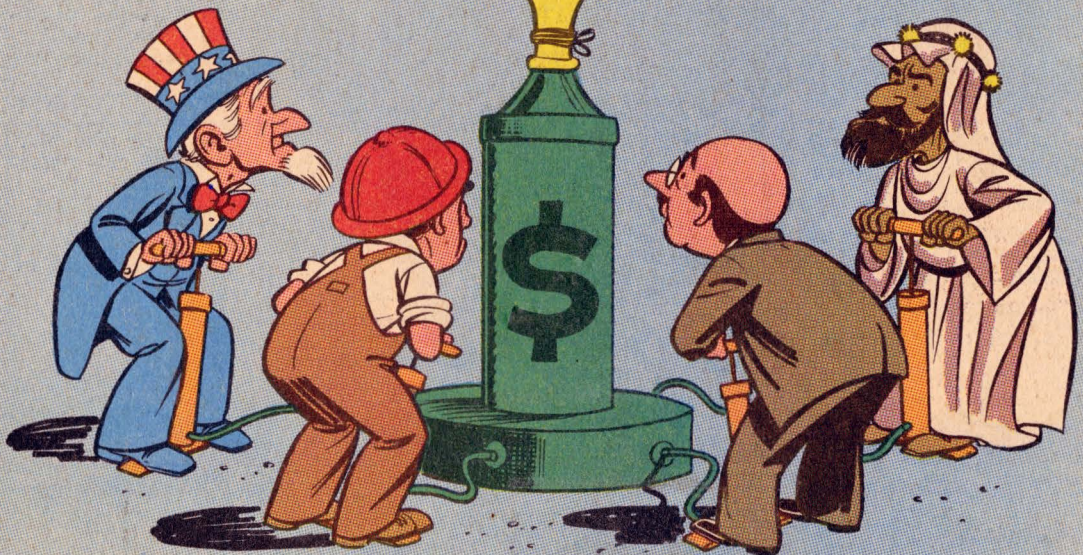
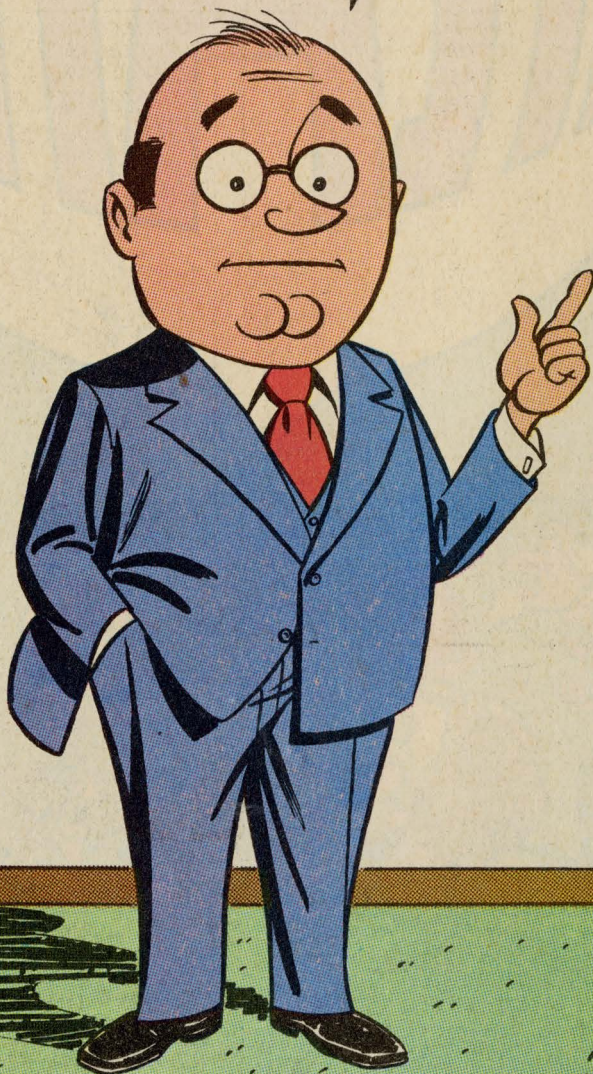


THE STORY OF
INFLATION



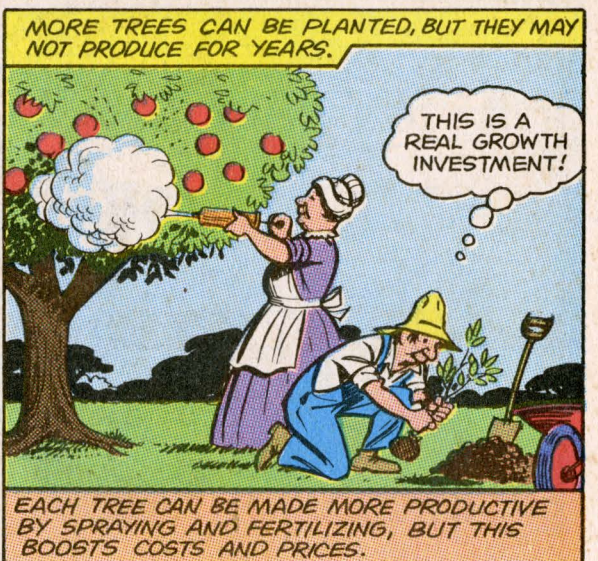
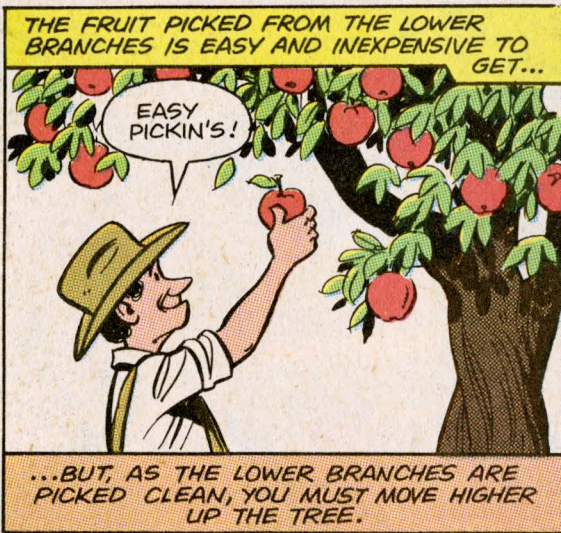
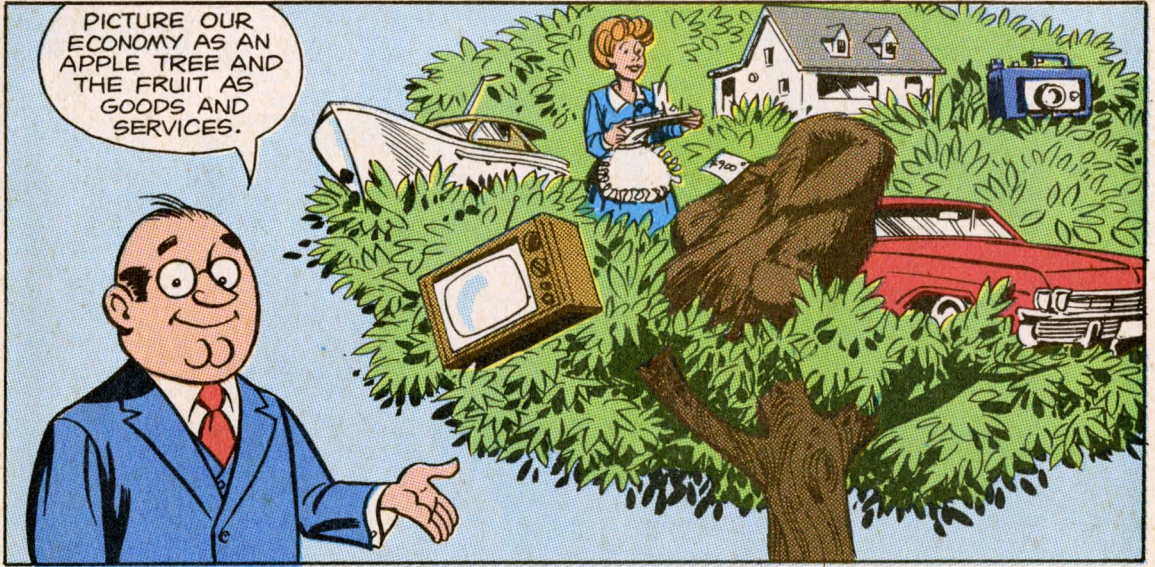
**FEDERAL RESERVE BANK
OF NEW YORK**

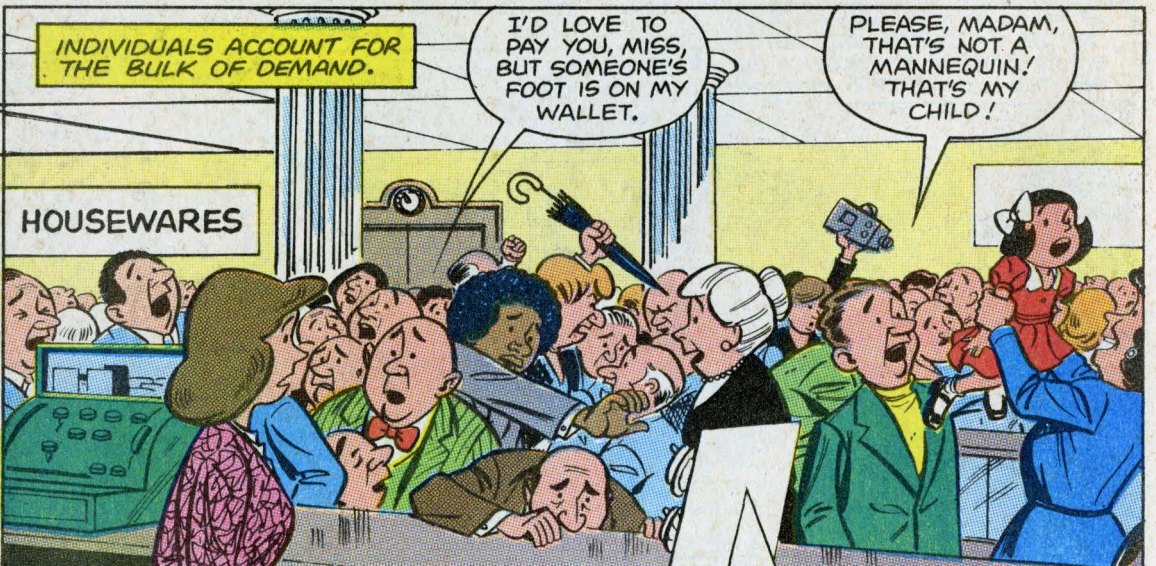
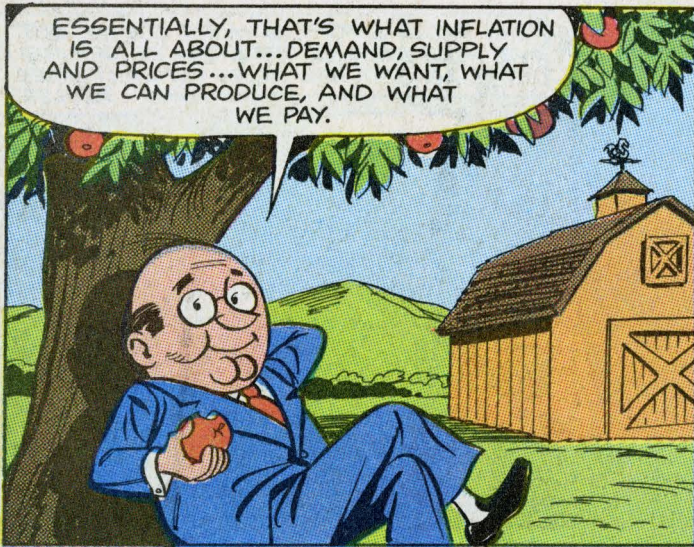
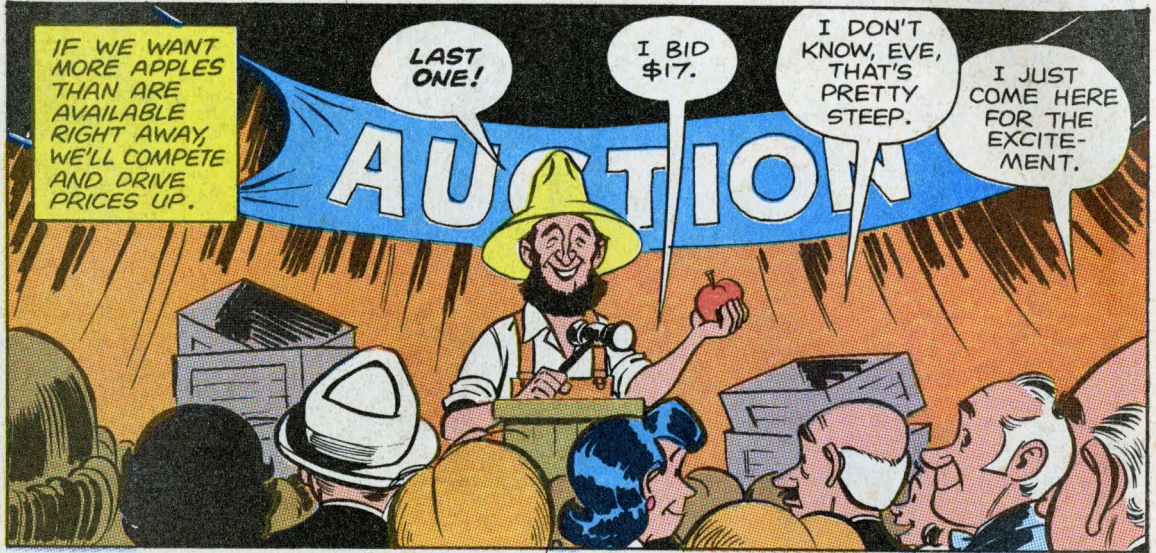
OF ALL ECONOMIC ILLS,
INFLATION CAN BE THE MOST DAMAGING
...BECAUSE IT VICTIMIZES ALL OF US
IN SOME WAY...AND THE MOST DIFFICULT
TO END BECAUSE ITS ROOTS ARE SO DEEPLY
ENTWINED IN OUR ECONOMIC
AND POLITICAL SYSTEM. HALTING
INFLATION OFTEN INVOLVES DIFFICULT
AND PAINFUL DECISIONS. LET'S LOOK AT
HOW INFLATION STARTS, HOW IT
AFFECTS US AND WHAT
WE CAN DO ABOUT IT.



