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10 Public Concern about Inflation and Unemployment in the United States: Trends, Correlates, and Political Implications

Douglas A. Hibbs, Jr.

I think Dick's going to be elected President but I think he's going to be a one-term President. I think he's really going to fight inflation, and that will kill him politically.

Dwight D. Eisenhower, 1968.

10.1 The Economy as a Public Issue

Although former President Eisenhower's forecast turned out to be wrong, numerous empirical studies show that macroeconomic performance has an important impact on mass political support for elected officials.¹ Moreover, during recent years economic issues (principally inflation, the energy crisis, and unemployment) have overshadowed other problem areas as sources of public concern. Indeed, not since the Great Depression of the 1930s and the immediate post-World War II reconversion scare has the state of the economy occupied such a salient place on the public agenda. As the Gallup Poll time-series data in figure 10.1 show, in every year since completion of the American withdrawal from Vietnam more than 70% of the public identified an economic issue as "the most important problem facing the country today."

In view of macroeconomic developments during the 1970s this comes as no surprise. The tight labor markets accompanying the Vietnam War boom and the Johnson administration's attempt to obscure the war's true cost through a policy of hidden deficit finance (abandoned too late with

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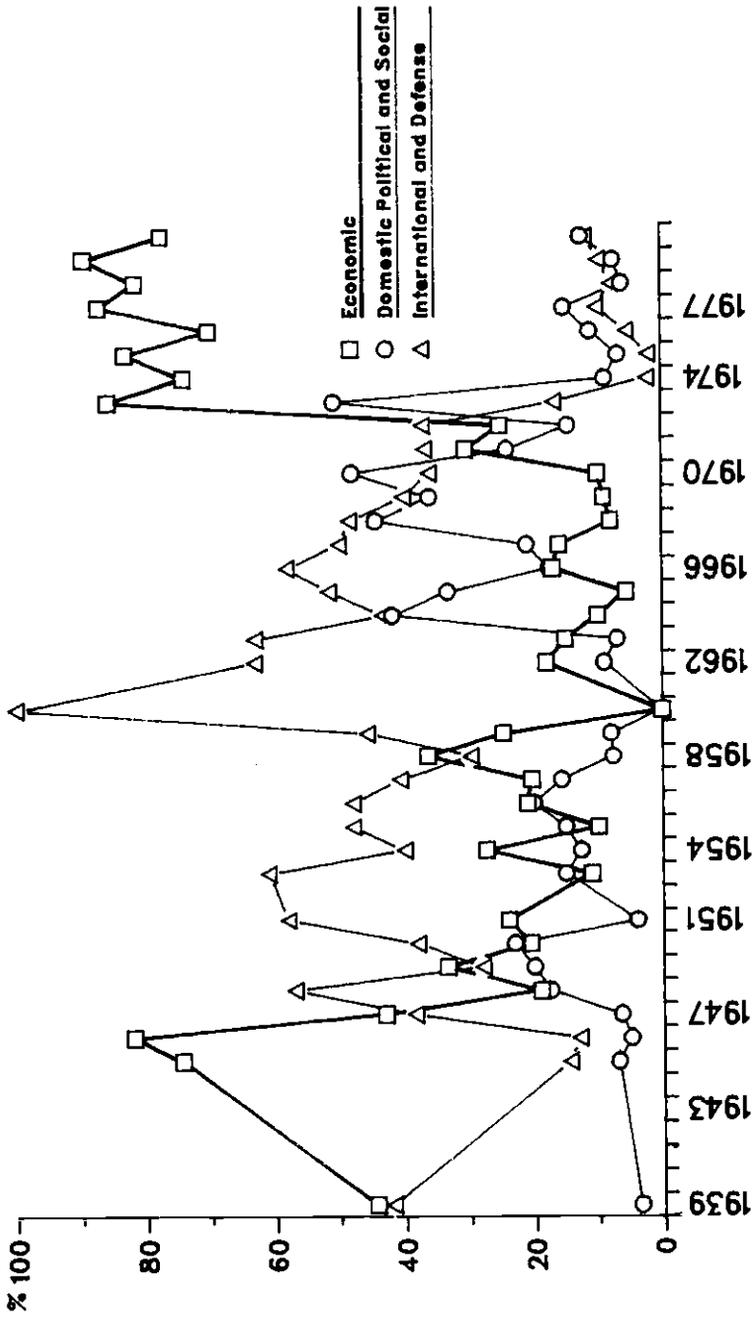


Fig. 10.1 Aggregate responses to the question, "What is the most important problem facing the United States today" (approximate wording)? Source: George Gallup, *The Gallup Poll, Public Opinion, 1935-71*, vols. 1-3 (New York: Random House, 1972), and American Institute for Public Opinion, *The Gallup Opinion Index*, various issues.

the 1968 tax surcharge) left the incoming Nixon administration facing accelerating prices. The new Republican administration pursued a deflationary macroeconomic policy to check the inflation. The high-employment budget surplus grew by about 20 billion (constant 1972) dollars in 1969 and showed an average constant dollar level of more than 5 billion for 1969–70.² Dr. Arthur Burns, Nixon's appointee as chairman of the Federal Reserve, accommodated the administration's fiscal policy; the nominal M2 money supply decelerated in 1969 and 1970, and the real money supply (deflated M2) increased by only 0.76% in 1969 and decreased by nearly 2% in 1970.³ The policy worked, helping produce the 1970–71 recession and reducing the consumer price inflation rate by more than 1.5 percentage points between early 1970 and mid-1971.

