THE CASE FOR ZERO INFLATION

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Benefits of Zero Inflation

The Federal Reserve System (the Fed), a creation of Congress, has the ability to end inflation. If Congress will pass legislation to establish zero inflation (or what economists call "price stability"[1]) as our nation's policy and the Fed will implement it, we will soon enjoy long-term government interest rates of 3 to 4 percent (short rates even lower), mortgage interest rates of about 6 percent, and business and consumer loans at around half of today's rates.

By eliminating inflation, we will establish the essential foundation for the highest sustainable levels of economic growth, employment, savings, capital formation, investment, productivity, competitiveness, and efficiency. We will greatly reduce the likelihood of future recessions, make our country more competitive in world trade, and improve the standard of living for everyone. All of our people will benefit; no one will lose.

Price Stability and the Deficit

Our economy will perform even better if we accompany zero inflation with zero budget deficits. House Joint Resolution 24, which I have sponsored, would achieve price stability and reduce the budget deficit more—and more quickly and painlessly—than any other way.

We reduce the budget deficit this way: As soon as our government is seen as serious about ending inflation, the "inflation premium" in interest rates will begin to disappear and long-term rates will start to fall. Since our government is paying interest on more than $3 trillion of national debt, each 1 percent drop in the average interest

Cato Journal, Vol. 12, No. 1 (Spring/Summer 1992).

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[1]Zero inflation and price stability both mean a level of inflation so low that it is inconsequential to decisionmaking.

rates paid will cut the deficit by $30 billion dollars a year. Each 1 percent drop in average interest rates saves $30 billion a year in interest—year after year—permanently.

As we continue reducing the deficit by lowering interest rates, and lowering interest rates by reducing inflation, the benefits compound. We will have permanently saved hundreds of billions of dollars during the five years that it will take to achieve zero inflation.

Savings, Investment, and Trade

When the American people understand that the value of their savings will not be destroyed by inflation, they will save more. Increased personal savings, plus savings generated by cutting the deficit, will generate a massive new pool of savings that will create the capital economists say is essential for America's future. In short, more savings means more investment. More investment means more jobs and a more productive and competitive economy, both at home and in world trade.

If, after achieving zero inflation, we maintain it, the benefits will be permanent. Working people, low-income people, and retired people will not have to live with the constant specter of prices for food, medicine, education, clothes, energy, and transportation rising year after year, usually faster than their incomes. They will not see their retirement savings eaten away by inflation.[2] And when they borrow, they can count on low interest rates.

Young families and others will be able to buy homes. At 11 percent interest, a 30-year $80,000 mortgage costs $762 a month. At 6 percent, that mortgage shrinks to $480 a month. At the lower rate, more working families could qualify for home loans and would astoundingly save more than $100,000 (including interest) during the life of the loan. As inflation comes down, mortgage rates will drop, the housing industry will boom, more people will be at work, and we can at last provide affordable housing. Also, small businesses and farms, often fighting for survival and always in debt, can flourish with stable prices and low-cost capital.

Our major international competitors, Japan and West Germany, will not tolerate high inflation. As a result, their prices are stable and predictable, and their costs of capital are low. Zero inflation and lower interest rates will make us more competitive in world trade. We can help reclaim our leadership position in the world economy and provide more jobs for our people. The benefits will be fabulous for all aspects of our economy and for all Americans.

[2]At a 5 percent annual rate of inflation money loses half its value in just 14 years.

Costs of Achieving Zero Inflation

But what about the costs? Clearly, if we were to try to accomplish zero inflation overnight, the result would be a major recession. But I am recommending that we get there over a period of years, not overnight.

Two factors clearly indicate we can reach zero inflation without much pain. First, we are now operating in a period of labor shortages. Even with moderate growth, most people who want work can and will be able to find it.

Second, as inflation decreases, long-term rates will come down, enabling us to continue moderate growth even as we coax inflation out of the system. Thus, the cost of achieving price stability would be an economy growing about as it does now for a relatively short period—not booming, maybe, but not bad, given today's rate of inflation.

Importance of Credibility

The current recession should not last long if government will provide coherent policy. We should insist on a time frame for achieving zero inflation that will not cause a major recession, which would inflict unnecessary pain and sap our will to succeed. I think five years is about right, but if we can achieve our goal a little sooner or if it takes a little longer, that difference is not critical. What is essential is that our plan be credible.

Misconceptions about Inflation

A few other questions should also be explored. Some people think inflation is caused by budget deficits. But if so, how were we able to bring inflation from double digits to 4 percent in the early 1980s while we were doubling the national debt? How could inflation have stayed under 5 percent while fiscal policy tripled the debt by 1989?

Some people think that inflation is good for employment. If true, why is it that Japan, West Germany, and other low-inflation countries have high employment while high-inflation countries like many in Latin America experience low employment? And why was it that the high inflation of the 1970s in our country was also a period of very high unemployment, so-called stagflation? Employment created by inflation is temporary. Because most recessions (and the resulting unemployment) are created to stop inflation, inflation cannot be good for long-term employment. If there is no inflation, there is no need for recession.

Some people think inflation is caused by supply-side shocks to oil and commodity prices. If so, how do you explain the low inflation in West Germany, Japan, Switzerland, and other countries that experienced even worse oil shocks than did the United States?

Some people want to exert more political control over the Fed by adding the Treasury secretary to the Fed's board. Legislation has been introduced in Congress to politicize the Fed. But would not that change almost ensure stimulative policies during election years and contractions during the years after? Some people say the Fed should be able to do whatever it wishes and not be accountable to anyone. But the Fed is part of our government; its actions have an enormous impact on all of our lives. So should it not be held accountable for producing the policy that is best for our country?

Some people think that inflation is caused by factors beyond our control and that there is nothing we can do about it. But inflation still is, as the dictionary says, too much money chasing too few goods. And the Fed controls the supply of money. The Fed wants to end inflation and is trying, but because so many in the Congress, the administration, and the public want the Fed to do so many different and inconsistent things, nobody believes the Fed. Passage of legislation requiring zero inflation will make our commitment clear and effective.

Conclusion

The Subcommittee on Domestic Monetary Policy, which I chair, has been exploring these issues and others in public hearings. The Federal Reserve Chairman, Alan Greenspan, and all the regional Federal Reserve bank presidents have endorsed my legislation. It has also been endorsed by two Nobel Prize–winning economists, by numerous other economists, by the U.S. Chamber of Commerce, and by the American Farm Bureau Federation, among others.

We hope support will be widespread. We think members of both major political parties should like the idea. Democrats will be especially attracted by the great benefits to our traditional constituency of working people, older Americans, farmers, small businesspeople, and low-income families. They are the ones who suffer most from rising prices and are least able to protect themselves. They generally are borrowers, not lenders, and would especially benefit from low interest rates. Republicans should like zero inflation because nothing is better for the stock market than low interest rates. Since inflation has the same effect on purchasing power as a tax, reducing inflation from 3 percent to zero is like lowering taxes by 3 percent. And all lovers of freedom, our nation's great treasure, should like zero inflation, regardless of their political stance.

There is some cost in fighting inflation, but the costs of not achieving zero inflation are immense—hundreds of billions of dollars of unnecessary government interest payments, constantly rising prices, less permanent growth and job creation, low savings, and a less-efficient and less-competitive economy.

We know the benefits of achieving zero inflation are great and the costs are small, and we know how to do it. We can help cure the major disease of our time—short-term thinking leading to short-term policies—by continuing our drive toward zero inflation. Adopting zero inflation as our nation's policy would be a tremendous gift to the American people—a gift that would "keep on giving" forever.