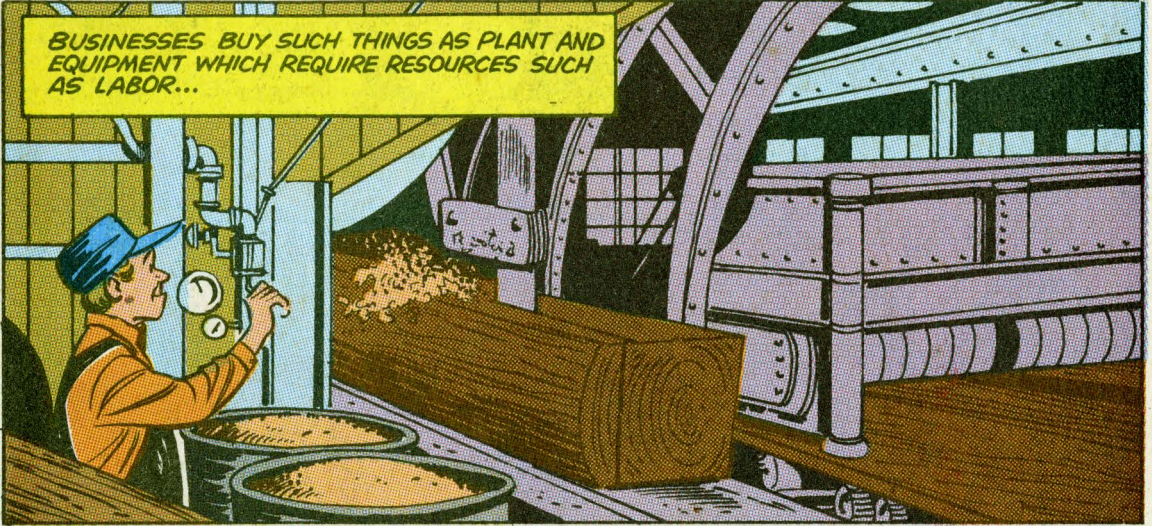
SCRIPT BY
CHARLES PARNOW

ART BY
AL WENZEL
LETTERING BY
IRV WATANABE

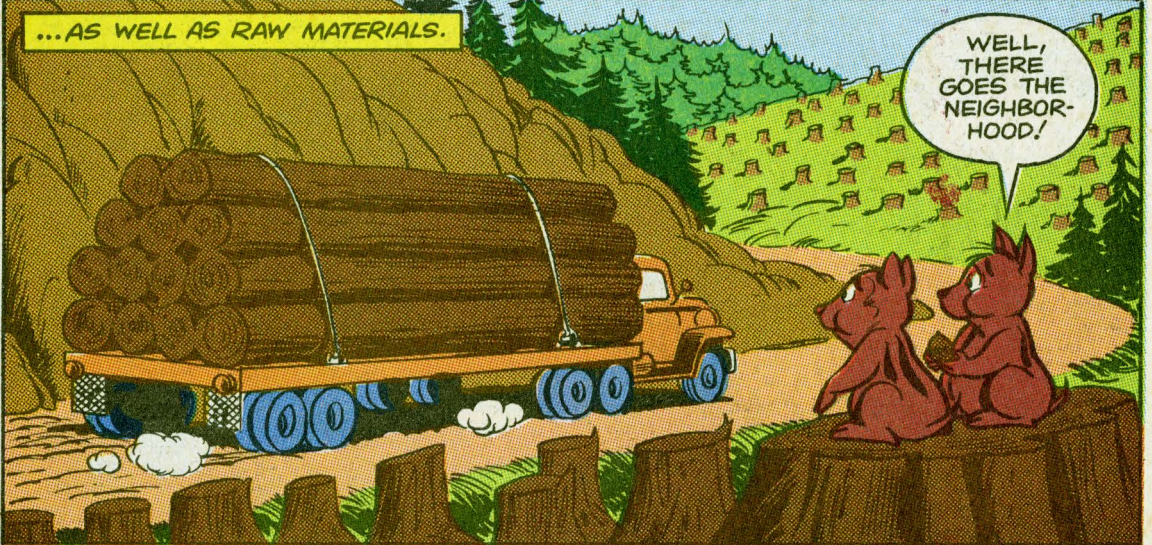




BUSINESSES BUY SUCH THINGS AS PLANT AND EQUIPMENT WHICH REQUIRE RESOURCES SUCH AS LABOR...



...AS WELL AS RAW MATERIALS.

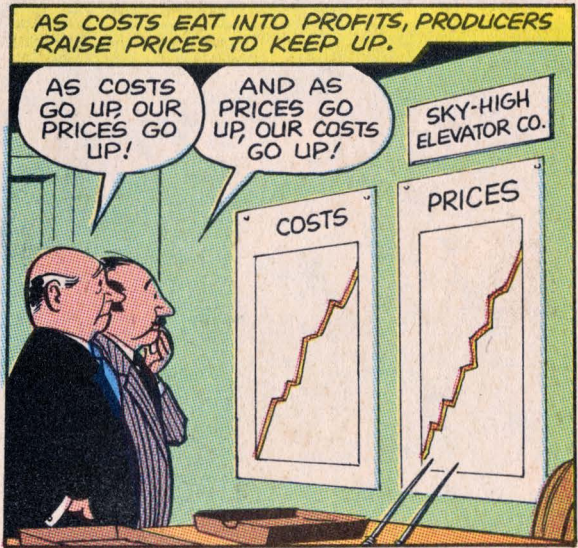
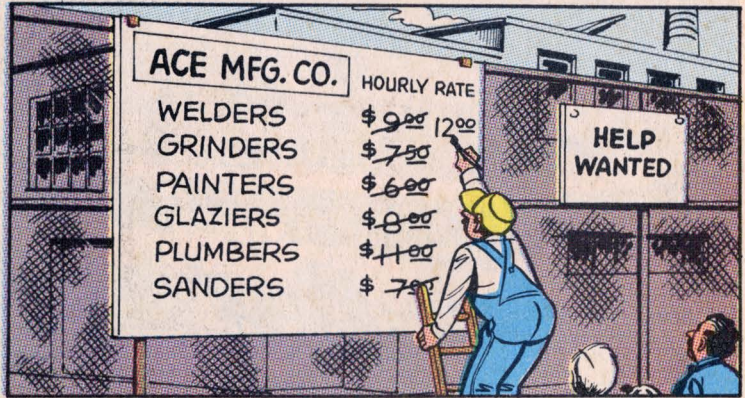
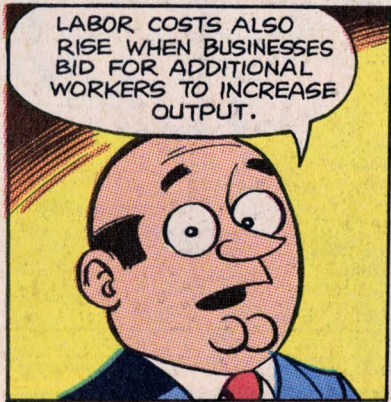
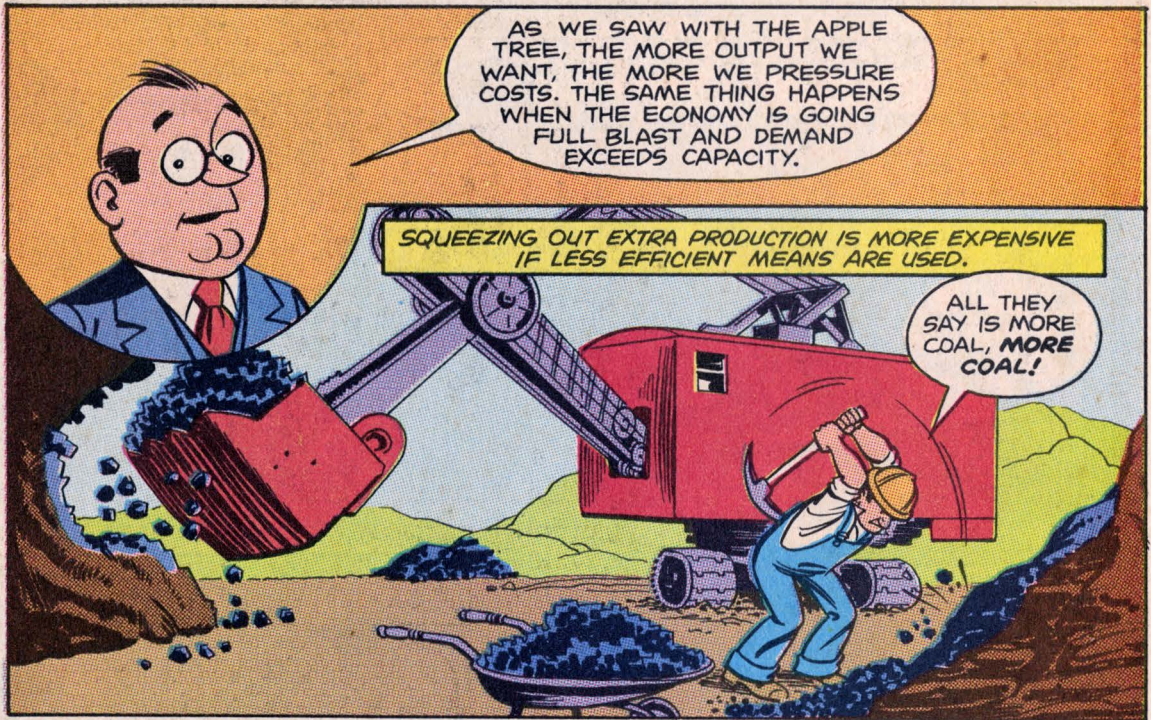


WELL, THERE GOES THE NEIGHBORHOOD!