By late 1971 wage and price controls were imposed and the policy of fiscal and monetary restraint was jettisoned in a successful attempt to stimulate an election-year boom.⁴ In 1972 the real high-employment deficit was increased by more than 8 billion dollars, nominal M2 was expanded by nearly 12%, and real M2 grew by 8.5%. However, new crises soon rocked the economy. This time the shocks were exogenous: dramatic increases in the world prices of food and raw materials in 1972–73 and the OPEC-induced quadrupling of the price of petroleum in late 1973 contributed to unprecedented double-digit rates of inflation throughout 1974. The Ford administration responded by launching the "Whip Inflation Now" media campaign and, more tangibly, by cutting back sharply the high-employment budget deficit, which in 1974 was reduced by about 9 billion 1972 dollars from the average of the preceding two years. Dr. Burns again accommodated the fiscal authority's policy of restraint, proclaiming that the shortage was "of oil not money"; nominal M2 decelerated substantially, and real M2 declined by a crushing 4.5% during 1974.

The consequence was at the time the most severe recession in postwar United States history. Unemployment stood at nearly 9% by the middle of 1975. Consumer price inflation declined from the double-digit rates of 1974 to the 5 to 6% per annum range in 1976.

The severity of the recession prompted the Ford administration to pursue expansionary policies in late 1975 and 1976, but the President apparently remained committed to his earlier priorities, declaring to a cheering Wall Street audience during the campaign that "after all, unemployment affects only 8% of the people while inflation affects 100%."

These priorities were reversed during the first years of the Carter administration, which emphasized the traditional liberal Democratic goal of moving the economy toward full employment. Over 1976–77 nominal M2 growth proceeded at a rate in excess of 12%, real M2 increased at a brisk 5.9% rate during 1977, and the high-employment budget deficit continued to rise, peaking at 29 billion 1972 dollars in 1977:4 after

Congress in May 1977 passed the tax cuts proposed by the administration to stimulate the economy. Fueled by these policy actions and no doubt also by the economy's endogenous recuperative capability, the rate of unemployment declined continuously, falling by about two percentage points between the end of 1976 and the beginning of 1979.

However, the cost was a steady acceleration of prices. The annualized rate of change of consumer prices increased from less than 5% in 1976:4 to more than 8.5% in 1978:4. Following the second great OPEC shock of 1979, which more than doubled the price of petroleum, consumer prices continued to accelerate sharply and inflation was running at more than 13% per year during the first two quarters of 1980.

The escalation of inflation to politically (and economically?) hazardous rates produced a dramatic policy reversal in late 1978 that continued through 1979 and into the election year. The administration implicitly acknowledged that the voluntary wage-price guidelines plan announced on 24 October 1978 was unlikely by itself to decelerate prices significantly, and the earlier commitment to achieving a sustained low rate of unemployment was for practical purposes abandoned. The high-employment budget deficit was reduced by 9 billion (1972) dollars in 1978 and by more than 11 billion (1972) dollars in 1979 and averaged a comparatively modest 4–5 billion during late 1979 and early 1980—the smallest high-employment deficits since 1974. On two occasions, 1 November 1978 and 6 October 1979, the discount rate was increased by a full percentage point and, perhaps more important, with the encouragement of the administration the monetary authorities refused to accommodate the inflationary pressures. Consequently, the nominal M2 growth rate was flat and real M2 declined in every quarter after 1978:3. The 1979/78 year on year decline in real M2 was over 2%, and the 1980/79 annual decline was a bruising 4%.

The macroeconomic history of the Carter administration looks like a "political business cycle" run backward: rising inflation, falling unemployment, and a favorable real income growth rate during the first twenty-four to thirty-six months of the administration were followed by negative growth rates, sharply increased unemployment, and, during the last two quarters, as the election approached, slightly decelerating consumer prices. Although the OPEC shock of 1979 was obviously beyond the administration's control, this is nonetheless somewhat ironic because William Nordhaus, an economist who wrote a seminal paper on electorally motivated macroeconomic policy cycles (1975), served on the President's Council of Economic Advisers during 1977–78. In any case recent events suggest that the assumption of stylized political business cycle theories that an expansionary policy is the politically optimal election-year strategy may be erroneous during periods of high and rising inflation. I return to this point below.

