money supply, reduced inflation despite its oil and gas imports. Canada, by raising the growth rate of the money supply, increased inflation despite its oil and gas exports.[29]

In March 1975, Congress passed Concurrent Resolution 113 stating the "sense of Congress" that the Federal Reserve should "maintain long run growth of the monetary and credit aggregates *commensurate with the economy's long run potential to increase production* . . . ."[30] The Resolution also called on the Federal Reserve to consult with Congress periodically on its objectives and plans with respect to the ranges of growth or diminution of monetary and credit aggregates for the upcoming twelve months. The Resolution was, in November of 1977, supplanted by largely parallel language in the Federal Reserve Reform Act.[31]

Paul Volcker, President of the New York Federal Reserve Bank, thinks that to deal with inflation one must focus not on money targets alone, but that one must look behind the money supply to nonmonetary factors. However, he emphasizes the need for "targeting" as a discipline on monetary authorities. He is of the opinion that "inflation is difficult to eliminate because of forces deeply imbedded in the structure of our economy, our social poli-

29. *See* Meltzer, *Money Growth and Inflation*, Wall St. J., May 17, 1978, at 22, col. 4.

30. H. Con. Res. 133, 94th Cong., 1st Sess., 89 Stat. 1194 (1975).

31. Volcker, *The Role of Monetary Targets in an Age of Inflation* 1, Address delivered at the Annual Meeting of the American Economic Association in New York (Dec. 30, 1977).

cies, and our political life."[32]

Monetary targets are set periodically by the Federal Open Market Committee (FOMC). These targets are set in terms of ranges expressed in billions of dollars, and are described as money stock measures and defined by the Federal Reserve System. The five categories of the money stock measures include the following: (1) M1,[33] which includes demand deposits at all commercial banks other than those due to domestic commercial banks and the United States government, less cash items in the process of collection and Federal Reserve float; foreign demand balances at Federal Reserve banks; and currency outside the treasury, Federal Reserve banks, and vaults of all commercial banks; (2) M2, which includes, in addition to currency and demand deposits, savings deposits, time deposits open account, and time certificates of deposits other than negotiable time certificates of deposit issued in denominations of $100,000 or more by large weekly reporting commercial banks; (3) M3, which includes M2 plus the average of the beginning and end of month deposits of mutual savings banks, savings and loan shares, and credit union shares; (4) M4, which includes M2 plus negotiable time certificates of deposit issued in denominations of $100,000 or more; and (5) M5, which includes M3 plus negotiable time certificates of deposit issued in denominations of $100,000 or more.[34]

As previously mentioned, Chairman Miller frowns upon the potential swelling of the money supply. Although the fundamental problems of the dollar are inflation and the trade deficit, Miller believes the number one priority is the reduction in the *growth rate* of the money supply.[35] Concern is primarily centered on targets[36] M1 and M2. For M1, Miller, when he became Chairman, favored a 4% to 6.5% annual increase; for M2 he favored a 6.5% to 9% annual increase — ranges which contemplate that actual money supply growth in 1978-79 will be lower than in 1977. The goal is to attain

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32. *Id.* at 23.

33. Recently, another money stock measure was devised, designated "M1 plus" and is defined as M1 plus savings deposits at commercial banks, new accounts at banks and thrift institutions, credit union share draft accounts, and demand deposits at mutual savings banks.

34. Fed. Res. Statistical Release H.6, table I (Aug. 3, 1978).

35. *See* Clark, *Speaking of Business*, Wall St. J., Aug. 29, 1978, at 16, col. 3.

36. The money supply targets are subject to change from time to time by the Federal Reserve System in an effort to try to control the growth rate of the money supply — a key factor involved in the fight against a spiraling inflation. Such targets, initially established by Miller, have since been changed in keeping with the objectives of correlating the growth rate of the money supply to the growth rate of the economy.

reasonable price stability by pursuing a monetary policy aimed at preventing increases in the growth of the money supply which fuel inflation. The desirable policy is to bring the money supply down to levels commensurate with the real growth rate of the economy.[37]

The dollar is recognized as the world's reserve currency and is vital as an international medium of exchange. Foreign trade contracts are often written in dollars even when United States citizens are not involved. No less important is the dollar as an international store of value. Foreign central banks hold total reserves valued at $320 billion, of which $200 billion are held in United States dollars. Deposits in the Eurodollar market approach $500 billion. These holdings naturally give foreign governments and investors a huge stake in the value of the United States dollar.