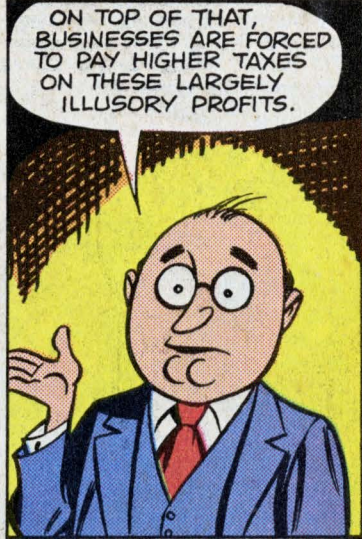
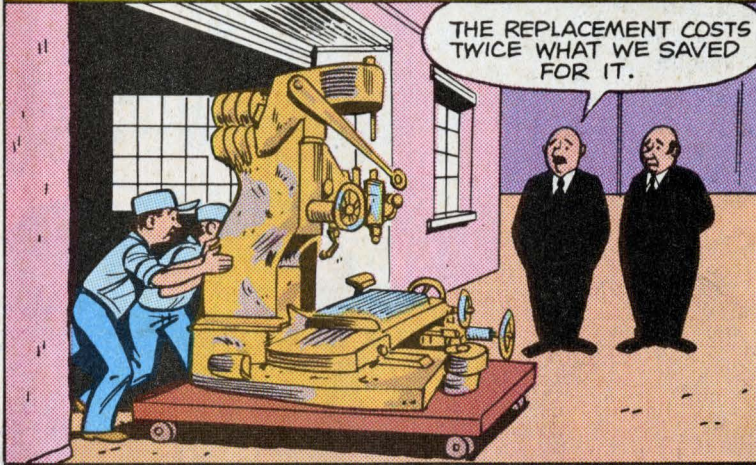
GOVERNMENT IS ANOTHER SOURCE OF DEMAND. THE FEDERAL GOVERNMENT SPENDS VAST AMOUNTS FOR ROUTINE ITEMS, NOT TO MENTION MAJOR THINGS SUCH AS DEFENSE.



LET'S SEE...ONE BATTLESHIP, TWO HOUSING PROJECTS, AND...A QUART OF MILK AND A LOAF OF BREAD? OH, THAT STUFF IS FOR THE MISSUS.



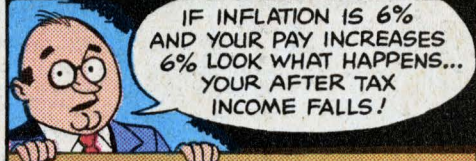
INFLATION ARTIFICIALLY BLOATS PROFITS, PARTLY BECAUSE ACCOUNTING PRACTICES DON'T ALLOW ENOUGH TO BE SET ASIDE FOR SUCH THINGS AS REPLACING WORN-OUT MACHINERY.



THE ILLUSION OF LARGE PROFITS ALSO INVITES SCALED-UP UNION DEMANDS FOR CONTRACTS THAT WILL MAKE UP FOR PAST AND FUTURE LOSSES TO INFLATION AS WELL AS PROVIDE WAGE INCREASES, TOO.



IF NEW AND HIGHER WAGES ONLY KEEP PACE WITH INFLATION, WORKERS' PURCHASING POWER FALLS BECAUSE THEY'RE PUSHED INTO HIGHER TAX BRACKETS.

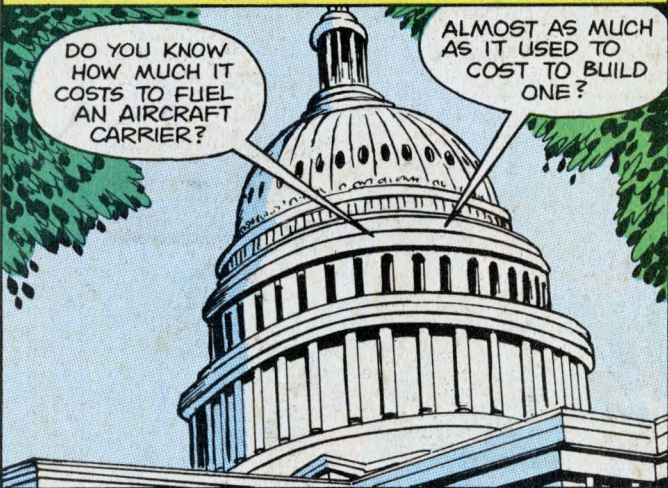


| | BEFORE 6% INCREASE | AFTER 6% INCREASE |
|---|--------------------|--|
| INCOME MINUS FEDERAL TAXES | \$ 20,000 | \$ 21,200 |
| = AFTER-TAX INCOME | \$ 3,800 | \$ 4,137 |
| AFTER-TAX INCOME ADJUSTED FOR INFLATION | \$ 16,200 | \$ 17,063 |
| | \$ 16,200 | ↓ REDUCED PURCHASING POWER \$ 16,097 |

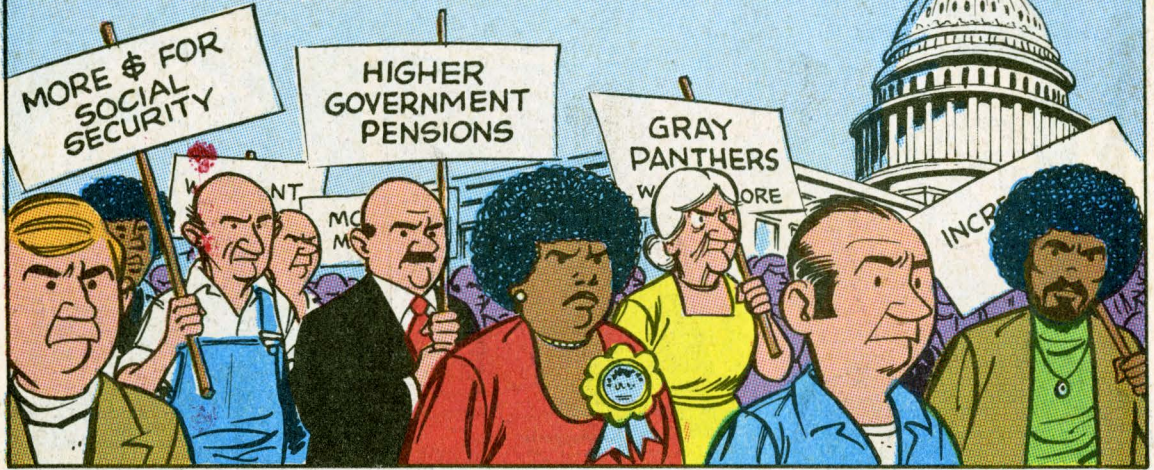
A RECENT FEDERAL TAX LAW CHANGE HELPS PEOPLE FROM BEING PUSHED INTO HIGHER TAX BRACKETS BECAUSE OF INFLATION.



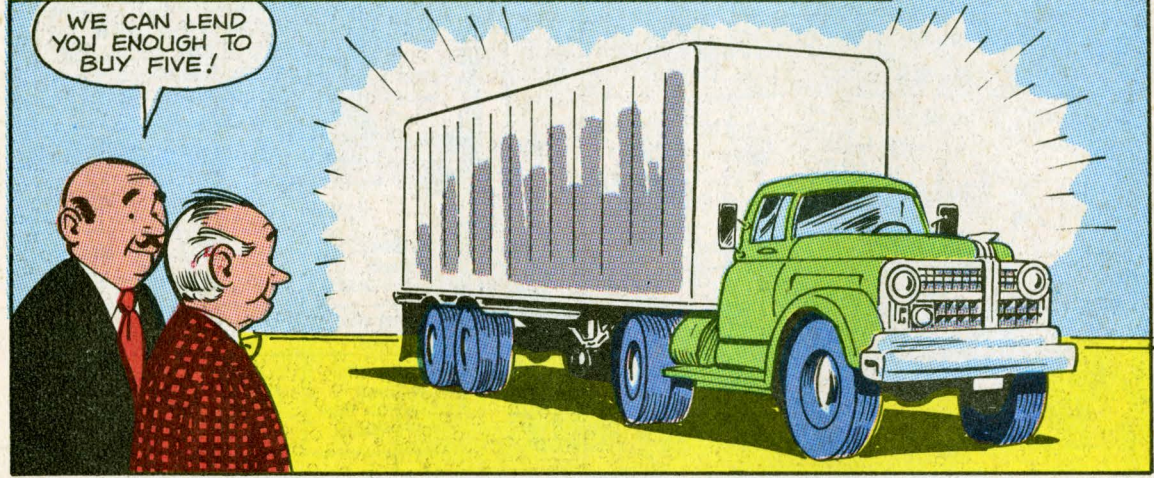
INFLATION HITS GOVERNMENT SPENDING IN TWO WAYS. IT RAISES THE PRICES OF THE THINGS GOVERNMENT BUYS, WHICH REQUIRES GREATER MONEY OUTLAYS.



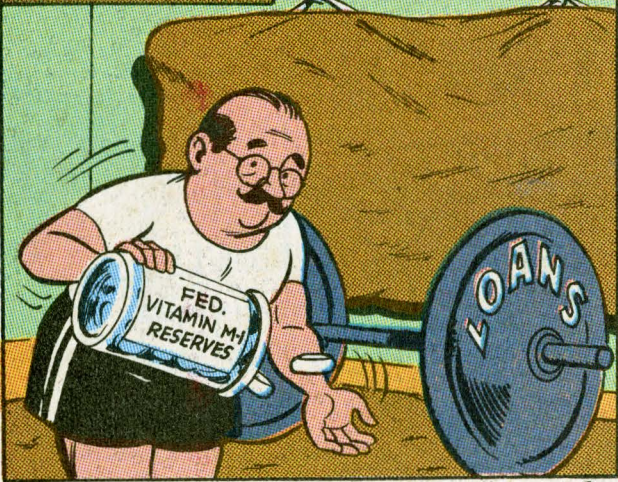
IT ALSO GENERATES PUBLIC PRESSURE FOR LARGER SOCIAL SECURITY, WELFARE AND GOVERNMENT PENSIONS TO KEEP PACE WITH INFLATION.



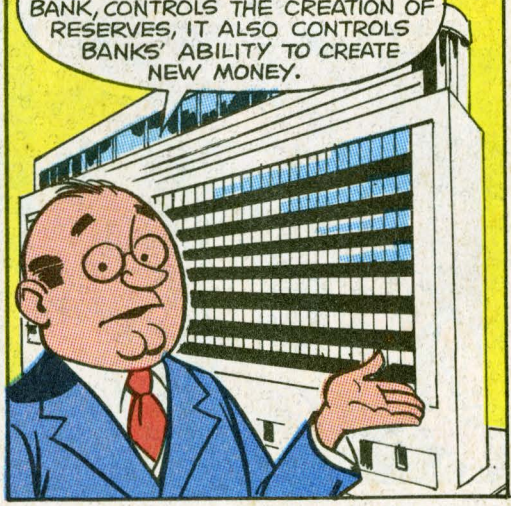
A BIG PART OF THE ECONOMY'S INCREASED SPENDING IS FINANCED BY BANKS CREATING NEW MONEY THROUGH THEIR LENDING AND INVESTING.



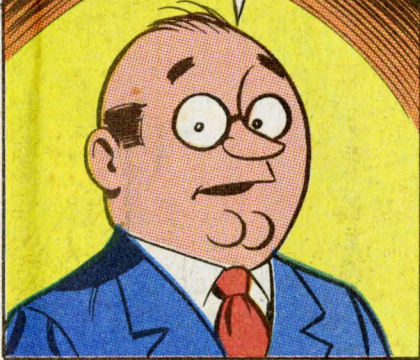
TO SUPPORT THE NEW MONEY THEY CREATE WITH LOANS AND INVESTMENTS, BANKS MUST HAVE CASH "RESERVES."



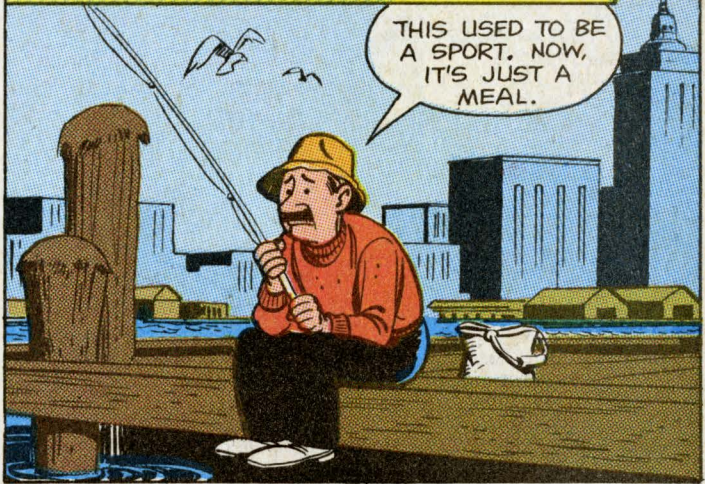
SINCE THE FEDERAL RESERVE SYSTEM, THE NATION'S CENTRAL BANK, CONTROLS THE CREATION OF RESERVES, IT ALSO CONTROLS BANKS' ABILITY TO CREATE NEW MONEY.



RISING PRICES BURN UP MONEY'S PURCHASING POWER AS EACH DOLLAR BUYS LESS AND LESS. LOST PURCHASING POWER EVENTUALLY AFFECTS EVERYONE.