10.2 Public Concern about Inflation and Unemployment

The Gallup data in figure 10.1 were organized in a way that shows the "economy" has become the dominant public issue in recent years, but inflation, unemployment, and to a lesser degree the energy crisis (except in 1974 and possibly 1979)⁵ are the variables preoccupying both policymakers and the mass public. Unfortunately, the Gallup data chronically confuse the "high cost of living" with "rising prices," that is, the price level and standards of living with the inflation rate, and therefore the Gallup series cannot be used to assess unambiguously public concern about unemployment and inflation.⁶

However, at intermittent periods between 1971:3 and 1974:4 and once every quarter thereafter surveys undertaken by the Survey Research Center at the University of Michigan have asked national samples of American households "which of the two problems—inflation or unemployment—do you think will cause the more serious economic hardship for people [may have the more serious consequences for the country] during the next year or so?"⁷ These questions encourage people to acknowledge (implicitly) the difficult choice that has been at the heart of recent macroeconomic policy debates and provide the best available time-series evidence on the public's relative concern about inflation and unemployment during the critical 1971–80 period.

Figure 10.2 shows (a) the aggregate responses to the Michigan inflation/unemployment question along with (b) the actual rates of inflation, unemployment, and growth of per capita real personal disposable income in the macroeconomy. Nothing in neoclassical economic theory adequately explains the high levels of public concern about inflation revealed by the data in figure 2a. The principal economic costs of anticipated inflation are the resources devoted to economizing cash balances and fixed-interest rate assets. However, this is likely to be a trivial matter when viewed in relation to the costs of unemployment (but see Feldstein 1979).

The menu of costs associated with unanticipated inflation is longer and more interesting, but in my view it does not provide a convincing explanation of the public's aversion to rising prices. The existing empirical evidence suggests that the aggregate wage and salary income share is not eroded by inflation (Bach and Stephenson 1974) and that rising prices have no dramatic effects on the size distribution of income (Blinder and Esaki 1978). Unanticipated price increases do of course arbitrarily redistribute wealth from nominal creditors to nominal debtors, and the aggregate amounts involved are probably large. But at the microlevel a great deal of "canceling" must also take place. People lose on some accounts (fixed price assets) and gain on others (fixed price liabilities). Empirical work suggests that the rich (and perhaps the very poor) are net losers

