

Try to imagine how things would be different if the United States had experienced higher inflation over the last five years, so that prices of things you buy had risen to higher levels than we actually see today. How different do you think your income (the total dollars you earn in a month) would be now, in comparison with your actual income now, if we had had the higher inflation?

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My income (in dollars per month) would be lower	28%
My income (in dollars per month) would be about same	35%
My income (in dollars per month) would be higher	31%
No opinion	6%

Do you agree that preventing high inflation is an important national priority, as important as preventing drug abuse or preventing deterioration in the quality of our schools?

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	US All	Economists
Fully agree	52%	18%
Somewhat agree	32%	28%
Undecided	4%	11%
Somewhat disagree	8%	26%
Completely disagree	4%	18%

Do you agree with the following statement? “If the government were to make a mistake next year, such as printing too much money, and creates prices that are 20% higher than they are today, I think that they should try to reverse their mistake, and bring prices back down where they are today.”

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	US All	Economists
Fully agree	46%	0%
Somewhat agree	22%	3%
Undecided	22%	5%
Somewhat disagree	4%	28%
Completely disagree	6%	64%

Which of the following comes closer to your biggest gripe about inflation:

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	US All	Economists
Relative price confusion and avoiding cash	7%	49%
Hurts my real buying power	77%	12%
Other:	15%	40%

What percent of the population do you think is hurt when there is sudden, unexpected, high inflation?

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Many people (not economists) put 100%

Please evaluate which of the following theories about the effects of general inflation on wages or salary relates to your own experience and your own job:

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	US All	Economists
Extra profits for employer (and no raise)	26%	4%
Employer will have to raise my pay.	11%	60%
Fairness	21%	11%
None or no opinion.	43%	25%

Do you agree with the following statement? “When I see projections about how many times more a college education will cost, or how many times more the costs of living will be in coming decades, I feel a sense of uneasiness; these inflation projections really make me worry that my own income will not rise as much as such costs will.”

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	US All	Economists
Fully agree	66%	5%
Somewhat agree	20%	15%
Undecided	7%	9%
Somewhat disagree	6%	30%
Completely disagree	1%	41%

Imagine that next year the inflation rate unexpectedly doubles. How long would it probably take, in these times, before your income is increased enough so that you can afford the same things as you do today? In other words, how long will it be before a full inflation correction in your income has taken place?

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Up to a month	0%
Until next negotiation (within a year)	11%
Several years	44%
Never will be restored	33%
Do not know	11%

Do you agree with the following statement? “Keeping inflation low is so high a priority that I would not like to see a national policy that caused the inflation rate to double from where it is today even if that policy were sure to double the real (inflation-corrected) growth rate of the economy.”

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Fully agree	21%	4%
Somewhat agree	15%	3%
Undecided	38%	5%
Somewhat disagree	18%	17%
Completely disagree	10%	71%

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Somewhat agree	21%	8%
Undecided	11%	3%
Somewhat disagree	14%	13%
Completely disagree	27%	77%

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Somewhat agree	20%	3%
Undecided	15%	10%
Somewhat disagree	14%	16%
Completely disagree	7%	71%

Which is the better explanation why inflation is reported so regularly in the news:

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	US All	Economists
Economists tell reporters it matters	39%	18%
General public interest	30%	56%
Neither or no opinion	31%	26%

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Example: we all decide to write an extra zero on our dollars

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- ▶ Hard to build inflation into tax liabilities (ex: when do you want to pay your taxes with high inflation)
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 - ▶ Currency a less useful unit of account
 - ▶ We spent multiple days talking about inflation that you could have spent learning something else

Is *unexpected* inflation bad?

$$i = r + \pi \quad (1)$$

Suppose

- ▶ You and your friend agree that 10% is a reasonable rate of interest on a loan you will give him
- ▶ You expect inflation to be 3%

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Unexpected inflation erodes the value of fixed payments

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People are risk-averse, so simply not knowing hurts us

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 - ▶ Which price level measure to use?
 - ▶ How many accountants and economists will you hire?