HOWEVER, PEOPLE WHO CAN'T INCREASE THEIR INCOMES IN PACE WITH INFLATION, SUCH AS MANY RETIRED WORKERS, CAN BE HIT HARDER AND EARLIER.



THIS USED TO BE A SPORT. NOW, IT'S JUST A MEAL.

PEOPLE BECOME INCREASINGLY DISCONTENTED WHEN THEY SEE INFLATION IMPOSING HEAVIER SACRIFICES ON CHERISHED DREAMS.

LAST YEAR, WE SQUEEZED OUR FOOD BUDGET TO AFFORD A VACATION. THIS YEAR, THERE'S NOTHING LEFT TO SQUEEZE.



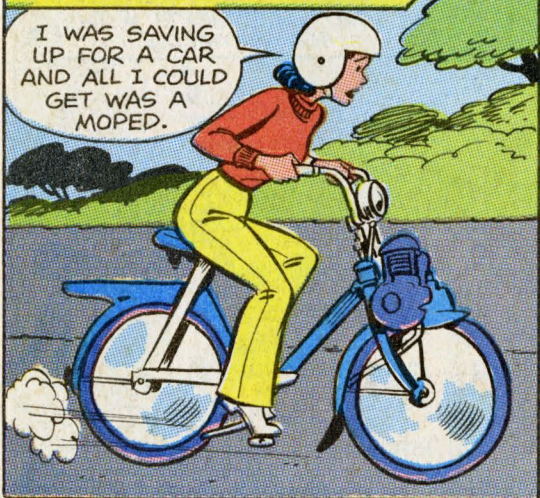
THE MOST FRUSTRATING ASPECT IS A SENSE OF HAVING BEEN CHEATED. THE BUILDER WHO SELLS A HOUSE BEFORE CONSTRUCTION FEELS ROBBED OF A FAIR PRICE FOR HIS MONTHS OF LABOR.

IF I FINISH BY FRIDAY, I'LL ONLY LOSE \$2,000. I WISH I KNEW THIS INFLATION WAS COMING!



THE SAVER SEES INFLATION MAKING A MOCKERY OF YEARS OF THRIFT.

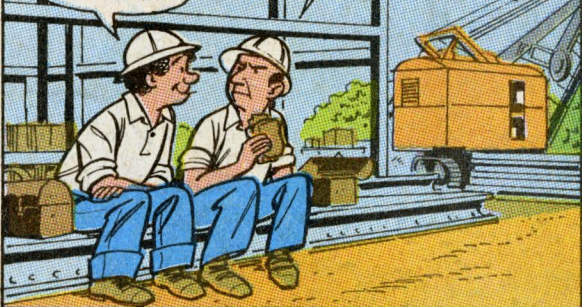
I WAS SAVING UP FOR A CAR AND ALL I COULD GET WAS A MOPED.



THE UNION WORKER SEES INFLATION UNDERCUTTING THE REWARD OF COLLECTIVE BARGAINING AS LONG-TERM CONTRACTS ARE DEVALUED.

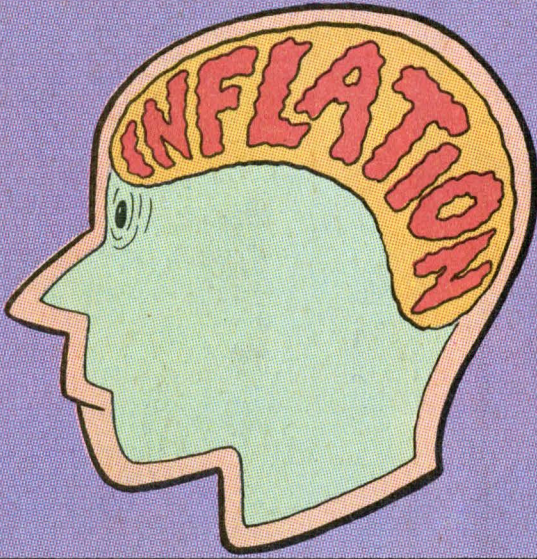
WE GOT AN 8 PERCENT INCREASE ON THE LAST CONTRACT.

AND 10 PERCENT INFLATION. **BIG DEAL!**



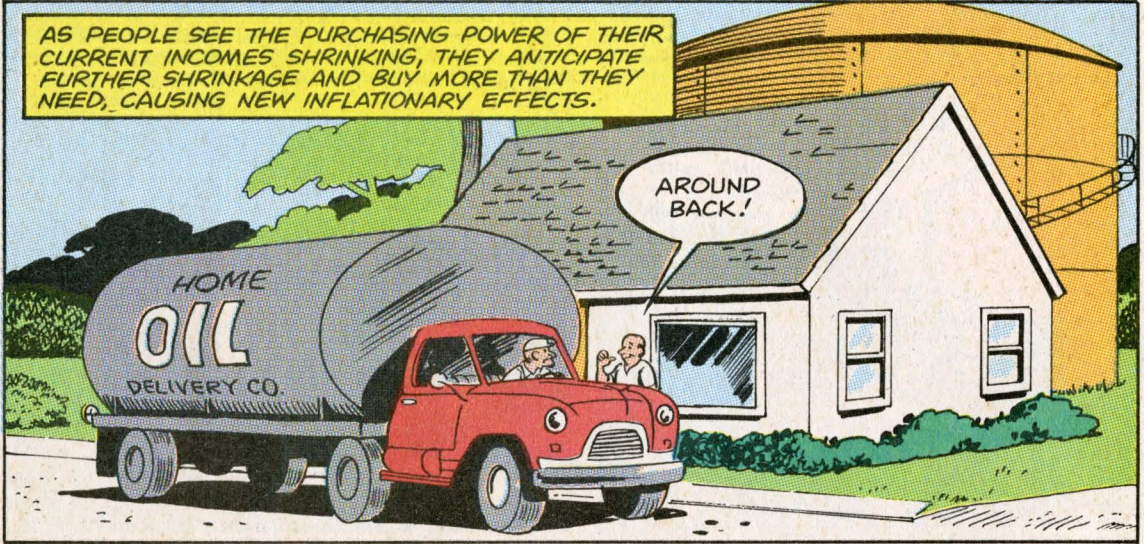
BUT INFLATION HAS EVEN WORSE EFFECTS.

EVEN IN THE PRICE SPIRAL'S EARLY STAGES, AN INFLATIONARY PSYCHOLOGY TAKES HOLD AND BEGINS CREATING DISTORTIONS.



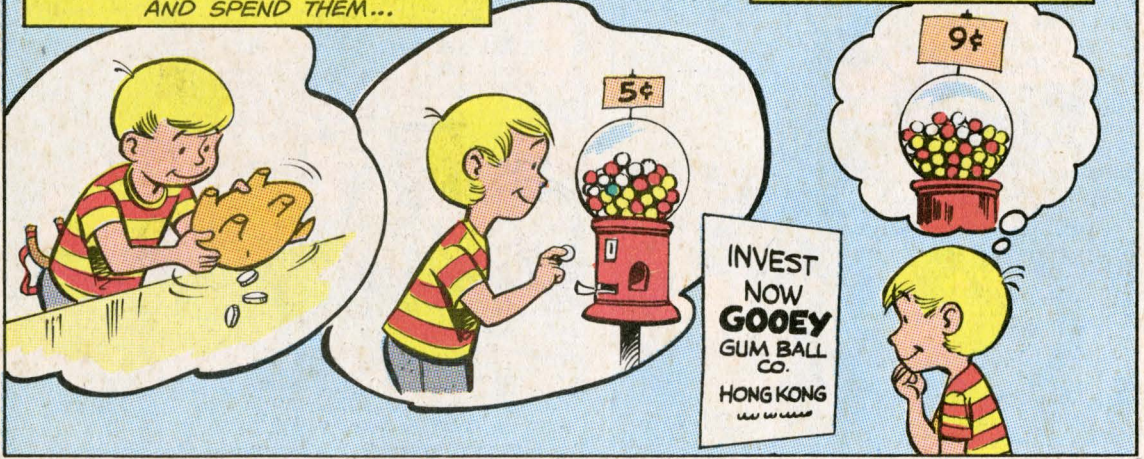
ALTHOUGH THE DISTORTIONS START WITH PEOPLE'S PERCEPTIONS, THE EFFECTS CAN BE VERY REAL.

AS PEOPLE SEE THE PURCHASING POWER OF THEIR CURRENT INCOMES SHRINKING, THEY ANTICIPATE FURTHER SHRINKAGE AND BUY MORE THAN THEY NEED, CAUSING NEW INFLATIONARY EFFECTS.



SOME MAY DECIDE NOT TO SAVE AS MUCH OF THEIR INCOME. OTHERS MAY DECIDE TO WITHDRAW SAVINGS AND SPEND THEM...

...OR PUT THEIR SAVINGS INTO INVESTMENTS WITH HIGHER YIELDS.

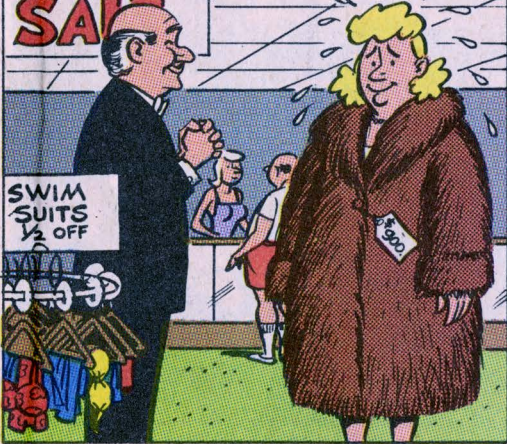


OTHERS WILL MAKE MAJOR PURCHASES SOONER THAN PLANNED TO BEAT ANTICIPATED PRICE INCREASES.

4TH of JULY SALE

I'LL TAKE IT!

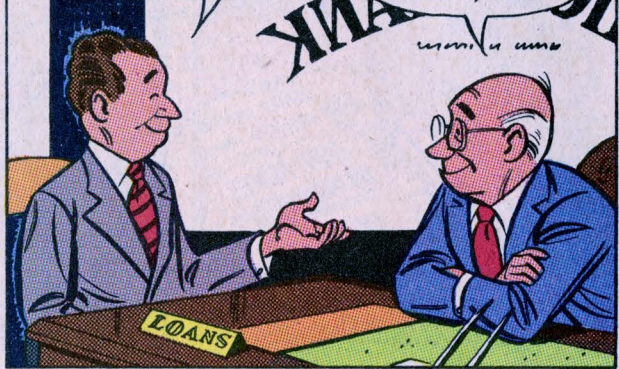
SWIM SUITS 1/2 OFF



IF INFLATIONARY EXPECTATIONS ARE STRONG ENOUGH, SOME PEOPLE WILL FINANCE MORE OF THEIR PURCHASES WITH LOANS BECAUSE THEY ANTICIPATE REPAYING IN CHEAPER DOLLARS. LENDERS ALSO ANTICIPATE CHEAPER DOLLARS AND BOOST INTEREST RATES TO COVER EXPECTED PRICE RISES.

I WANT TO BORROW AS MUCH AS I CAN.

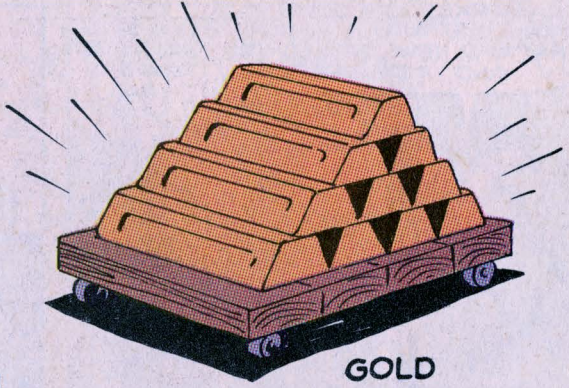
YOU HAVEN'T SEEN OUR INTEREST RATE, YET.



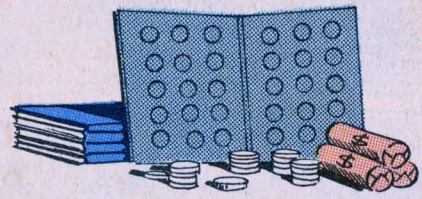
AS INFLATION RISES, REAL GOODS BECOME MORE VALUABLE IN RELATION TO MONEY, AND SAVINGS MAY BE DIVERTED INTO NONPRODUCTIVE INVESTMENTS.