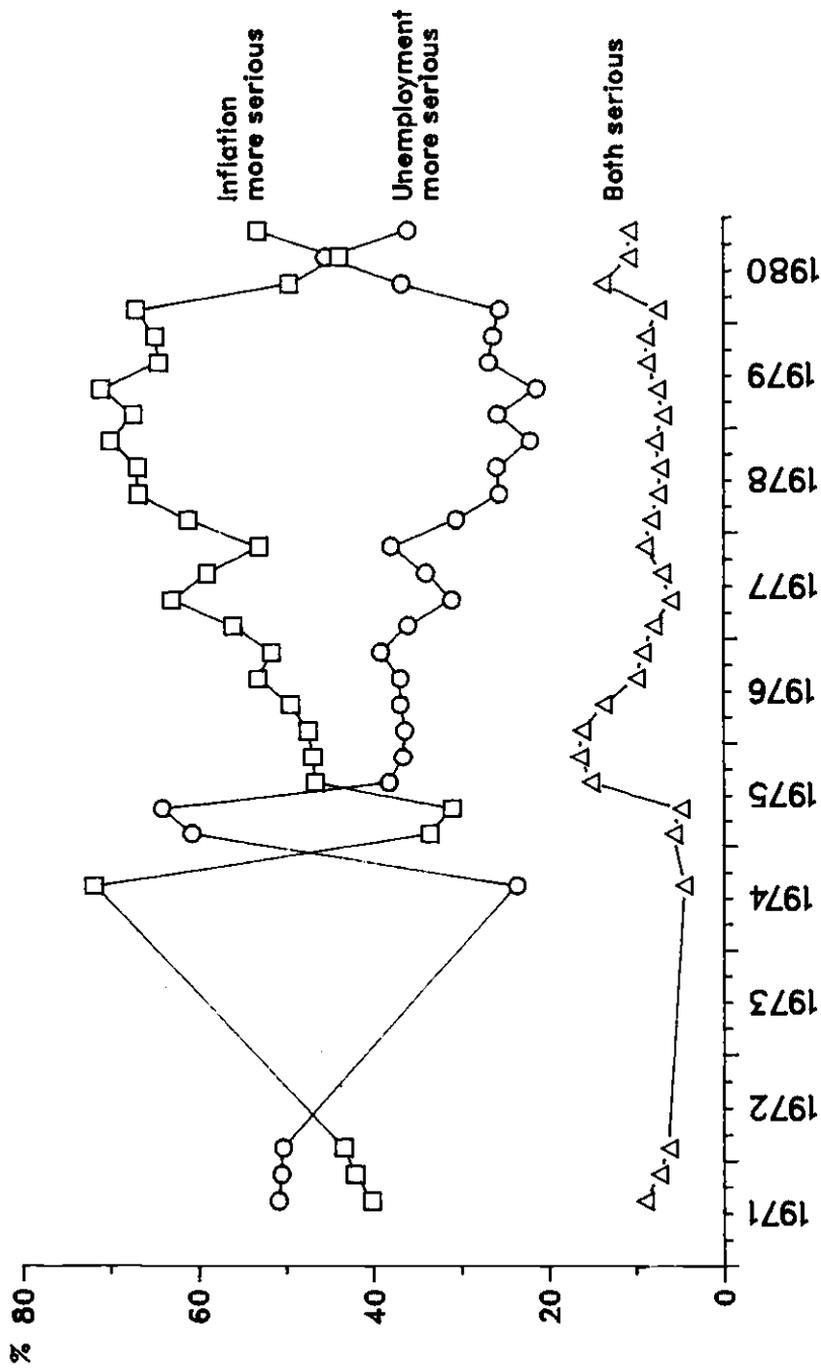


Fig. 10.2a Public concern about inflation and unemployment (see text for question wording). Source: University of Michigan, Survey of Consumer Sentiment.

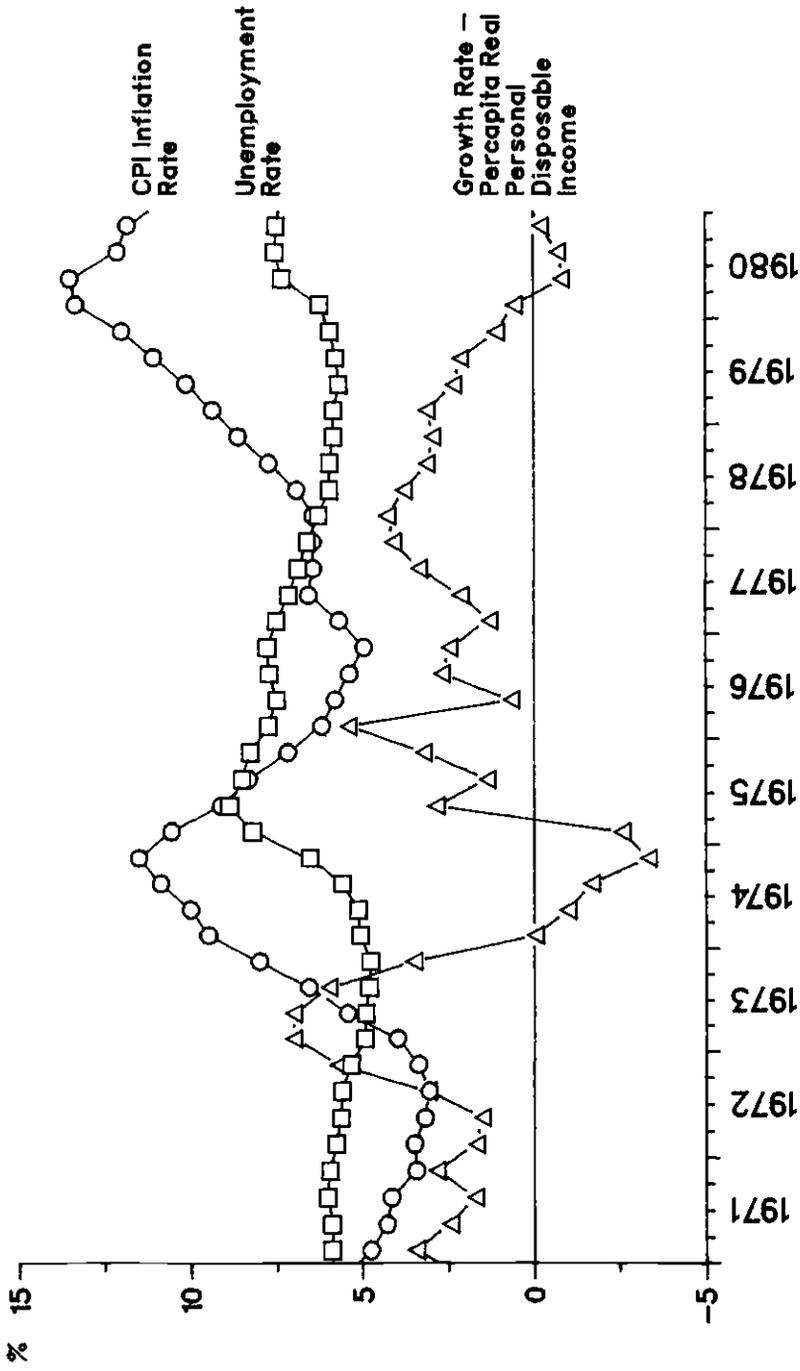


Fig. 10.2b Macroeconomic outcomes, 1971:1 to 1980:4.

(Minarik 1979; Palmer and Barth 1978), which is consistent with public opinion data showing that high-income households are more concerned about inflation than low- and middle-income households (Hibbs 1975).