Professor Robert Triffin of Yale has pointed out that the fantastic expansion of United States monetary growth preceded the oil price explosion of 1973 and fueled the world-wide inflation of which the higher oil price is only one and not the majority component. Dollar reserves prior to 1973 had already more than doubled by an amount exceeding all previous years and centuries. He cautions that if such a process is not arrested it will continue to fuel world inflation even if the energy problem could be solved tomorrow.

Whether the steps to raise the federal funds and discount rates really express a determination to slow the pace of dollar creation remains to be seen. A serious effort to do that should also include drastic controls over federal expenditures to curb the deficit and facilitate monetary restraint. These are very real dangers which our political leaders must confront.[38]

The argument has been made that oil imports are not the basic cause of our inflationary problem. The rationale is that the dollar has been plunging against the Japanese yen; yet it is noted that United States oil imports amount to 19% of its energy consumption, while Japan's oil imports amount to 73% of its energy consumption. These statistics are offered to prove that our oil imports do not constitute the major factor in our inflation problem. Rather, it is argued that the flight from the dollar is the nagging cause of our problem, and that the dollar fell not primarily because the United States imported too much oil but because the United States created too many dollars. If the dollar is sliding, the warning signal, we are

37. Levine, *supra* note 4.
38. *See Review & Outlook: A Reserve Currency*, Wall St. J., Aug. 21, 1978, at 8, col. 1.

told, is that we are creating too many dollars. However desirable a better energy policy would be, the argument persists that the essential step in defending the dollar is a more restrained monetary policy.[39]

The wide differences in views concerning the inflation problem is further illustrated by Chairman Miller's recent remarks that the dollar's decline against the yen represents a breakout of the yen rather than a decline of the dollar. He said the yen is appreciating because of the very high Japanese balance-of-payments surplus. He counseled that what the United States must do is to reduce its inflation rate and pare back its current-account deficit. When that happens, he said, we will have a stable dollar again.[40] As helpful as the diagnosis may be in the long run, immediate curative procedures are not specified.

Irwin L. Kellner, Economist for the Manufacturers Hanover Trust Company, stated in the Bank's Summer 1978 Business Report that, "there is only one way to cure inflation once and for all and that it is for the Federal Reserve to slow the pace of money creation." Kellner contends that the only fundamental cause of inflation is too much money entering the economy chasing too few goods; that is, demand-pull inflation. He points out that the money supply has grown faster than the Federal Reserve's public announced targets. He points out further that in the recent past alone (May-June 1978) the growth rate of the money supply, M1, exceeded 12%. He states that notwithstanding President Carter's good intentions to cut back on government spending, he runs into enormous political pressures aimed at reinstating the funds he would like to cut out. These pressures come from congressmen whose areas would be affected or from the constituents themselves. In other words, people are willing to fight inflation and reduce the cost of government by tightening belts as long as it is someone else's belt.

President Carter has become gravely concerned about the sharp decline in the dollar in the foreign exchange markets and the effect which the devaluation of the dollar has upon inflation. He has therefore asked Treasury Secretary Michael Blumenthal and Chairman Miller to consider what actions[41] might be appropriate and to recommend future actions the President might take regard-

39. *Review & Outlook: A Dollar Primer*, Wall St. J., Aug. 14, 1978, at 12, col. 1.
40. *Miller Finds Japan's Yen Overvalued*, Int'l Herald Tribune, Aug. 1, 1978, at 9, col. 6.
41. *See* pp. 367-68 *infra*.

ing the dollar.[42] Carter is supposed to have misread the dollar's link to inflation and the trade gap despite the warnings sounded late last year about the virulence of inflation and the potential dangers of the trade deficit — the two underlying forces behind the dollar's weakness. Stated as a formula: inflation + trade deficit = dollar's weakness.