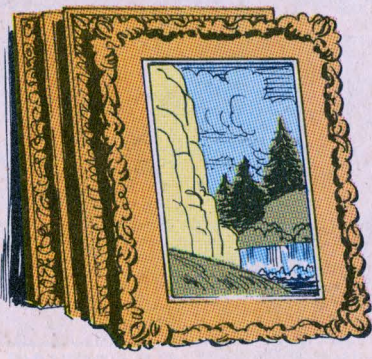
JEWELS



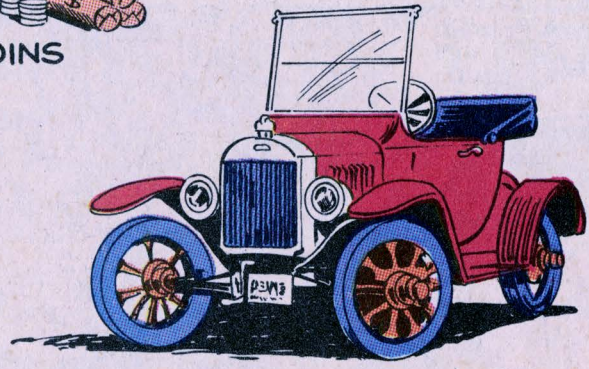
GOLD



COINS



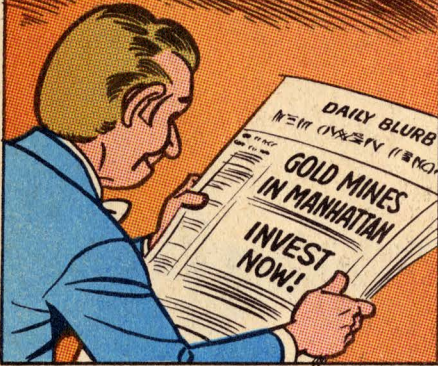
ART



ANTIQUES

THE RACE FOR HIGHER RETURNS CAN CHANGE INVESTING TO SPECULATION.

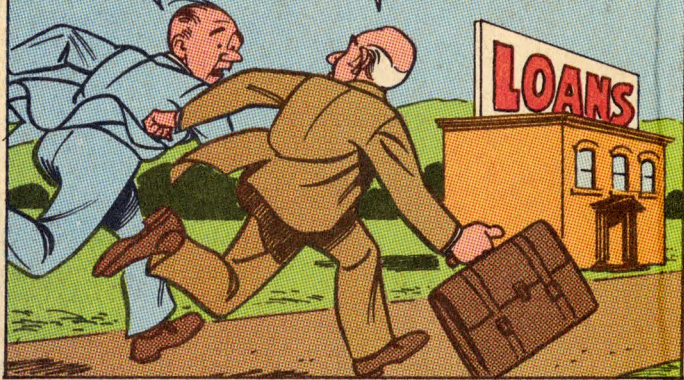
THIS CAN'T MISS! I'M GONNA BUY 100 SHARES!



COMPETITION FOR FUNDS CAN DISTORT FINANCIAL MARKETS AND...

I NEED A \$30 MILLION LOAN FOR A NEW AIRLINER!

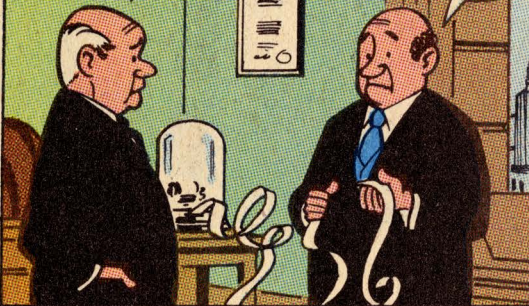
I NEED A LOAN FOR INVENTORIES!



...CAN MAKE SOME MARKETS MORE VOLATILE AND PARTICULARLY VULNERABLE TO DOWNWARD PRESSURE.

THE MARKET WAS GOING UP. THEN THERE WAS A RUMOR THAT BAD NEWS WAS COMING, AND IT DROPPED.

MAYBE THAT RUMOR OF BAD NEWS WAS THE BAD NEWS?



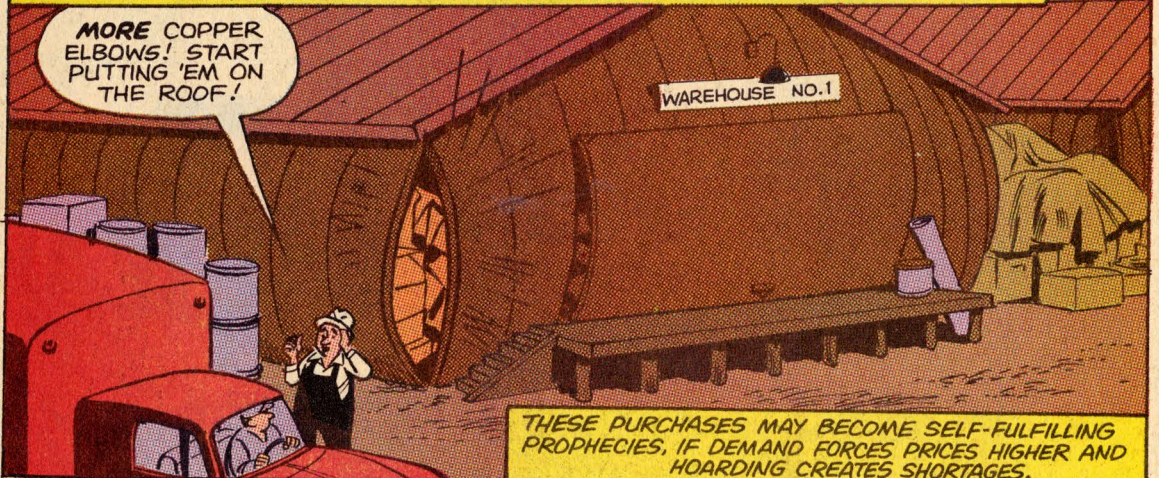
LIMITED AVAILABILITY, SOARING INTEREST RATES AND UNCERTAIN RATES OF RETURN CAUSE SOME BUSINESSES TO CANCEL OR DELAY CAPITAL SPENDING.

WE'LL HAVE TO CANCEL THE PROJECT AT LEAST UNTIL RATES COME DOWN.



SOME BUSINESSES ALSO MAY GO ON SPECULATIVE BINGES, OVERSTOCKING RAW MATERIALS AND SEMI-FINISHED GOODS AS A HEDGE AGAINST RISING PRICES AND SHORTAGES.

MORE COPPER ELBOWS! START PUTTING 'EM ON THE ROOF!



THESE PURCHASES MAY BECOME SELF-FULFILLING PROPHECIES, IF DEMAND FORCES PRICES HIGHER AND HOARDING CREATES SHORTAGES.

INFLATION BECOMES A MERRY-GO-ROUND DRIVEN BY TOO MUCH MONEY. THE LONGER IT TURNS, THE FASTER IT GOES. ON THIS MERRY-GO-ROUND ARE THREE HORSES--RISING COSTS, DISTORTIONS AND EXPECTATIONS. THERE ARE NO FREE RIDES. WORSE YET, EACH RIDE IS MORE EXPENSIVE. THE MERRY-GO-ROUND CAN BE SLOWED AND, EVENTUALLY, STOPPED, BUT THERE ARE COSTS AND DIFFICULTIES. LET'S LOOK AT SOME ANTI-INFLATION STRATEGIES.

RISING COSTS

DISTORTIONS

EXPECTATIONS

MORE THAN 1,600 YEARS AGO, ROMAN EMPEROR DIOCLETIAN SET WAGE-PRICE GUIDELINES TO CONTROL A RAMPANT INFLATION.



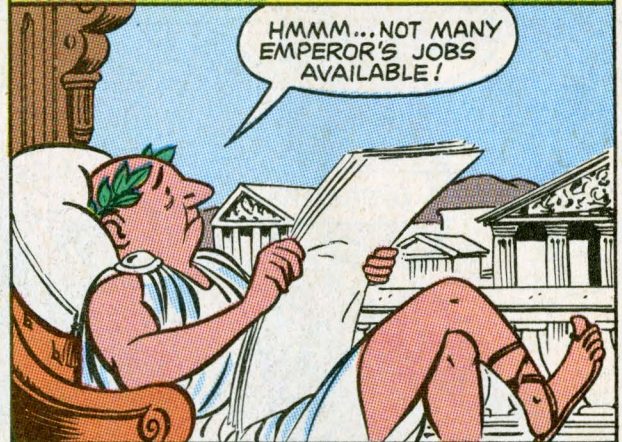
DIOCLETIAN WASN'T FOOLING AROUND. HE ORDERED THE DEATH PENALTY FOR VIOLATIONS OF HIS RULES.



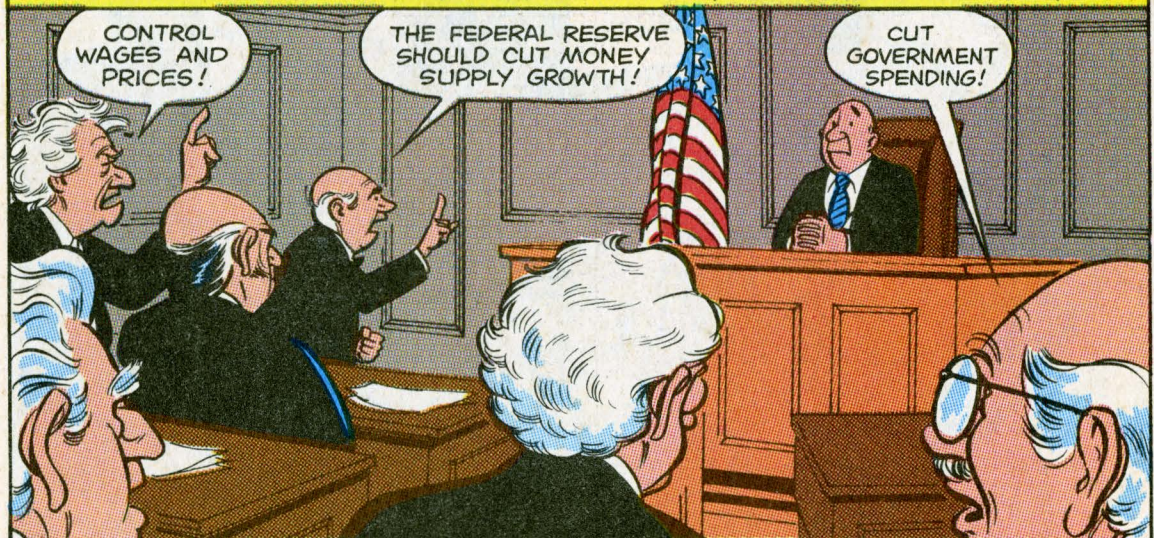
DIOCLETIAN'S RULES RESULTED IN CHAOS BECAUSE HE KEPT PRICES SO LOW PRODUCERS WITHHELD GOODS AND SERVICES FROM THE MARKET.

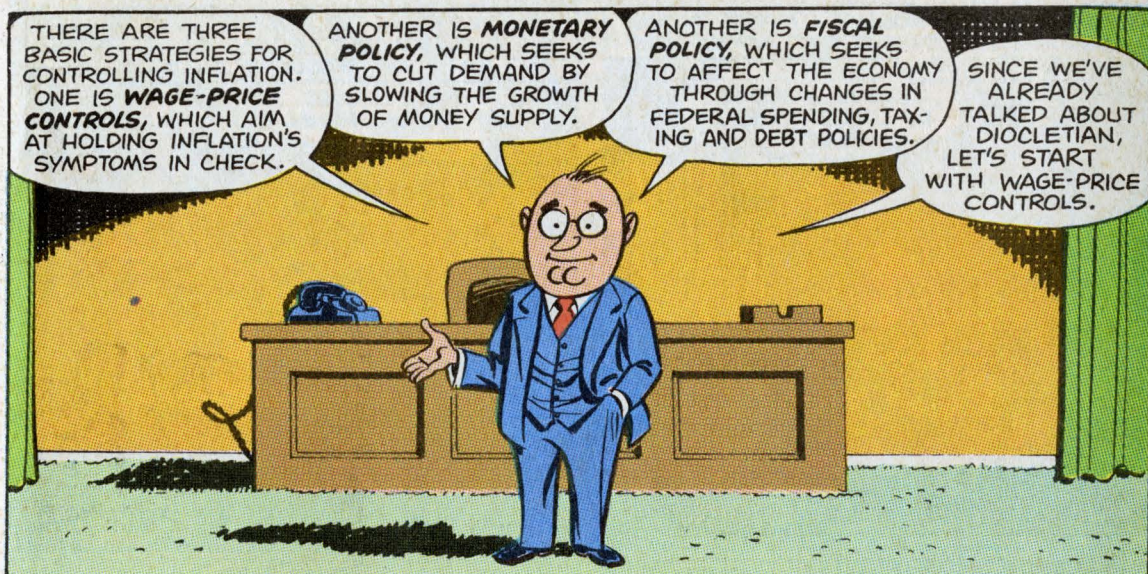


DIOCLETIAN WAS FORCED OUT OF OFFICE, OF COURSE, INFLATION DIDN'T END THERE.