One of the major inflation-induced wealth redistributions is intergenerational: from the old and retired, who are likely to be net creditors, to the young and economically active, who are likely to be net debtors (Bach and Stephenson 1974; Palmer and Barth 1978). Surprisingly, however, microanalysis of the Michigan public opinion data shows that retirees were less concerned about inflation (more concerned about unemployment) than the young (Hibbs 1979). Perhaps this is true because retirees in surveys taken in the 1970s were old enough to have experienced the Great Depression and the event was traumatic enough to counteract their current economic self-interest. In theory, the aged poor—retirees whose welfare depends on social security—are perhaps the most exposed to inflation. Since 1974, however, social security has been indexed to inflation, thus limiting the adverse effects of rising prices on the aged poor.

To the extent that state revenue is raised by direct taxation based on progressive nominal schedules, inflation increases the effective rate of income taxation (inflationary fiscal drag) unless the authorities take compensatory action. Although discretionary tax cuts have neutralized much of the potential gross transfer to the state,⁸ it probably is true that inflation has made possible a growth of government revenue higher than politicians could have achieved by making explicit real claims on the electorate. The (unobserved) difference between the historical time path of effective tax rates and what would have occurred in a world of stable prices (or indexed taxes) may explain some of the public's concern about inflation.

However, neither the income, wealth, nor tax effects of inflation appear large enough to explain widespread public aversion to rising prices, and therefore less tangible and partly psychological factors are probably more important than easily identified objective costs. As Okun has argued, sustained high rates of inflation may undermine "the foundations of habit and custom," forcing people "to compile more inflation and to try to predict the future—costly and risky activities that they are poorly qualified to execute and bound to view with anxiety" (Okun 1975, p. 383). Empirical evidence does indicate that high rates of inflation are associated with high variability of the inflation rate, and that these quantities are correlated with variations in relative prices and with the variance of inflationary expectations (Cukierman and Wachtel 1979; Klein 1976; Parks 1978; Vining and Elwertowski 1976). Presumably this heightens uncertainty about the future stream of prices and leads to greater incidence of unanticipated inflation.

It is also possible that people fail to credit inflation-induced windfall gains, for example, on fixed-interest liabilities such as home mortgages, against the losses incurred on such money-valued assets as pension and life insurance reserves. Perhaps more important, the connection between rising wages and rising prices may not be well understood by the mass public. Although there is no solid empirical evidence supporting this conjecture, it is possible that inflation tends to be viewed as an arbitrary tax that chips away the purchasing power of nominal income increases which people believe they deserve to enjoy fully. For example, between 1975:4 and 1976:4 nominal personal disposable income per person rose by about 7.5%, but prices increased by about 4.9%, leaving a more modest 2.6% real gain. Perhaps some people entertained the mistaken idea that their standard of living could have risen by 7.5%, or nearly so, if it were not for the "evil" of inflation.

Since 1973 one important factor contributing to popular concern about inflation has probably been the decline in real income experienced by the consumers of food, raw materials, and especially petroleum as a result of the shift in the terms of trade in favor of the producers of these commodities. It is likely that many people blamed rising prices for the shrinkage of their real income, even though the immediate post-OPEC inflationary burst was to a large extent merely the mechanism of a change in relative prices. In the third quarter of 1974, for example, per capita real personal disposable income declined by almost 2%, inflation was running at double-digit levels, and more than 70% of the public considered inflation a more serious problem than unemployment. Inflation, however, was hardly the root cause of the erosion of real income. Had the real loss absorbed by the oil-consuming nations taken place about a stable price level, the pain would not have been any less unpleasant, but inflation could not have been held responsible. However, if people were confused, it is understandable: as James Tobin (1976) has pointed out, neither President Ford, nor his economic advisers, nor the Federal Reserve Authorities, and very few outside economists told the public that anti-inflationary policies could not restore the former terms of trade or the real income loss.

It is no mystery why people are concerned about high and rising unemployment rates—after all, unemployment is a real quantity representing lost real output and underutilized human resources. Remember too that the measured unemployment rate is just that—a rate—and a far larger fraction of the labor force experiences bouts of actual unemployment during any given time interval than the average percentage numbers might suggest. In a twelve-month period the fraction is likely to be about three times the average "official" rate. Moreover, in addition to households touched directly by some form of unemployment or underemploy-

ment, an even larger number will be aware of unemployment among relatives, friends, neighbors, and, of course, workmates.

When inflation is viewed in this light, it is perhaps puzzling that the public is so concerned about it. Indeed, in the Michigan data people who were actually unemployed at the time of the interviews often expressed *less* concern about unemployment than did some (employed) blue-collar groups (see Hibbs 1979). This implies that for many individuals fear of future unemployment, the memory of past unemployment, or the aggregate social costs of unemployment are more powerful influences than the pain of contemporaneous personal experience. One of the reasons must be that unemployment no longer poses an economic disaster for many of those affected directly.⁹ In the 1930s the unemployed often went hungry. Today public transfers to the unemployed provide a significant cushion against the economic pain and most suffer only temporary reductions in income.¹⁰ In other words, as Feldstein (1978) has emphasized, the private costs of unemployment are much lower now than in the past.

