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Research Seminar on the Processes of Inflation

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RESEARCH SEMINAR ON THE PROCESSES OF INFLATION

This is a request for financial support for a special Research Seminar on the Processes of Inflation which will be offered in the Department of Economics at the University of California at Berkeley, beginning in the academic year 1959-60. In order to achieve the unique objectives of this new seminar, it is necessary that the ordinary departmental support be supplemented by additional resources.

The object of this seminar is to stimulate faculty and graduate student work in an extremely important area of public policy. In addition to the faculty members who will be directly responsible for its administration, it is intended that other faculty members of the Economics Department will participate. Hence the seminar will serve to focus the attention of economists with different specialties on problems related to inflation and will provide an arena where the implication of their current research for the analysis of the problems of inflation can be explored.

I. Need for a Research Seminar in the Processes of Inflation

The proposed seminar will be unique in several respects. It offers the possibility of making an important contribution to research and training in economics through its particular combination of (1) the choice of a critically important policy issue for investigation, (2) a multi-faceted approach to the problem that makes use of the various relevant branches of economics, and (3) emphasis not merely on current research but on stimulating graduate students and faculty members to continue to work on the problems in the future, either directly or in connection with other types of investigations that they may later pursue.

A. The nature and importance of the policy issue.

No economic problem has been the subject of more widespread discussion and debate among professional economists and in the community as a whole than inflation. Thus far, this debate has failed to produce a consensus as to the causes, course or consequences of this phenomenon. And, without such a consensus, there can be no agreement concerning the public policies which should be adopted.

Among the important unresolved questions dealing with inflation and, therefore, calling for further research are the following: Does a commitment to full employment imply inflationary pressures? Is inflation a necessary accompaniment to sustained economic growth? Does creeping inflation necessarily turn into runaway inflation? What are the roles of the monetary and financial mechanism and of the government's fiscal operations in the inflationary process? Does the existence of administered and regulated prices generate inflation? What is the relation between the wage determination process and inflation?

Aside from the intrinsic importance of the problem itself, it is highly desirable that academic interest in the processes of inflation be expanded at this time. As a result of the current interest in inflation, two official investigations are being undertaken. These investigations by the Nixon and Douglas committees will be policy oriented but they will also be politically motivated. The academic research seminar can utilize information which these committees will uncover to throw light on the basic steps involved in the generation of inflation. In addition to these official investigations, the National Monetary Commission's research effort can be expected to generate more precise information on the functioning of specific financial sectors than has hitherto been available. The research seminar will utilize these emerging pieces of information, as well as others, to investigate the

inflationary processes.

The significance of yesterday's economic analysis in determining today's public policy is quite apparent; equally true, but often overlooked, is the importance of today's popular discussions as a determinant of the direction that tomorrow's economic analysis will take. This seminar will monitor popular and political discussions of inflation. The purpose in doing this will be to try to shorten the time gap between changing public behavior and attitudes and the recognition and absorption of such changes by economic analysis.

Another important reason for undertaking research on the problems of inflation now is that there is increased awareness that the complex goals set for economic policy may be internally inconsistent. The goals set for the economy include both those concerned with the aggregate behavior of the economy and those directed toward particular institutional arrangements and the performance of particular sectors or markets. Among the aggregate aims are price stability, full employment and an "adequate" rate of growth. Among the more specific goals are the right of collective bargaining, minimum wage standards, urban renewal, expanded education, protection of domestic industries and agriculture against market forces, foreign aid, and an expanded expenditure on national defense. It is important to examine in detail the inter-relations among these policy goals, in the light of the observed inflationary pressure, in order to determine whether these various aims are inherently mutually incompatible or whether the apparent inconsistencies are due to specific techniques which have been used to implement them. If it is found that some of these goals are in fact mutually incompatible, then a further step in research is indicated. In this event, it becomes necessary to define the various sets of consistent policy aims. In particular, it is important to determine what combinations, if any, of the market structures make possible the simultaneous realization of the aggregate policy goals of full employment, accelerated growth, and

stable prices.