INFLATION IS A RECURRING PHENOMENON THAT POLICYMAKERS MUST STILL DEAL WITH.





THERE ARE THREE BASIC STRATEGIES FOR CONTROLLING INFLATION. ONE IS **WAGE-PRICE CONTROLS**, WHICH AIM AT HOLDING INFLATION'S SYMPTOMS IN CHECK.

ANOTHER IS **MONETARY POLICY**, WHICH SEEKS TO CUT DEMAND BY SLOWING THE GROWTH OF MONEY SUPPLY.

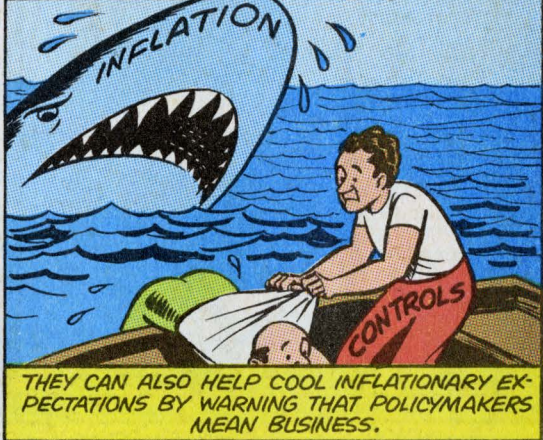
ANOTHER IS **FISCAL POLICY**, WHICH SEEKS TO AFFECT THE ECONOMY THROUGH CHANGES IN FEDERAL SPENDING, TAXING AND DEBT POLICIES.

SINCE WE'VE ALREADY TALKED ABOUT DIOCLETIAN, LET'S START WITH **WAGE-PRICE CONTROLS**.

WE FEEL THREATENED BY INFLATION AND TEND TO CALL FOR IMMEDIATE PROTECTION, USUALLY FROM THE PRICES HURTING US THE MOST.



THE BIG ADVANTAGE OF **WAGE-PRICE CONTROLS** IS THAT THEY PUT ASIDE THE IMMEDIATE DANGER AND ALLOW TIME FOR OTHER STRATEGIES TO COOL DEMAND.



BUT, OF COURSE, **CONTROLS HAVE PROBLEMS**, AS DIOCLETIAN FOUND OUT.



FIVE DOLLARS FOR ONE PIZZA WITH EVERYTHING!

FOR \$5.00, I WON'T EVEN LIGHT THE OVEN!

ALSO, WHICH PRICES SHOULD BE CONTROLLED?



CONTROL **HARDWARE** PRICES!

CONTROL **CLOTHING** PRICES!

CONTROL **FURNITURE** PRICES!

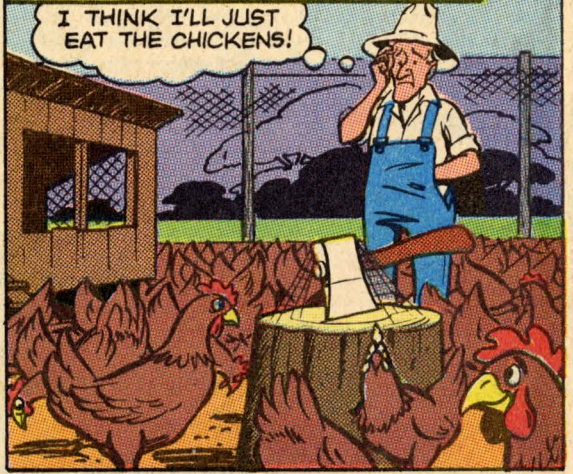
THERE'S ANOTHER PROBLEM. SUPPOSE CHICKEN PRICES ARE FROZEN AND FEED PRICES ARE ALLOWED TO RISE.

HMMM...
CHICKEN FEED IS
NO LONGER CHICKEN
FEED!



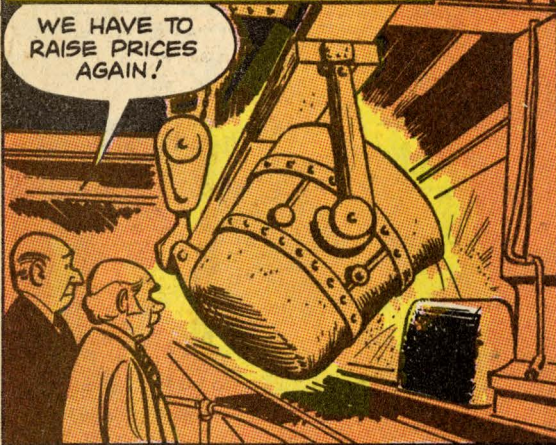
AT SOME POINT, THE FARMER WON'T BE EARNING A REASONABLE RETURN FOR HIS EFFORTS AND WILL STOP PRODUCING CHICKENS.

I THINK I'LL JUST
EAT THE CHICKENS!



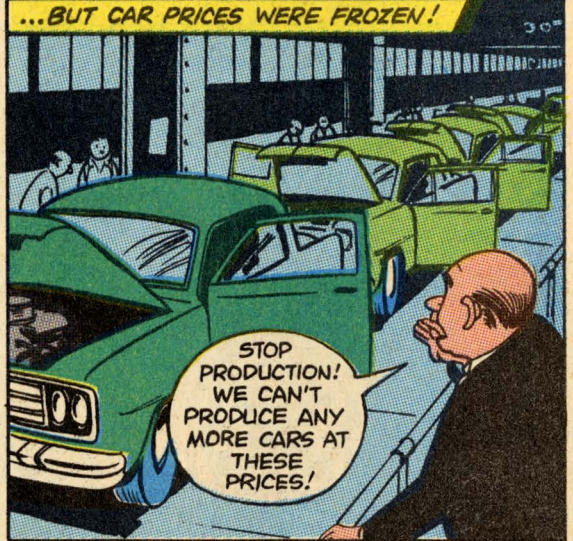
THE PROBLEM BECOMES EVEN LARGER WHEN YOU CONSIDER HOW THE SAME LINKAGE AFFECTS OTHER THINGS IN OUR ECONOMY. SUPPOSE STEEL WAS ALLOWED TO RISE...

WE HAVE TO
RAISE PRICES
AGAIN!



...BUT CAR PRICES WERE FROZEN!

STOP
PRODUCTION!
WE CAN'T
PRODUCE ANY
MORE CARS AT
THESE PRICES!

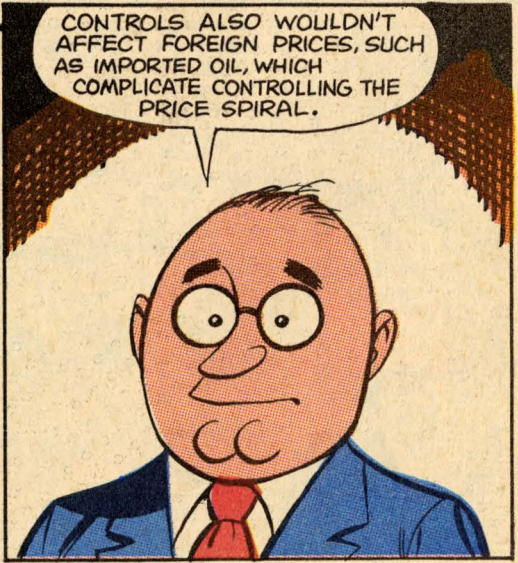


CONTROLLING WAGES RAISES STILL MORE PROBLEMS SINCE MANY WAGE EARNERS FEEL THEIR INCOME SHOULDN'T BE SQUEEZED.

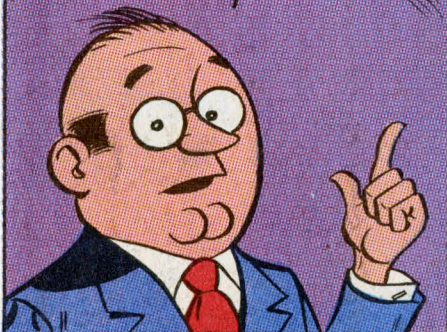
THEY BETTER NOT MONKEY
WITH HOW MUCH MONEY I MAKE
WITH THIS WRENCH!



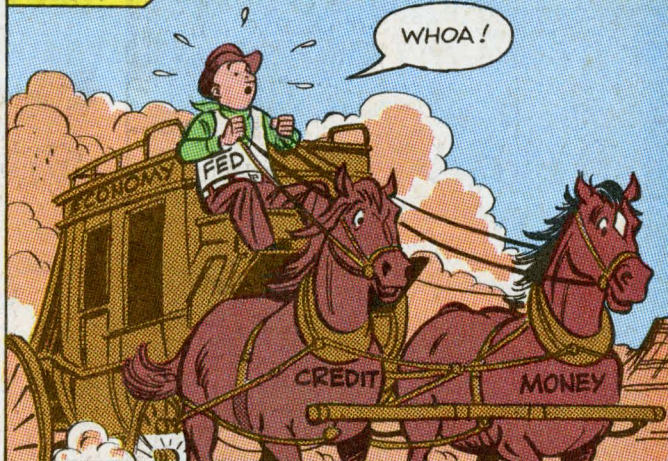
CONTROLS ALSO WOULDN'T AFFECT FOREIGN PRICES, SUCH AS IMPORTED OIL, WHICH COMPLICATE CONTROLLING THE PRICE SPIRAL.



CONTROLS WOULDN'T REALLY AFFECT THE **EXCESS DEMAND** THAT'S CAUSING INFLATION. FOR THAT, YOU NEED **MONETARY POLICY** AND **FISCAL POLICY**.



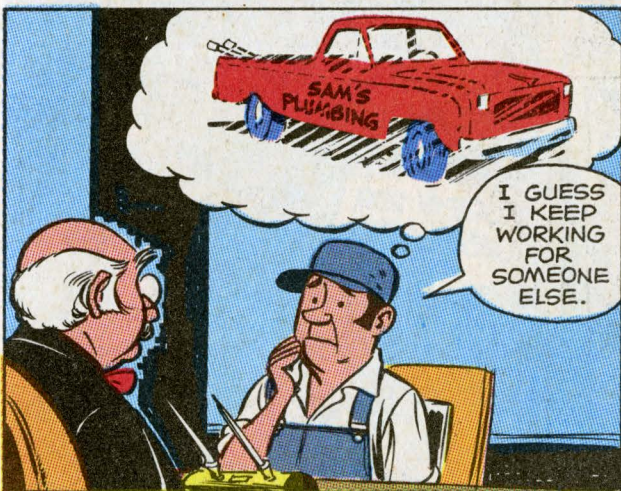
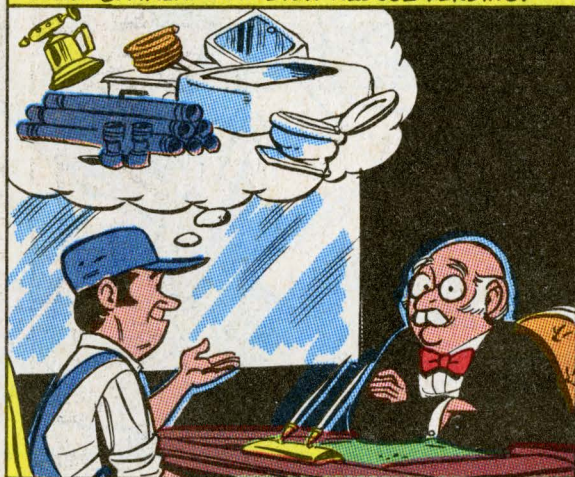
MONETARY POLICY AIMS AT HOLDING BACK DEMAND BY RESTRAINING BANKS' CREATION OF MONEY AND CREDIT.



FOR EXAMPLE, SAM NEEDS A LOAN TO OPEN HIS OWN BUSINESS.