Turning again to the aggregate survey and economic data in figures 2a and 2b, it is obvious that the public's relative concern about inflation responds to the prevailing macroeconomic situation. In late 1971 and early 1972 as the recession was coming to an end, the conjunction of comparatively low and falling inflation rates and modest real income growth rates produced popular majorities more concerned about unemployment than inflation. However, by the summer of 1974 inflation was raging at more than 10% per annum, real income per capita was falling by nearly 2% on an annual basis, and almost three-quarters of the public viewed inflation as the more serious economic problem.

The situation was reversed six months later. The inflation rate was falling sharply, unemployment increased to its highest level since the Great Depression, and only one person out of every three expressed greater concern about inflation than unemployment. As the economy moved from severe recession into "stagflation" for the eighteen months encompassing late 1975 and 1976, popular concern about inflation increased sharply and hovered about the 50% mark.

During the first year of the Carter administration, unemployment fell dramatically, the annualized inflation rate increased to about 6.5%, and public concern about inflation drifted upward averaging 58% for the year. Over the next eight quarters unemployment stabilized at just under 6%, and beginning in 1978:1 consumer prices *accelerated* in every subsequent quarter until the third quarter of 1980. Predictably, the public's relative concern about inflation shot upward. During 1978 and 1979 only about one person in four was more concerned about unemployment than inflation, and two-thirds or more of the public typically identified inflation as the more serious economic problem. The situation changed with the onset of the recession that began in 1980. The unemployment rate rose sharply between 1980:1 and 1980:2, and during the third quarter the

inflation rate declined from its mid-year peak. Consequently, by 1980:3 the fractions of the electorate viewing unemployment and inflation as the more serious problem were approximately the same—about 45%. By the election quarter unemployment had stabilized, however, and 53% of the public saw inflation as the more serious problem.

Regressing the percentages of the public more concerned about inflation than unemployment on the actual rates of inflation, unemployment, and per capita real personal disposable income growth yields more systematic information about the response of public opinion to macroeconomic developments. Such statistical analyses support the following conclusions.¹¹

1. Relative concern about the problem of inflation is quite insensitive to the prevailing *level* of the unemployment rate. Indeed, if real income per capita is growing at the usual rate (2.3% per year, the 1970–80 average), then at any *stable* unemployment rate within the range experienced during the last decade a solid majority of the public is likely to be more concerned about inflation than unemployment *if* the rate of inflation runs higher than 5.0–6.0% per annum.

2. However, changes in the unemployment rate are associated with sizable movements in the opinion distribution. Each percentage point increase in the rate of unemployment produces a decline of about twelve percentage points in public concern about inflation. Great fluctuations in the public's view of inflation and unemployment are therefore associated with movements of the economy into and out of recessions.

3. As indicated in (1) above, public opinion does appear to be sensitive to the inflation rate level. Each percentage point of inflation adds about 1.4 points to the percentage of the public believing inflation to be a more serious problem than unemployment. Since this effect was estimated in the presence of the per capita real disposable income growth rate (see below), it implies that people find rising prices distasteful even when money income adjusts fully to cost-of-living increases.

Public sensitivity to the inflation rate is even greater when rising prices are accompanied by declining per capita real disposable personal income. In these circumstances (prices rising, real income falling) each percentage point of inflation adds about 1.4 plus 0.7 times the rate at which real income is decreasing to the percentage of the public more concerned about inflation than unemployment.¹²

4. Changes in the inflation rate (accelerations and decelerations of prices) have quite dramatic effects on public opinion. A 1% increase of the inflation rate typically yields a transitory upward movement of about eleven percentage points to public concern about inflation. Since the best autoregressive predictors of this quarter's inflation rate are the inflation rates one and two quarters ago, this result may partly reflect the public's aversion to *unanticipated* movements in prices.¹³

5. Aside from the consequences of the (unusual) conjunction of high

inflation and falling real income, the growth rate of real income alone typically has a positive association with popular concern about inflation. When real income is rising, each percentage point of the growth rate adds approximately two points to the percentage of the public more concerned about inflation than unemployment. When real income is declining, the public's relative concern about inflation changes on the margin by 2.0 times the marginal income change minus 0.7 times the inflation rate.

These results suggest that recession rather than inflation typically is viewed as the more important threat to living standards and that, therefore, when real income is increasing at a brisk pace, the public's attention turns away from the unemployment issue toward the problem of inflation. Conversely, declining real income generally increases public concern about the unemployment issue.

10.3 Political Implications

If one believes, as I do, that economic policy is responsive to and constrained by public views of economic developments, then the public opinion data discussed earlier help illuminate the political environment facing macroeconomic policy officials. More direct evidence on the political implications of macroeconomic outcomes, however, is available from econometric models of how economic conditions affect mass political support for the President.

Figure 10.3 shows the elasticities of political support with respect to real and nominal macroeconomic performance for every President since Kennedy.¹⁴ (The political support index is the percentage of the public responding "approve" to the well-known Gallup Poll question "Do you approve or disapprove of the way [the incumbent] is handling his job as President?") The elasticities give the long-run proportional changes in political support expected from unit proportional changes in the economic performance variables that are sustained indefinitely. (Practically speaking, given the dynamic structure of the model from which the elasticities were computed, "indefinitely" means five to six years.)