Addressing the inflation component in the formula, we return to the problem of the money supply: "[m]any currency traders view excessive growth of the money supply as one of the main inflation contributors because it leads to a situation where too much money is chasing too few goods. An increase in interest rates is a way of checking monetary expansion."[43] The currency market traders also urge a policy of toughness of government spending and more rigorous standards for wage and price behavior — shades of TIP.[44]

The Federal Reserve Bank of Minneapolis suggests that the Federal Reserve should announce and stick to a policy of bringing the inflation rate down to a specified level by gradually reducing the growth rate of the money supply. Mark H. Willes, President of the Minneapolis Federal Reserve Bank, says it offers the best chance of avoiding a severe recession in the near future. Additionally, Willes believes that more emphasis should be placed upon microeconomics as distinguished from macroeconomics. The former relates to the behavior of businesses and individuals in the economy, while the latter is a study of gross national product, unemployment, and the other aggregates, together with reasons for their movements. The key element in Willes' approach is referred to as "rational expectations," which is explained as follows:

> In an everyday, practical sense rational expectations is simply an assumption about people's behavior. The assumption claims that people make economic decisions in a way that tends to take into account all available information bearing significantly on the future consequences of their decisions. And they tend to use that information in a way so as not to repeat their past mistakes.
>
> This information . . . can include, among other things, knowledge about government policy actions already taken and about strategies or approaches government policy makers regularly take when economic signals begin to change. So, rational

42. *Dollar Surges as White House Breaks Silence*, Wall St. J., Aug. 17, 1978, at 3. col. 1.
43. Farnsworth, *Carter Misread Dollar's Link to Inflation, Trade Gap*, Int'l Herald Tribune, Aug. 21, 1978, at 3, col. 1.
44. *Id.*

expectations attribute to people a reasonably thorough, broad-view approach to appraising the future on matters that are going to make a big dollar-and-cents difference to them.

. . . .

Stated that way the concept hardly seems astonishing. Yet consider what it can do to standard economic theory.

Suppose the economy is weak. The Federal Reserve seeks to stimulate business by pumping more money into the economy. Prices rise, but workers go on accepting largely unchanged wages. Businessmen see increased profit opportunities so they expand, hiring more workers.

That's the conventional scenario. The rational expectationists say that workers are too perceptive to swallow it. Instead the workers quickly begin demanding higher wages to offset prospective higher prices.

So what can a policy maker do? The Minneapolis Fed suggests that the Federal Reserve might announce, and stick to, a policy of bringing the inflation rate down to a specified low level by gradually reducing the growth rate of the money supply. The bank concedes that this would require a period of adjustment, but Mr. Willes says he thinks it offers the best chance of avoiding a severe recession in the not distant future.[45]

Professor Milton Friedman's views, commonly referred to as the "monetarist approach," although highly regarded, have not been put into practice by most economists or the Federal Reserve. Professor Friedman poses a dilemma. He states that if the money growth is accelerated, the result might be double-digit inflation. He also states that if the money growth is decelerated we will probably have a recession in late 1978 or in early 1979. Thus, he argues that whatever we do will produce a severe recession later and that a recession can be postponed only at the cost of increased inflation. Professor Friedman goes further and pleads for a constitutional limit on spending. He was a strong supporter of California's Proposition 13, which drastically limits property taxes. As the leading exponent of monetarism, he emphasizes that moderate changes in the growth rate of the money supply are the main determinants of economic trends, and contends that because economic changes lag so far behind the money growth fluctuations, the best the Federal Reserve can do in its monetary policy is to promote the steady *moderate* growth of the money supply. Chairman Miller's approach is to adjust monetary policy on a pragmatic basis; that is, try

45. Clark, *Speaking of Business*, Wall St. J., Aug. 22, 1978, at 18, col. 3.

to deal with conditions as they change from time to time.[46]

III. FOREIGN REACTIONS

More than $500 billion are held by European central banks and other European financial institutions. This amount currently exceeds the M1 money stock in the United States and is slightly less than one-half of the total of the M1 and M2 money stock. Dollars were accumulated abroad in order to maintain the value of European currencies, which eventually would have affected their export industries; that is, large quantities of dollars held by the private sector would have depressed the dollar value and depreciated the local currency value. To meet this situation the central banks used the dollars accumulated by them to buy United States treasury securities. During the period of such purchase of treasury securities by foreign central banks, interest rates in the United States tend to be lower than they otherwise would be, exemplifying the law of supply and demand.[47] However, in mid-September of 1978, the Federal Reserve tightened credit controls by increasing the federal funds rate, which triggered a rise in interest rates across the board with a resultant increase of the prime rate to 9.5%. European reaction to this situation has been sternly critical of the mode in which the United States handles its affairs.