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Currently, this problem is exemplified by the question as to whether the maintenance of full employment with stable prices is consistent with the existence of effective trade unions and oligopolistic industries. Even though some economists have maintained that a commitment by the government to maintain full employment is inconsistent with stable prices, the emphasis in much of the discussion is upon cost push or sellers' inflation. In such cost push or sellers' inflation the generating force is the behavior of trade unions and administered prices, and the monetary and fiscal mechanism of the state are permissive factors. The question of whether the aggregate policy goals of full employment and stable prices are inherently inconsistent or whether they are inconsistent in fact due to the existence of trade unions and oligopolistic industries is of the utmost importance for the determination of public policy.

B. The need for a broad approach.

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In spite of the fact that the processes of inflation involve factors that are the special concern of many of the subdivision of economic science, most investigations of the problem are narrow in that they are the work of specialists in one or another of the subdivision of economics. From the processes involved in inflation it seems self-evident that it is necessary to cut across the traditional boundaries of the subdivision of economics if all of the economic aspects of this issue are to be examined. This objective will be aided by two peculiar characteristics of the Berkeley seminar. First, the seminar will be directed jointly by specialists in money and banking, labor and business cycles, three of the subdivisions of economics which are most closely concerned with the problem of inflation. In addition the seminar will draw in other members of the department who will look at the

processes involved in inflation from the perspective of their special area. In all cases the papers and discussions of the various specialists will be subject to criticism and comments by economists specializing in other areas of economics. It is expected that this broad approach will give each participant (faculty as well as student) a rounded view of the problems involved.

G. The need for "carry-through".

The work on inflation thus far has been of two sorts: (1) conventional research ^{usually oriented toward one of the subfields of economics,} resulting in books and articles which may arouse some interest in occasional readers but seldom stimulate further work and (2) symposia, in the form of Congressional hearings, papers and discussion at conferences, etc., which bring together different views but almost never result in a synthesis or general agreement or provide an agreed basis for further research.

The proposed seminar will be different in two respects: (1) one of its chief purposes is to stimulate research and to get people in the various special fields to look at the inflation problem in terms of not only their own field but also in terms of what other fields can contribute, (2) the seminar will continue for at least three academic years, thereby enabling results to accumulate and interests to mature. *It is hoped that, on the part of some of those participating, research interests will be stimulated.*

II. Proposed Research

In general, it is expected that the research stimulated by the seminar will yield results in the following areas:

- 1) The nature and magnitude of the impact that new and rapidly changing institutions in the money, labor and product markets have had upon economic processes.
- 2) The relevance of traditional economic analysis to the problems of inflation once its wider institutional setting is considered.
- 3) The adequacy of traditional policy prescriptions to satisfy the modern policy objectives, given the modern institutional framework.

That will continue well beyond the three years.

Among the specific topics to be examined in the seminar are the following:

- 1) The effect of changing money market institutions upon the financing of economic activity and its impact upon the efficacy of monetary policy.
- 2) The effect that the existence of a large government debt has upon the supply of risk capital.
- 3) An examination of the process by which a so-called key wage bargain works its way through the economy.
- 4) An analysis of the proposition that a rise in wage rates when unemployment exists tends to expand employment.
- 5) A study of the relation between changes in relative prices and changes in the price level.
- 6) A study of the extent to which the movement of wages during inflation is characterized by changing relative wages, and in examination of the characteristics of those labor markets in which relative wages rose, in which relative wages fell.
- 7) A study of the relation between unionization and wage-price movements.
- 8) A study of the time rate of change of prices and the competitiveness of the particular product markets.
- 9) An examination of the structural changes in the economy that have occurred to see whether or not they have affected the likelihood of inflation.
- 10) Whether or not ratchet effects in prices exist, and if they do how do they work and how significant are they?
- 11) The backlog effects operating in particular sectors of the economy such as service trades and oligopoly (a thesis of Galbraith) and their effects upon inflation.
- 12) The role of differential trends in productivity among industries and their effect upon price movements. Is the rate of change of wages in general too dependent upon the wage increases that occur in industries that enjoy a

relatively rapid increase in productivity?

Obviously the list of topics can be expanded. The above list is illustrative of the topics that will be discussed in the research seminar. It is expected that as a result of the existence of the seminar, faculty members and graduate students will be stimulated to work on problems dealing with inflationary processes and public policy in relation to inflation. It is anticipated that the results of particularly fruitful seminar sessions will *developed into papers to be submitted to* be ~~published in~~ the professional journals.