The elasticities implicitly reveal the public's long-run, proportional aversion to various economic outcomes. So that persistent developments are not obscured by short-run realizations of the variables, the time plots show four-quarter moving averages of the long-run elasticities implied at each period. For convenience figure 10.3 displays absolute values of the moving averages, though of course the underlying unemployment and inflation parameters are negative and the real income growth rate parameter is positive. Notice also that the "real" elasticities are the sum of the absolute values of the unemployment real income growth rate elasticities.

Several patterns are apparent from the data in figure 10.3. First, the

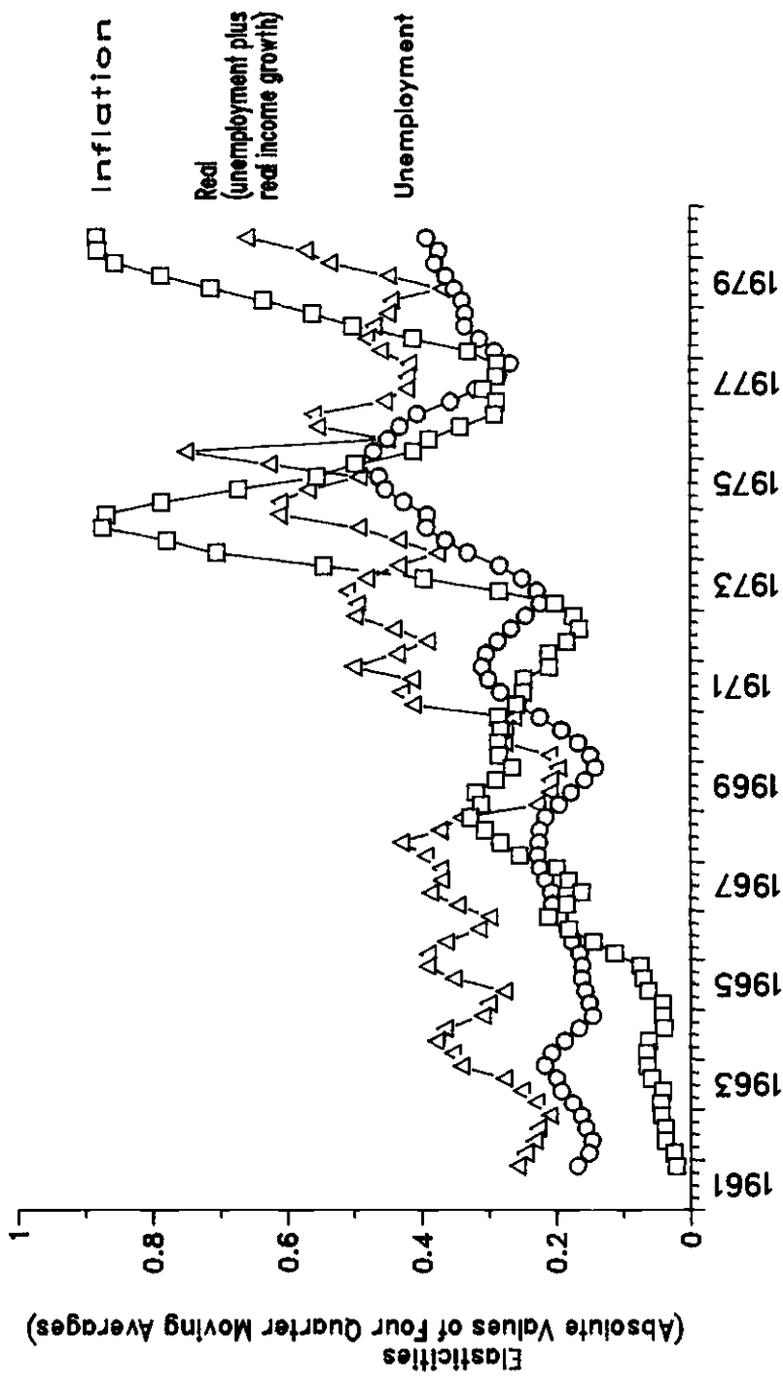


Fig. 10.3

Implied long-run elasticities of political support with respect to nominal and real macroeconomic outcomes.

elasticities increase, typically quite dramatically, from the 1960s to the 1970s. For example, if the real variables (unemployment and the per capita real disposable income growth rate) had changed simultaneously in an unfavorable direction by a factor of 1% in the 1960s, on average the expected long-run proportional decline in support for the President would have been on the order of 0.3 of a percentage point (the real elasticity mean for 1960–69). During the 1970s the expected long-run proportional decline in the President's support from the same sustained movement in the real macroeconomy would have been on the order of 0.55 of a percentage point (the real elasticity mean for 1970–79). As the figure indicates, the upward increase of the nominal, inflation elasticities over time is even greater: the mean over 1960–69 is 0.14 as compared to a mean of 0.46 for 1970–79. These results are hardly surprising in view of the favorable economic conditions in the 1960s—virtually a “golden age” of economic performance—and the “stagflation” characteristic of more recent years.