Chancellor Helmut Schmidt criticized Carter's policies and rebuked Congress and the United States business community for allowing an "irresponsible" oil import policy and for neglecting American leadership in economics. Schmidt said that he was astounded that the United States — with the world's strongest economy — is producing a balance of trade deficit which has a serious effect on the dollar. He stated that the dollar's erratic movement on the international money markets will stop only if oil imports are cut. A contrary view has been expressed. In a recent article,[48] Stuart Van Dyke, Jr., justified the United States policy of oil imports by pointing out that the United States has an area of 3,000,000 square miles compared with West Germany's 94,000 square miles, and that climate conditions and public transportation requirements

46. Clark, *Monetary Maverick: Milton Friedman, Man of Many Roles Now Is a Tax Revolutionary*, Wall St. J., July 17, 1978, at 1, col. 1.

47. Allan, *Foreign Bankers Reduce Holdings in Treasury Issues*, N.Y. Times, Apr. 21, 1978, at D-1, col. 4.

48. Van Dyke, *Energy Needs in Two Worlds*, Int'l Herald Tribune, Aug. 9, 1978, at 6, col. 4.

in the United States compel a greater need for sources of energy. Schmidt's views prompted him to talk about the need for Western Europe to work out its own economic problems without the help of the United States. Specifically, he subscribed to the idea of a Western Europe basket of currencies as a means to bypass dependence on the United States dollar as the basic internationl reserve currency.[49]

Joining Chancellor Helmut Schmidt in his critical views is West German Economics Minister Otto Graf Lambsdorff, who urged the United States as the world's banker to put its financial house in order. He noted the need to curb inflation and to adopt an energy program, pointing out that no other currency can take over the international reserve role of the United States dollar. He emphasized that neither the deutschemark or any other European currency nor the yen is in a position to take on the role of an international reserve currency in place of the dollar. He said further that, as a result of the dollar's decline, West Germany and Japan are experiencing difficulties in their foreign trade despite the cheaper prices they now pay for raw materials.[50]

French President Valéry Giscard d'Estaing maintains that substantial reduction in United States oil imports is a precondition for an improvement in the world economy. He has expressed impatience with the inaction of the United States Congress, many members of which are opposed to higher priced oil which would result from import cutting, particularly when faced with midyear elections. He maintains that any Senate efforts to strip the President of his powers to tax imported oil would leave the President a workable alternative, that is, setting the quotas by administrative action as distinguished from an import fee, which would require congressional approval. European countries with successful export industries — for example, West Germany — argue that the falling dollar is forcing up the value of their currencies and is thus squeezing their profitability.[51]

The devaluation of the dollar has caused Europe to come forth with self-protective measures. The weaker the dollar grows, the more Europeans tend to look to themselves for getting currency

49. *Chancellor Schmidt Criticizes Congress and U.S. Business*, Wall St. J., May 1, 1978, at 23, col. 4.

50. *German Official Chides U.S. on Its Inflation Curbs*, Wash. Post, Sept. 1, 1978, at 1-5, col. 1.

51. Lewis, *Giscard Oil Warnings to Carter*, N.Y. Times, July 13, 1978, at D3, col. 1.

matters in order. Most European planners share a desire to protect the dollar, and they believe that creation of a strong, all-European currency would relieve some of the worldwide financial responsibilities that now put pressure on the dollar. Similarly, European financial leaders have vowed not to support any system that could hurt the United States currency.[52]

In the quest for financial self-preservation, new phrases have come upon the scene, such as "basket of currencies" and "cocktail of currencies." Various devices have been suggested such as the European Unit of Account (EUA). EUA is a basket of European currencies used in computing certain market transactions such as credit arrangements and intergovernmental dealings which would be based on the EUA rather than the dollar. It is really a symbolic statement of independence rather than a precisely formulated financial medium with wide potential use.[53]

H. Johannes Witteveen, former Managing Director of the International Monetary Fund (IMF), offered a helpful explanation of the function of Special Drawing Rights:

> Central banks that have accumulated surplus dollars could turn them in to the Fund and get the equivalent in Special Drawing Rights. While holding the SDRs, the central banks would continue to be credited with the interest from dollars they could be earning, for instance, from investments in the United States Treasury securities.
>
> Created 10 years ago, Special Drawing Rights represent a market basket of currencies, which nations hold as reserves along with gold bullion and dollars to settle their international accounts. One SDR unit is worth $1.22.
>
> There are already some $10 billion of these units, along with $90 billion of dollar assets and, at current prices, some $175 billion of gold included in the reserve assets of nations.
>
> As the SDRs expunge the dollars, there would simply be an adjustment in the composition of this international liquidity and not an increase.
>
> The plan can go nowhere without United States approval, since any creation of SDRs requires an 85 percent majority vote in the International Monetary Fund, and the United States alone can muster 20 percent, more than enough to block the plan (pur-

52. *Shaky Dollar Aids Europe Currency Plan*, Int'l Herald Tribune, Aug. 22, 1978, at 1, col. 1; Carr, *Defending Europe Against Vagaries of the Dollar*, Financial Times (London), Sept. 19, 1978, at 14, col. 1.

53. Spivak, *Western European Nations Seek Stability In Currencies Via United States Money Policy*, Wall St. J., Apr. 24, 1978, at 8, col. 1.

suant to Article XV, Section 2 of the Articles of Agreement of the International Monetary Fund).[54]

Japan's Minister of Economic Affairs, Nobuhike Ushiba, points to the weakness of the dollar and offers the standard prescription that the United States should curb its inflation and its appetite for energy. Ushiba is apprehensive that in the present disordered state of the world economy, nations are tempted to take protectionist measures with a ruinous impact on world trade. He says Japan's aims are to reduce its trade surplus and to expand more rapidly its domestic economy. To attain the growth goal, a program of public works will be initiated. This approach has been criticized by outside economists and is likely to do little for Japanese import demand compared with what tax cuts for consumers would do. Ushiba counters with the argument that his countrymen's savings rate is more than 25%, so that even if there is a tax cut the consumer will put the extra money into savings.[55]

A. Summit Meeting

In mid-July of 1978 the Western industrial nations met in Bonn to pledge steps each would take to implement promises of economic expansion. If the pledges are carried out, it is estimated that the average annual rate of economic growth for the twenty-four member nations of the Organization for Economic Cooperation and Development (OECD) will have climbed back toward the 4.5% level at which unemployment ceases to rise. West Germany pledged to stimulate its economy by up to 1% of the gross national product — about $6 billion — and said that it was near agreement on a package of tax cuts, investment aids, and increased family allowances. The United States pledged to reduce oil imports. Some doubt was expressed as to whether the West German measures, as well as those of the United States and other participating countries, will be accepted by the legislatures of the nations involved.

All of the pledges made at Bonn were quite vague and qualified, and OECD officials remain skeptical about the West's ability to carry out all the pledges made. For instance, the OECD assumes prompt passage by the West German Parliament of the 1% stimulus package, and while the government is apparently making strides on

54. Farnsworth, *U.S. Resisting Witteveen's Plan For Supplanting Surplus Dollars*, N.Y. Times, Apr. 24, 1978, at D1, col. 4.

55. Silk, *Growing Japanese Concern Over Worldwide Depression*, N.Y. Times, May 9, 1978, at 53, col. 2.

putting together that package, the opposition party controls the Upper House that must approve it.

The OECD also assumed that Japan will be able to raise its economic growth rate to 9% during the first half of 1979 in order to meet its pledge to achieve a 7% growth rate during the coming fiscal year. In Japan, as the dollar slid to another postwar low against the yen, the Government announced a supplementary budget designed to help it meet its growth goals.

The one exception to the call for growth is the United States, where growth is already high relative to the other member nations. The OECD argues that Washington should accept a slowdown next year to combat inflation and curb the enormous payments deficit that is depressing the value of the dollar.[56] In mid-August of 1978, Japan announced that it may not be able to keep the key promise made at the Summit Conference in Bonn, that is, maintain a national growth rate of 7% in fiscal 1978.[57] At a still later date the Japanese government disclosed that it would introduce additional budgetary measures aimed at keeping the economy moving toward the previously announced growth rate target of 7%. These budgetary commitments are not only for "roads and highways but also for restructuring industries, creating new employment, and improving the quality of life."[58] Apparently in anticipation of the growth program, Japan's central bank has begun to accept bids to buy goverment bonds from 416 banks, credit associations, and securities firms.[59]

B. OPEC and the Dollar

The Organization of Petroleum Exporting Countries (OPEC)[60] is gravely concerned about the declines in the exchange value of their substantial oil export earnings, as well as the erosion of their dollar-denominated assets. The actual losses resulting from the

56. *Carter Officials May Be Too Optimistic About Growth, OECD Says*, Wall St. J., July 26, 1978, at 5, col 1.