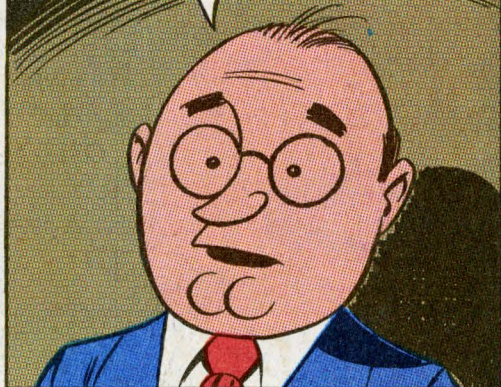


BUT, SUPPOSE THE BANKER TELLS SAM THAT MONEY IS TIGHT, AND HE CAN ONLY GET THE MONEY HE NEEDS AT A HIGHER INTEREST RATE. SOME BANKERS MAY EVEN REDUCE LENDING.



THUS, TIGHT MONETARY POLICY HAS THE EFFECT OF CUTTING SAM'S DEMANDS.

ALTHOUGH MONETARY POLICY IS A LOT MORE COMPLEX, THIS EXAMPLE GIVES A BASIC IDEA OF WHAT IT'S ALL ABOUT. BUT, LIKE CONTROLS, MONETARY POLICY ALSO HAS DRAWBACKS.



ONE PROBLEM IS THAT MONETARY POLICY IS INDIRECT, AND ITS RESULTS DON'T SHOW UP IMMEDIATELY. FOR EXAMPLE, PRICES MAY CONTINUE UPWARD EVEN AFTER DEMAND SLACKENS.



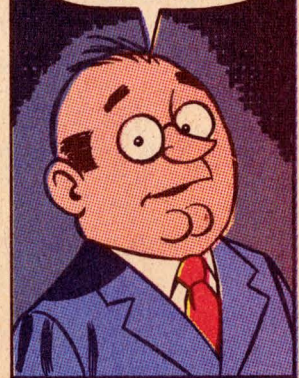
SECOND, SETTING POLICY IS A DIFFICULT BALANCING ACT. TOO MUCH RESTRAINT COULD CAUSE A RECESSION WITH FALLING OUTPUT AND RISING UNEMPLOYMENT; TOO LITTLE RESTRAINT AND INFLATION KEEPS ROLLING ALONG.



MONETARY POLICY'S SLOW EFFECTS AND THE STRIVING FOR BALANCE OFTEN LEADS TO PUBLIC DEBATE ABOUT WHAT'S BEING DONE OR WHAT SHOULD BE DONE.



WHILE **MONETARY POLICY** IS DIFFICULT IN TERMS OF DEGREE AND TIMING, **FISCAL POLICY** HAS POLITICAL AND LEGISLATIVE PROBLEMS.



IT'S A POPULAR NOTION THAT CONGRESS CAN SIMPLY SLASH ITEMS FROM THE FEDERAL BUDGET. BUT IT'S NOT THAT EASY.



MOST FEDERAL SPENDING INVOLVES PROGRAMS THAT HAVE BEEN ESTABLISHED IN A WAY THAT MAKES THEM DIFFICULT TO REDUCE MUCH LESS ELIMINATE.

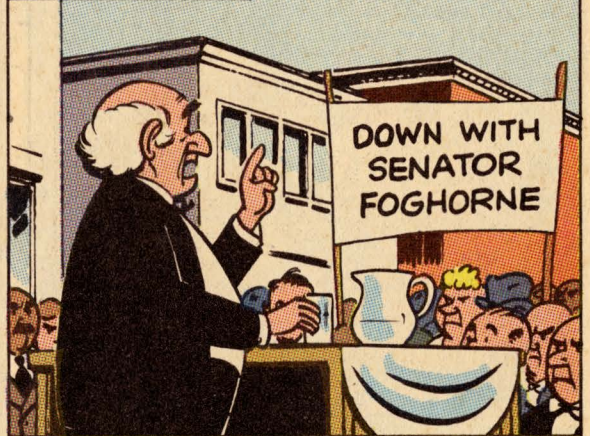
EVEN FREEZING NEW PROGRAMS IS DIFFICULT. TO DO THAT, OUR ELECTED REPRESENTATIVES IN CONGRESS WOULD HAVE TO IGNORE VOTERS WHO WOULD BENEFIT FROM THE PROPOSED PROGRAMS.



SPENDING CUTS ALSO ARE TROUBLESOME BECAUSE THEY SOMETIMES LEAD TO MORE UNEMPLOYMENT.



THUS, SPENDING CUTS HAVE POLITICAL CONSEQUENCES THAT ELECTED OFFICIALS FIND HARD TO IGNORE.

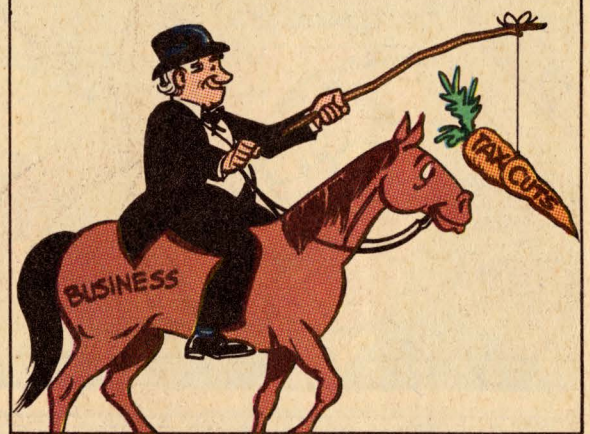


BUT THERE'S ANOTHER WAY OF CUTTING DEMAND WITH FISCAL POLICY... A TAX INCREASE.

A TAX INCREASE WOULD COOL DEMAND BY REDUCING PEOPLE'S SPENDABLE INCOME, BUT ITS UNPOPULARITY OFTEN KEEPS THIS WEAPON AGAINST INFLATION FROM BEING USED.



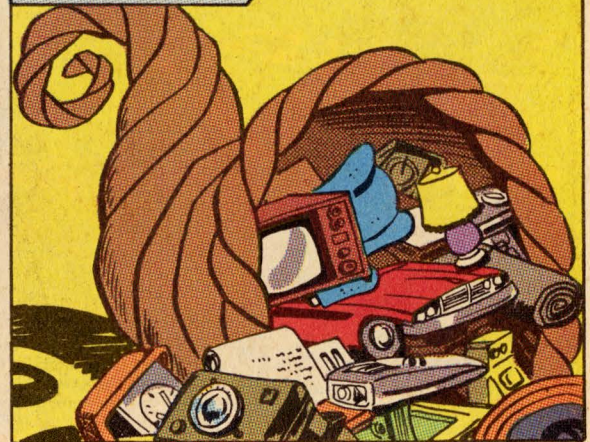
BUT THERE'S MORE TO FISCAL POLICY. TAX CUTS CAN INDUCE BUSINESSES TO SPEND ON NEW PLANT AND EQUIPMENT THAT WOULD BOOST OUTPUT AND EXPAND EMPLOYMENT.



TAX INCENTIVES CAN ALSO ENCOURAGE SAVING TO PROVIDE THE FUNDS FOR IMPROVEMENTS IN PRODUCTION FACILITIES.

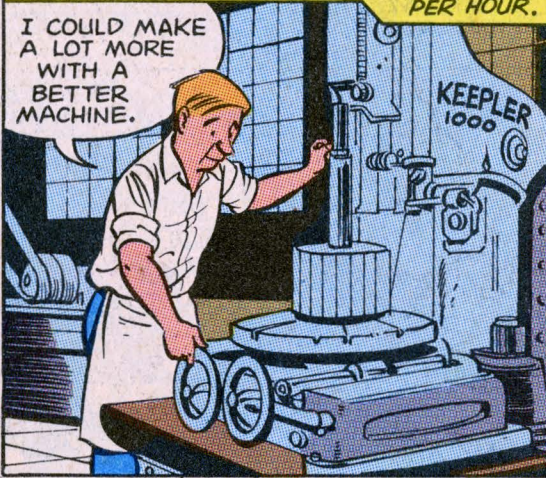


THE INCREASED OUTPUT PROVIDED BY NEW TECHNOLOGY AND GREATER EFFICIENCY SHOULD HELP RELIEVE SOME OF THE DEMAND PRESSURES ON THE ECONOMY.



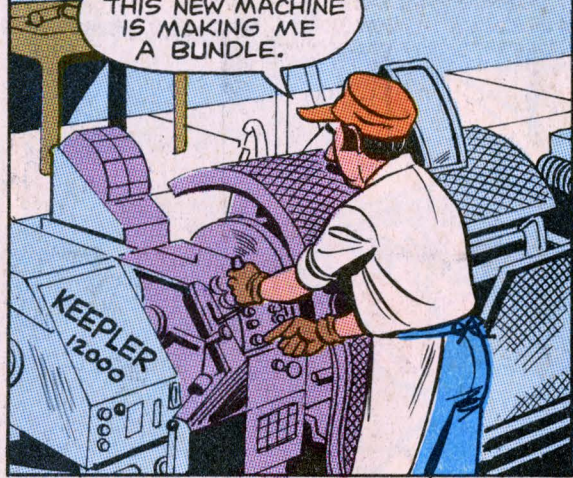
INCREASED CAPITAL SPENDING GENERALLY MEANS WORKERS CAN BOOST OUTPUT PER HOUR.

I COULD MAKE A LOT MORE WITH A BETTER MACHINE.

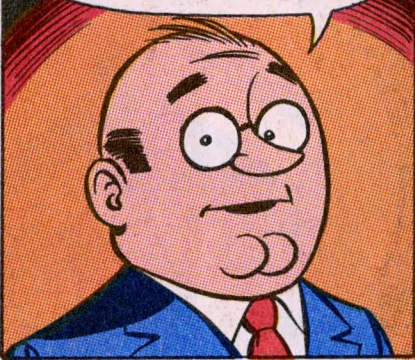


IF PRODUCTIVITY RISES, SO CAN WAGES.

THIS NEW MACHINE IS MAKING ME A BUNDLE.



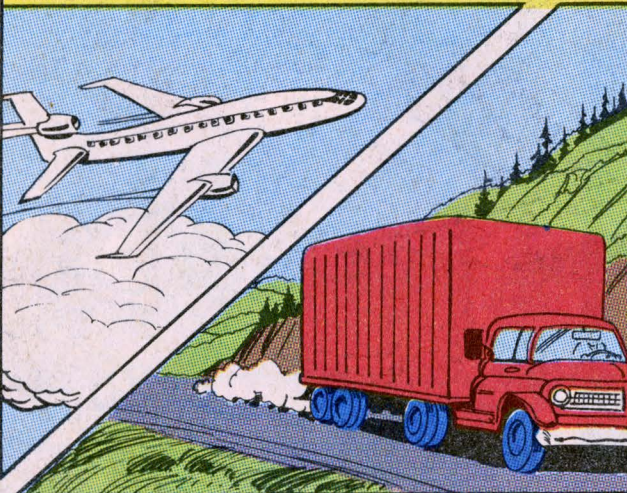
MOREOVER, THESE WAGE INCREASES WOULDN'T CREATE INFLATIONARY PROBLEMS. THAT'S BECAUSE WAGE HIKES ARE INFLATIONARY ONLY WHEN PAY INCREASES FASTER THAN PRODUCTIVITY GAINS.



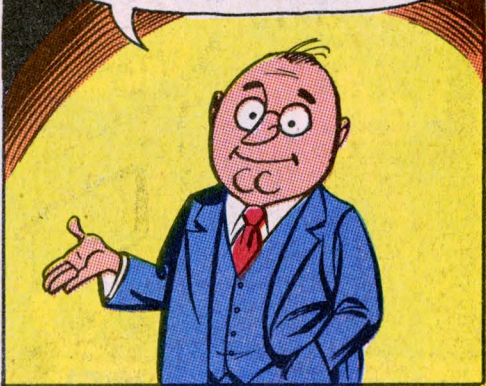
ANOTHER PROPOSAL IS TO CUT COSTLY GOVERNMENT REGULATIONS THAT HELP KEEP PRICES HIGH.



DEREGULATION HAS ALREADY STARTED IN SOME INDUSTRIES AND THERE ARE SCORES OF OTHERS WHERE REGULATIONS SHOULD BE REVIEWED.



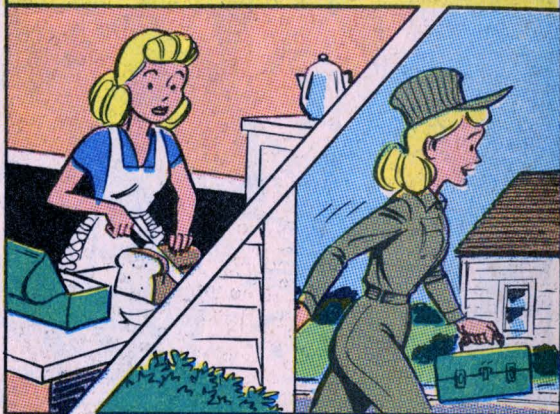
CHANGES IN OUR TAX STRUCTURE AND DEREGULATION ARE LONG-RANGE SOLUTIONS THAT MAY NOT YIELD RESULTS FOR SOME TIME. IN THE MEANTIME, ATTACKS ON INFLATION WILL MAINLY CUT DEMAND...AND LOWER DEMAND MEANS HIGHER UNEMPLOYMENT.