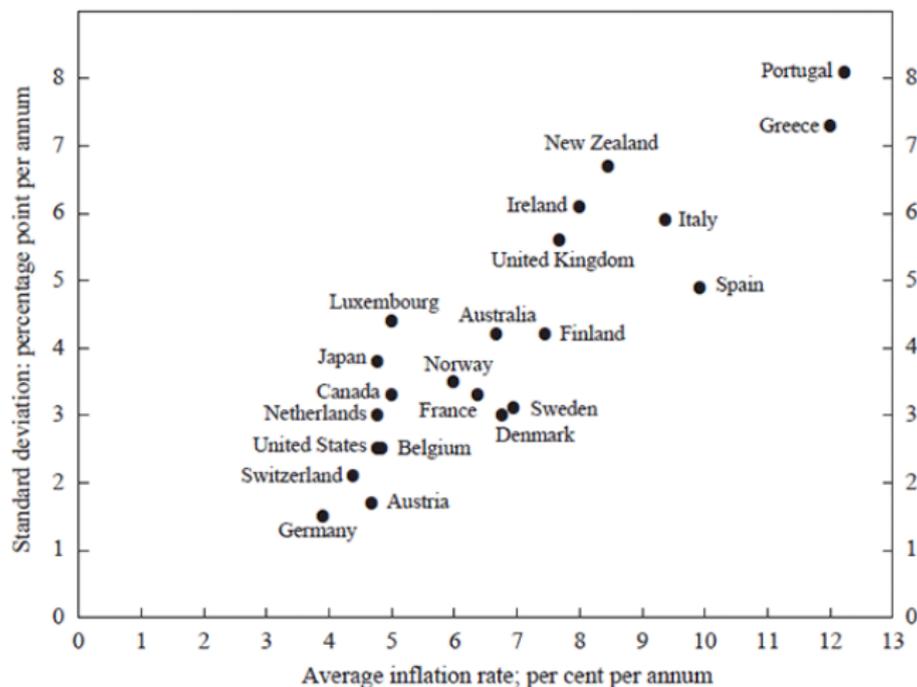
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- ▶ Inflation-adjusted contracts are costly to execute
 - ▶ Which price level measure to use?
 - ▶ How many accountants and economists will you hire?
- ▶ Inflation in the US is just not a big deal

One more cost of stable inflation

Higher average inflation causes more variable inflation

Mean and Standard Deviation of Inflation Rates (1960-1993)
(22 OECD Countries)



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- ▶ When inflation falls, employers do not have to cut nominal wages
- ▶ People like getting nominal raises (increases productivity)

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- ▶ Even more time spent avoiding holding money
 - ▶ Cannot see relative prices easily
 - ▶ Makes collection of other taxes more difficult...which makes money finance even more likely
 - ▶ Buckets full of cash are heavy

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Government budget constraint:

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What does the Fed do? “monetizing the debt”

“Inflation tax”

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If money increases do not change Y or V , then the value of seigniorage is a transfer from the holders of money to the government

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Cannot be infinite

- ▶ Takes time to buy goods and bonds
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- ▶ Value of seigniorage is $\frac{\Delta H}{P}$

Seigniorage

3% of US gov revenue

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- ▶ Nations that expect low inflation
- ▶ **Nations without independent central banks**

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Why does the Fed help the treasury? Politics.

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Sustained money-financed deficit \Rightarrow long-run inflation

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If prices are going up, how do you pay for the same *real* deficit?

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Then what happens to inflation?

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Then what happens to inflation?

If you owe \$100 in taxes in a year, when do you pay it?

Group questions

Suppose money base (high powered money) is \$400 B. How much additional revenue per year would be generated by increasing inflation from 2% to 10%? *These are reasonable numbers for the US.* Would the same calculation be reasonable if we increased the inflation rate to 1000%?