57. Scott-Stokes, *Growth Target Is Seen Eluding Japan*, Int'l Herald Tribune, Aug. 19-20, 1978, at 7, col. 3.

58. *Japan Plans To Disclose More Budgetary Steps To Increase Growth*, Wall St. J., Aug. 28, 1978, at 22, col. 4; Scott-Stokes, *Japan Approves Measures To Spur Sagging Economy*, Int'l Herald Tribune, Sept. 4, 1978, at 5, col. 1.

59. Tharp, *Japan Unveils New Stimulative Package in Bid for Goal of 7% Economic Growth*, Wall St. J., Sept. 5, 1978, at 6, col. 1.

60. Major Middle East OPEC countries include: Saudi Arabia, Iran, Iraq, Kuwait, Abu Dhabi, UAE and Qatar; other OPEC countries are: Venezuela, Nigeria, Libya, Indonesia, Algeria, Gabon, and Ecuador.

dollar depreciation are not easy to assess because of the different uses to which the dollar-denominated assets are put, — *i.e.* the purchase of United States governmental securities or their importing purchase needs. The various suggestions made to date by the oil ministers of the OPEC countries are concerned with a variety of currency baskets. On close analysis of the currencies comprising the different baskets, it has been virtually impossible to reach a consensus among the OPEC countries as to which basket would be the fairest and most workable for the countries involved. The dilemma confronting the OPEC countries was candidly stated by Jahangir Amuzegar, Executive Director of the IMF:

> [A]ny change of the oil-pricing formula away from the dollar when the dollar is weak is likely to further erode world confidence in the U.S. currency and to add to its downward pressures (citation omitted). The dollar's plunge following the switch may help boost oil exporters' receipts from immediate oil shipments; but it would also further depreciate their huge dollar balances, and would thus certainly be resisted by surplus members. This is perhaps a major reason why Saudi Arabia has so far objected to any switch from the existing dollar system.[61]

The United States Treasury has opposed any shift by OPEC from the dollar pricing.[62]

Amuzegar also makes the point that the drop in the dollar value aggravates inflation in the United States and has a rather slow beneficial effect on America's balance of trade. In essence, with gold out of the monetary system and the SDRs not yet firmly in place, the present order is in practice a dollar standard under which the United States shares the control of world liquidity with some other major currency centers, the international private banking community, and the IMF.[63] By any measure, the United States dollar is the world's most outstanding currency due to the sheer size of the United States economy and also because the dollar is now virtually the international system's main means of payment and its principal reserve asset. Amuzegar points out, however, the vulnerability which "is the mirror of America's underlying economic conditions, e.g., the rate of domestic inflation, the size of the budget gap, the deficits in the balance of trade and payments, the cyclical trend of the economy, and above all the structural competitiveness

61. Amuzegar, *OPEC and the Dollar Dilemma*, FOREIGN AFFAIRS 745 (July 1978).
62. *Id.*
63. *Id.* at 746.

of U.S. industries."[64] He remarks:

> The 1976-78 "dollar debacle" is chiefly attributed to the U.S. huge oil imports ($45 billion in 1977), balance-of-trade gap ($29 billion), and balance-of-payments deficit ($20 billion). Actually it has been the product of a complex set of factors: a faster U.S. growth rate compared to its main trading partners; two mammoth budgetary deficits ($60 billion each) in 1977 and 1978;[65] phenomenal increases in the trade surpluses of Japan and Germany (both, ironically, more dependent on foreign oil than the United States); the specter of another round of domestic inflation in the American economy in 1978; and a growing worldwide lack of confidence in the dollar's future — based on the real or imaginary belief that the United States is neither willing nor able to stem the dollar's fall.[66]

"Only a sharp cut in oil imports could provide a quick effective cure for the dollar."[67] Amuzegar impliedly suggests that most other efforts made to date, well-intentioned as they have been, do not go to the heart of the problem.