THE ECONOMY SOMETIMES HAS TROUBLE ABSORBING WORKERS AS FAST AS THEY SEEK JOBS, ESPECIALLY IF MANY ARE UNSKILLED, SUCH AS TEENAGERS.

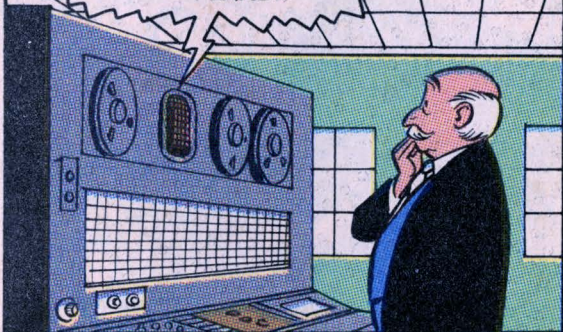


FOR EXAMPLE, INFLATION'S IMPACT ON LIVING STANDARDS HAS PROMPTED MANY HOUSEWIVES TO SEEK JOBS. WHEN THEY CAN'T FIND WORK, THE UNEMPLOYMENT RATE GOES UP.

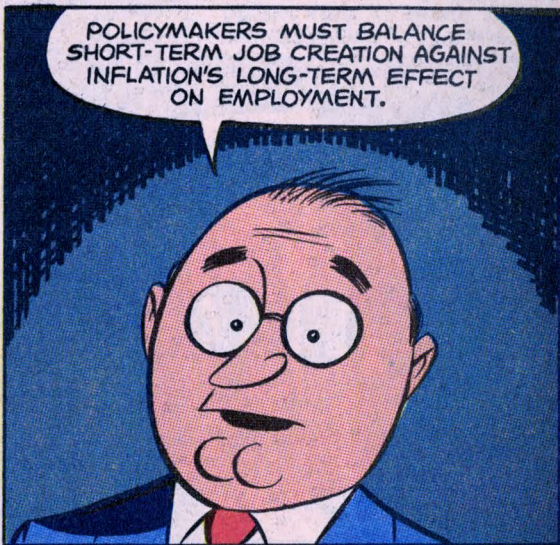


WORSE YET, AS INFLATION DISTORTS PROJECTIONS OF THE RETURN ON NEW INVESTMENTS, POTENTIAL JOBS ARE LOST.

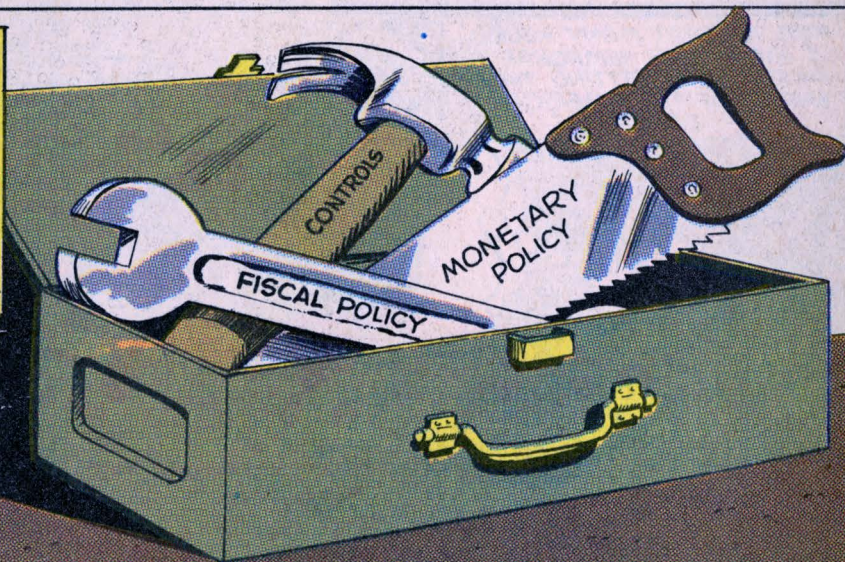
THE PROFIT OUTLOOK IS UNCERTAIN, SO WE'LL HAVE TO CANCEL THOSE BUILDING AND HIRING PLANS.

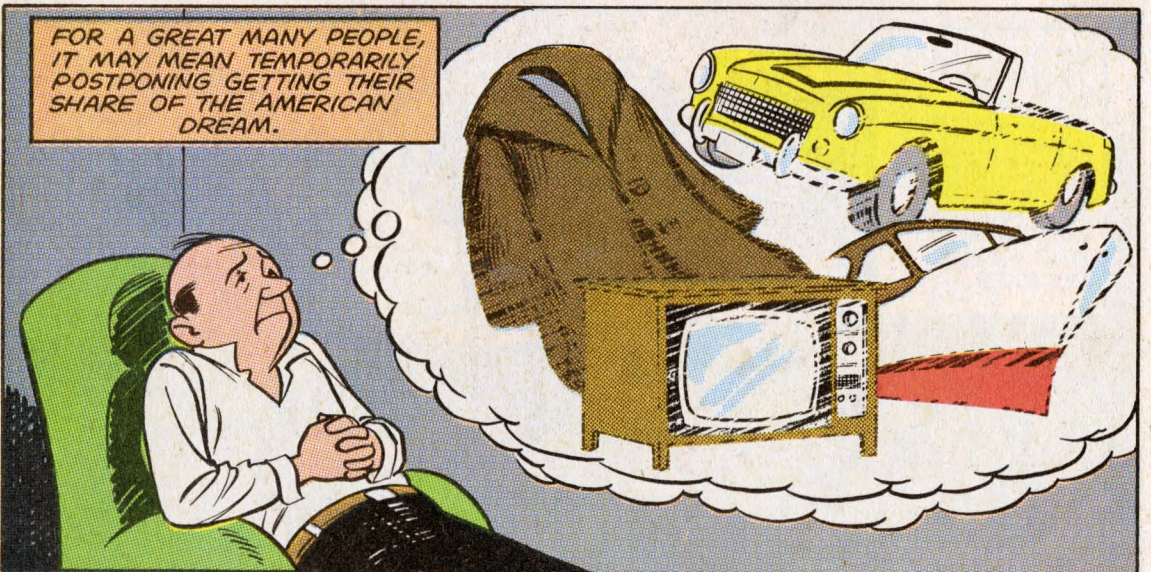
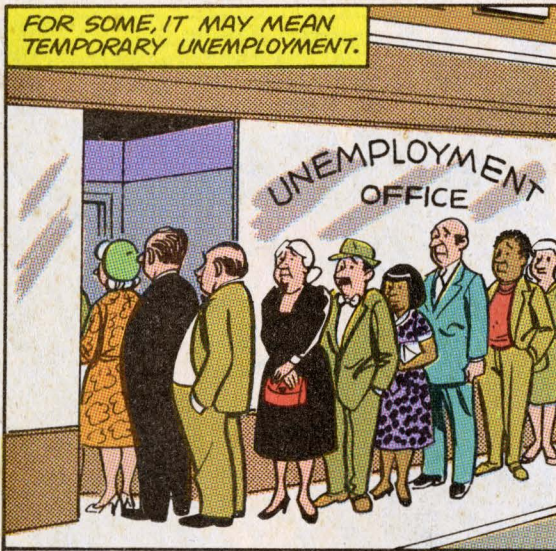
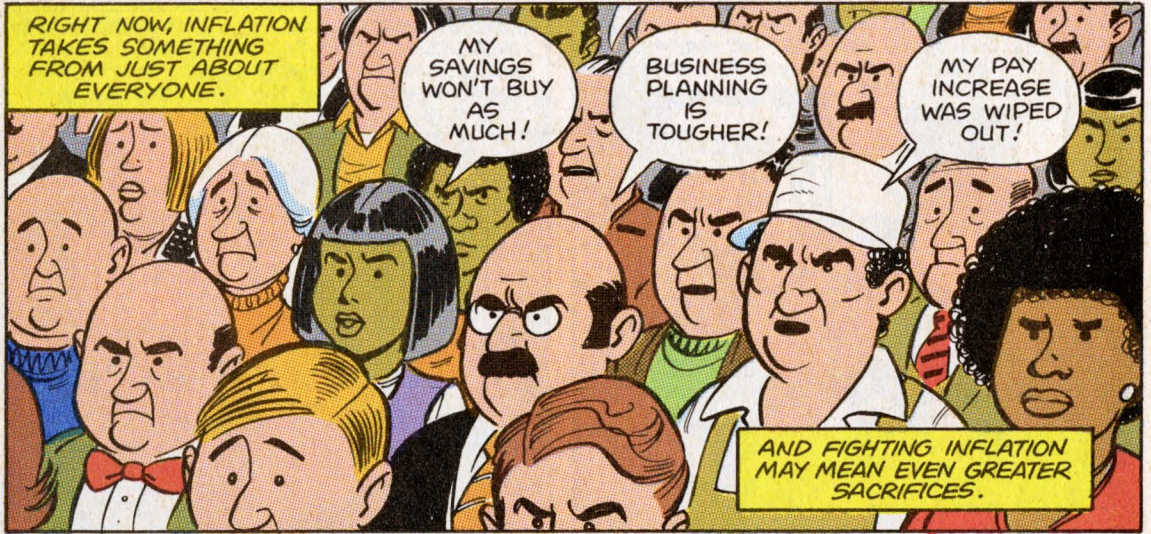


POLICYMAKERS MUST BALANCE SHORT-TERM JOB CREATION AGAINST INFLATION'S LONG-TERM EFFECT ON EMPLOYMENT.

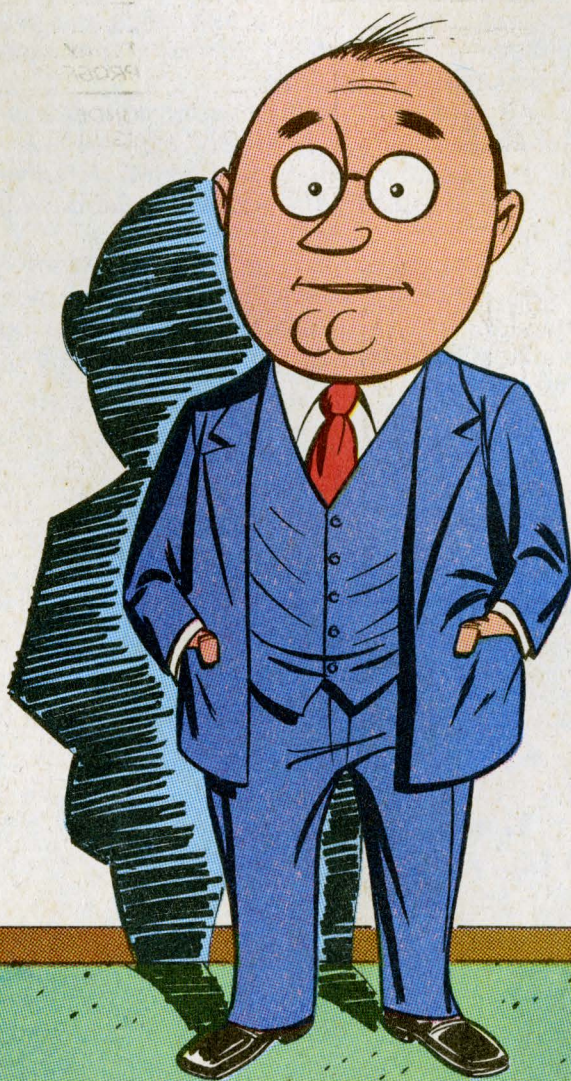


OF THE THREE TOOLS WE'VE DISCUSSED TO BRING INFLATION UNDER CONTROL, POLICYMAKERS HAVE RELIED PRIMARILY ON MONETARY AND FISCAL POLICIES.





BUT A DELAY
IN FULFILLING OUR
HOPES IS BETTER THAN
SURRENDERING THEM
ALTOGETHER TO CONTINUED
INFLATION.



INFLATION...TAXING THE AMERICAN DREAM—a new audiovisual package from the Federal Reserve Bank of New York — helps bring a discussion of inflation alive by telling students what's happening, why and what can be done.

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The Story of Checks
and Electronic Payments
The Story of Consumer Credit
(in English or Spanish)
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