Underlying the various specific topics on which research will be stimulated by the seminar is a common approach to the problems posed by inflation. This approach holds first that inflation is a process in time. Its nature and effects can be assessed only by dynamic analysis. Secondly, the inflationary process is typically associated with changes in important market institutions. It is essential to assess how these changes affect the path and the equilibrium values of the relevant variables. In contrast to the approach that will be adopted by this seminar, traditional research on inflation has been dominated by techniques of comparative statics and has assumed or found it convenient to conclude that institutional changes themselves have not affected the movement of important economic variables such as commodity prices, wages or the supply of money and its velocity of circulation.

III. Training Functions of the Research Seminar

The Department of Economics expects that the Research Seminar on the Processes of Inflation will aid in the training of graduate students in three ways. It will provide faculty supervision and financial support of two first or second year graduate students who as Research Training Fellows will receive training in research techniques by aiding the research efforts of the participating faculty members. It will provide faculty supervision and fellowship support of two advanced graduate students in the writing of doctoral dissertations in the area described in the preceding paragraphs, And, it will furnish, in

regularly scheduled meetings, a forum for the discussion by faculty and student participants of research completed and underway, of current official reports and proceedings, and of current literature relevant to the group's purpose.

In the performance and direction of research, emphasis will be placed on (1) the social problem involved and (2) the policy implications involved, rather than on the development of research techniques per se. Frequently, graduate students concentrate so intensively on the acquisition of certain techniques of analysis that they come to regard the technical apparatus of economics as an end in itself, to the detriment of their knowledge and appreciation of the social problems for the analysis of which the tools have been designed. The Research Seminar on the Processes of Inflation, by concentrating on one area of applied economics and policy formation, would aid the graduate program at California in the following ways:

- a. It would afford graduate students an opportunity to apply the techniques of economic theory and statistics acquired in other courses to concrete problems in the area of inflation.
- b. It would afford them an opportunity to trace the interrelationships among phenomena which they have hitherto considered in isolated academic compartments: i.e., Monetary theory and fiscal policy, labor markets, product markets, business cycle and growth theory.
- c. It would expose them more fully to an appreciation of both the importance and the complexity of a widely discussed issue in all of its ramifications--political and social as well as purely economic.

IV. The Organization and Faculty Participants in the Research Seminar

The Chairman of the Department has approved the new seminar to begin in

the fall of 1959. Administration of the research seminar will be the responsibility of three members of the senior faculty of the Department of Economics at the University of California at Berkeley. A wider faculty group drawn from both the Department of Economics and the School of Business Administration will actively participate in the direction of graduate student research and the seminar.

The members of the faculty who will assume direction of the research seminar are Professors Robert A. Gordon, Hyman P. Minsky and Lloyd Ulman. They will be responsible, in conjunction with the graduate committee of the department, for selecting the Research Training and Dissertation fellows, for engaging in and directing research in their special problem areas as indicated below, for coordinating the efforts of the other participating faculty members and for organizing and administering the seminar.

Professor Gordon will direct research on the cyclical aspects of the inflationary problem. His work on costs, prices and profits in the interwar period and on prewar and postwar investment opportunities, *will help to provide a* ~~which will serve~~ ~~a~~ basis for comparing the differences, if any, between the forces at work in the interwar period and the present, ^{and} defines the areas of research which will be his special interest. In process under his direction is a doctoral dissertation dealing with the behavior of prices during prewar and the postwar recessions.

Professor Minsky will direct research on the role of financial intermediaries and the monetary aspects of inflationary processes. His research on money market changes, the relation between the monetary system and the overall behavior of the economy, the condition for sustained growth and the role of the national debt in determining economic growth delineate the areas of the

seminar's activities that will be his special responsibility. In process under his direction are doctoral dissertations dealing with the distributional effect of a tight money policy and ^{with the} ~~ordinary business firm's~~ demand for cash balances ^{by business firms}.

Professor Ulman will direct research on the relation of developments in the labor market to the inflationary process. His work on the economic determinants of union bargaining strength and the economic impact of unions indicate the areas of the seminar's activities that he will be responsible for. A dissertation in process under his direction investigates the relationship between union bargaining strength and the structure of product markets. He will presently engage in research at the level of the firm on employer responses to wage changes.