> Faced with these unhappy choices, a host of other suggestions have been offered by economists and businessmen to prop up the ailing dollar. These measures have included the sale by the U.S. Treasury of foreign-currency-denominated bonds in order to engage in more aggressive market interventions; larger currency swap arrangements with foreign central banks; the use of IMF credit, and the sale of Treasury gold in the open market. Supplementing these "quick-fire" actions have been suggestions regarding the need for: the passage of an effective U.S. energy conservation and production program; a convincing anti-inflation policy; new tax and welfare policies that could reduce unemployment through increased business investment instead of public work programs; and innovative measures to improve dwindling American competitiveness in some key industries.[68]

France and West Germany, evincing an impatience with the "dollar problem" and the questionable status of the dollar as the desirable reserve asset, have resolved to take action as a self-protective measure for the European economy. On September 16, 1978, they announced they would work on a proposed new European Monetary System (EMS) aimed at bringing greater exchange rate

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64. *Id.* at 747.

65. The books have not yet been closed on the United States deficit for 1978, which will be less than $60 billion.

66. Amuzegar, *supra* note 61, at 747.

67. *Id.* at 748.

68. *Id.*

stability in Europe. It is contemplated that Community leaders may decide in December 1978 on the establishment of the system.[69] It is reported that agreement had been reached in three areas: the kind of unit to be used at the core of the system; intervention policy; and the size and scope of the planned new European monetary fund. A round of discussion with Community partners is planned for the near future. A key point of difference between the West German and French approach is rumored to have been resolved. West Germany and other members of the present "snake"[70] currency system generally favor a fixed yardstick against which the movements of the participating currencies would be measured. France, apparently supported by Britain and Italy, seemed initially to prefer a continually altering yardstick based on a basket of currencies. However, it is hoped that after a discussion is held with Community partners, perhaps these opposing views will be resolved. Developments of this proposal will bear watching, for it is significantly indicative of the steps West Germany and France are taking as leaders to challenge the United States dollar as the sole reserve currency of the International Monetary System.[71]

These new developments in Europe initiated by Giscard d'Estaing and Helmut Schmidt suggest the fulfillment of a prophecy:

> The old order changeth, yielding place to new, And God fulfills himself in many ways, Lest one good custom should corrupt the world.[72]

IV. THE NEW DETERMINED EFFORT

The United States has been criticized, worldwide, for ineptly managing its economy. West Germany, France, Japan, and Switzerland have been its major critics. Their complaint is that, in the

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69. To date, however, the EMS has reached an impasse because of basic differences on the price of farm products. The EMS, spearheaded by France and West Germany, as of this writing, comprises also Belgium, the Netherlands, Luxembourg, Denmark, Ireland, and Italy. The United Kingdom has deferred its decision to join, subject to resolving internal factional differences.

70. The "snake" is the current European currency arrangement: currencies are set at fixed rates and float against each other within a narrow band — a so-called parity grid.

71. Carr, *Giscard and Schmidt Settle Differences*, Financial Times (London), Sept. 16, 1978, at 1, col. 7. *See also* Jonquieres & Riddell, *A European Monetary System: Condemned to Succeed*, Financial Times (London), Sept. 18, 1978, at 14, col. 3. Jonquieres, *EEC Exchange-Rate Compromise Leaves U.K. As Sole Opponent*, Financial Times (London), Sept. 19, 1978, at 1, col. 3. Riddell, *The Pound in Your Pocket*, Financial Times (London), Sept. 20, 1978, at 20, col. 1.

72. Alfred Lord Tennyson, "Morte d'Arthur."

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wake of a spiraling inflation, the United States dollar has been measurably weakened in relation to the deutschemark, the French franc, the Swiss franc, and the Japanese yen. The administration, painfully aware of the dollar's plight, launched a major new initiative on November 1, 1978. Alfred E. Kahn was named anti-inflation chief. Mr. Kahn is addressing his attention to the guidelines for wage and salary increases of 7% and a price guideline that generally would permit price increases up to 1/2 of 1% less than the increases put through in 1976 and 1977. Relaxation of these standards has already taken place in response to the objections of the labor and business sectors of the economy. It is contemplated that in administering the guidelines program, a flexible approach will be employed.

An ingenious ingredient of the newly introduced program is the proposal made that wages and salaries will be "insured" against the effects of inflation. Groups of workers who agree to accept from their employer a pay increase that falls within the 7% guideline would be eligible for a tax credit equal to the amount by which their pay increase falls below the inflation rate; that is, workers will be compensated in effect for price increases which exceed pay increases. Just as in the case of wage and salary controls during World War II, the proposed guidelines, which are not controls, will have to be implemented by numerous interpretations and regulations to accommodate them to different situations. Organized labor is opposed to the guidelines and prefers wage and price controls, apparently on the theory that the best protection for employees is to place a ceiling on prices so that the real wage can be maintained.[73]

The broadside launched by the administration extends beyond the wage-price spiral. It includes within its thrust an all-out effort to strengthen the dollar in foreign exchange markets. To this end, President Carter requested Chairman Miller and Treasury Secretary Blumenthal to study the problem and make recommendations. This phase of the "New Determined Effort" is in full swing.

The Federal Reserve Board has announced: (1) approval of a one percentage point increase in the discount rate at Federal Reserve Banks from 8-1/2% to 9-1/2% — a further step which will diminish the amount of borrowings of member banks from the Federal Reserve and contribute to reducing the growth rate of the money supply; (2) establishment of a supplementary reserve re-

73. *See* T. Gaines, The New Policy Initiatives, Manufacturers Hanover Trust, Economic Report 1 (Nov. 1978).

quirement, in addition to existing reserve requirements, equal to 2% of time deposits in denominations of $100,000 or more — a step which, together with the increase of the discount rate, should increase the incentive for member banks to borrow funds from abroad and strengthen the dollar in foreign markets; and (3) increases in the Federal Reserve Reciprocal Currency (SWAP) arrangements with the central banks of West Germany, Japan, and Switzerland by $7.6 billion to $15 billion — a step which permits the purchase and reduction of the supply of dollars in the world in the international exchange markets.[74]

In turn, the Treasury, to augment the measures taken by the Federal Reserve Board, has announced: (1) the issuance of up to $10 billion of Treasury securities denominated in foreign currencies intended primarily for sale to private foreigners — a step to make foreign currency available to the Treasury; (2) drawing $3 billion in foreign currencies from its reserves at the IMF and selling $2 billion of its IMF Special Drawing Rights (SDRs) for foreign currencies; and (3) increasing its gold sales to at least 1.5 million ounces monthly beginning in December 1978, up from 300,000 ounces currently and about double the previously announced level of 750,000 ounces that was to have begun in November of 1978.

The currencies acquired from the IMF, the sale of SDRs, and the issuance of foreign currencies denominated securities — together with amounts available through the Federal Reserve swap lines — provide up to $30 billion in foreign currencies for support operations in exchange markets.

The goal of these measures is to reverse the decline in the dollar's value abroad. By showing an intention to support the dollar, the Treasury and the Federal Reserve hope to stem unwarranted diversification out of dollars by private and official foreigners. In the long run, the recovery of the dollar will depend on actions by the government to change underlying inflationary expectations.[75]

It is hoped that a combination of the proposed guidelines relative to wages and prices and the aggressive steps taken by the Federal Reserve Board and the Treasury will be the felicitious mix that will have a restraining effect on spiraling inflation and will enhance the value of the dollar in relation to foreign currencies in the international exchange markets.

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74. *See* VOICE OF THE FEDERAL RESERVE BANK OF DALLAS, FEDERAL RESERVE AND TREASURY SUPPORT THE DOLLAR 1-2 (Nov. 1978).

75. *Id.* at 3-5.

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V. CONCLUSION

It must be apparent to the reader that no one has yet come forth with a quick and easy solution to the global enigma of inflation. At this juncture, therefore, it is still a riddle to be solved. Certainly there is no dearth of trained talent analyzing and suggesting ways out of the morass. Fifty years ago, John Maynard Keynes said that the inflationary process "engages all the hidden forces of economic law on the side of destruction and does it in a manner which not one man in a million is able to diagnose."[76] More optimistic and hopeful is the approach of the Organization for Economic Cooperation and Development spearheaded by West Germany and France. At the mid-July 1978 summit meeting in Bonn, all the countries attending pledged to take appropriate steps in an effort to stem the tide of the inflationary flow. It would be ironic if future historians should record that men were able to avoid a nuclear holocaust but floundered in solving the plaguing puzzlement of money supply, inflation, currency valuations, and the other macroeconomic concepts which beset our industrial world.

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76. J.M. KEYNES, *Inflation and Deflation*, in ESSAYS IN PERSUASION 78 (1932).