The Economics Department at the University of California at Berkeley has long enjoyed a rich tradition in empirical and policy oriented research. The research seminar will serve as a forum for the discussion of these aspects of the faculty's current research which are related to the public policy aspects of the inflationary processes. In addition, the research group will call upon members of the faculty for survey discussions of the relation between their fields of special competence and the inflationary processes.

Among the faculty resources of the University of California at Berkeley which can be drawn upon by the Research Seminar are: (the faculty members are listed under headings which indicate their special research fields).

1. Monetary Theory and Institutions: Professors Howard Ellis and David Alhadeff.
2. Industrial Organization: Professors Joe S. Bain and Richard Caves.
3. Wages, productivity and price comparisons: Professors Walter Galenson, Gregory Grossman and Arthur Ross.
4. Public Finance: Professors Earl Rolph, Julius Margolis and George Break.

5. Economic Development: Professors Harvey Leibenstein and Henry Rosovsky.

6. *Libar* International aspects and transmission of inflationary pressures: Professors *Philip* Scitovsky, Bell, and *John* Kettcher

7. Distribution Costs and the Secular Rise in Prices: Professor Richard Holton.

The inclusion of Professors Leibenstein and Rosovsky will be made possible by the close cooperation between this research group and the proposed Institute of Economic Development on the Berkeley Campus. It is hoped that the two groups will cooperate on research (1) which compares long-run price behavior in this and other countries with shorter-run inflationary processes in the United States and (2) which tests the assumption that periods of rapid growth are associated with secular inflation.

Professors Alhadaff, Holton, Ress and Margolis are in the School of Business Administration at the University of California.

In addition to the above permanent members of the faculty at Berkeley, each year at the Berkeley campus there is a Visiting Ford Research Professor in Economics. In the near future Professors Kaldor, Lundberg, Patinkin and Habakuk will be in residence at Berkeley. No doubt they will serve as further resources for the group's research and will be available for participation in the seminar.

It is also expected that economists at other institutions will be invited to read papers to the seminar.

V. Financial Assistance that is Needed

Most of the funds that are requested to support the Research Seminar on Inflationary Processes are for fellowships *and assistantships* to graduate students. As it is planned to carry on the research effort of the seminar throughout the year, the fellowships are based upon a calendar rather than an academic year.

This requires that some faculty members should be in residence during the summer for the purposes of this ongoing research. Hence a small sum is allocated to Faculty summer stipends. As it would be useful to occasionally invite Economists not in the faculty of the University of California at Berkeley to speak to the seminar, funds are allocated to outside speakers and travel. It is expected that this fund would also serve as a small contingency reserve.

In addition, funds are requested to support a half-time secretary for the research seminar. No funds are provided in the budget for faculty released time during the academic year and supplies. These will be provided by the Department of Economics

In view of the late date it will be impossible to appoint adequate Fellows for the academic year 1959-60, and in addition faculty members have committed their time for the summer of 1959. Nevertheless the seminar will begin during the academic year 1959-60. During the academic year 1959-60 the seminar will require \$7,700 primarily to support research and secretarial assistance. The budget for 1960-61 and 1961-62 calls for \$18,580 each year, primarily to support Graduate Fellowships. The total request by the Department of Economics is for \$44,860 for the period 1959-62.

BUDGET

Research Seminar on the Processes of Inflation

	1959-60 through 1961-62		
	<u>1959-60</u>	<u>1960-61</u>	<u>1961-62</u>
Research Training Fellowships (\$2,000 each)	---	\$4,000	\$4,000
Doctoral Dissertation Fellowships (\$3,000 each)	---	6,000	6,000
Total Fellowship Funds		\$10,000	\$10,000
Research Assistants	\$ 4,000		
Faculty Support: Summers	---	4,800	4,800
Secretarial assistance	2,000	2,000	2,000
Outside speakers, travel, misc.	1,000	1,000	1,000
University overhead, 10%	700	780	780
Total	\$ 7,700	\$18,580	\$18,580

Total three years 1959-60 through 1961-62 \$44,860.

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