Second, popular support for the President was relatively more sensitive to nominal, inflation economic performance than to real economic performance in the 1970s than in the previous decade. In the 1960s the mean of the real elasticities was about twice the mean of the inflation elasticities (0.3 versus 0.14); in the 1970s the average real and nominal elasticities were both in the vicinity of one-half. By the second quarter of 1980 the relative impact of inflation on political support had increased enormously. For the four quarters of President Carter's administration spanning 1979:3–1980:2 the mean of the real elasticities was about 0.66—somewhat higher than the average for the previous decade. However, the corresponding mean of the inflation elasticities was 0.88—higher than at any period (including 1974) in the preceding twenty years.¹⁵

From a political as well as an economic point of view, then, the Carter administration's policy reversal in late 1978 comes as no surprise. But the policy change came late—too late to reverse the upward trajectory of inflation by a margin great enough to influence decisively the President's standing with the public by the election. However, the administration's anti-inflation policies did manage successfully to create an election-year recession. Hence President Carter and the Democratic party went before the electorate in 1980 with the worst of all possible situations—high inflation, increased unemployment, and falling real disposable income. As a result, they were trounced soundly by Mr. Reagan and the Republicans.¹⁶

10.4 Politically Feasible Policies

It is not surprising that President Carter was in deep political trouble because of high and rising inflation rates. Since the late 1960s solid

pluralities (more recently majorities) of the public have identified “Government” as opposed to “Business” or “Labor” as the institution most responsible for inflation (see figure 10.4), and great majorities regularly agree that the federal government “spending more money than it takes in” and “printing money with nothing to back it up” are “extremely important” particular causes of inflation. (For example, the percentages of the public agreeing that government spending and money creation are extremely important causes were 79 and 74 respectively in the April 1980 *New York Times*/CBS News Poll.) On this score the public is in general agreement with the economics profession’s diagnosis of the proximate sources of inflation. Today few economists dissent from Milton Friedman’s assertion that the *proximate* cause of inflation “is always and everywhere a monetary phenomenon resulting from and accompanied by a rise in the quantity of money relative to output” (Friedman 1966). As the public opinion data seem implicitly to acknowledge, the most important indicator of fiscal pressure on the money supply and therefore on the inflation rate is the size of the budget deficit.

The anti-inflation policy favored by the majority of economists is straightforward: contract the supply of money and credit thereby raising interest rates and unemployment and reducing the rate of growth; that is, induce a recession to depress inflationary expectations and, ultimately,

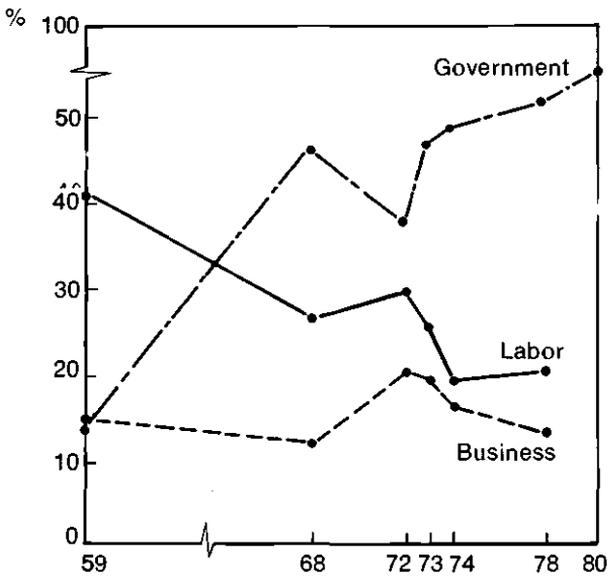


Fig. 10.4 Responses to the question, “Which is the most responsible for inflation—government, business, or labor?” Source: Gallup Polls and 1980 *New York Times*/CBS Poll.

actually reverse price acceleration. Here the public and the economics profession part company. Sizable majorities in the opinion surveys repeatedly oppose letting interest rates and unemployment rise to fight inflation,¹⁷ preferring instead, as the data in figure 10.5 suggest, a policy of wage and price controls. Indeed, there is solid popular support for controls even if the policy means a reduction in real wages. Fifty-one percent of the respondents in the April 1980 *New York Times*/CBS News Poll were willing to accept government limitations on their wage increases "to a rate considerably lower than the present rate of inflation" (39% were "not willing"), and the July 1978 Harris/ABC News Poll found 68% of the respondents willing to accept a pay raise "less than the cost of living" if there were "some assurance" that it would contribute to bringing inflation under control.

With the exception of unorthodox thinkers such as Galbraith, Lekachman, and Heilbroner, and a few of the more conventional economists such as Bator and Tobin, the American economics profession has generally opposed incomes policies on the grounds that they introduce distortions and inefficiencies in labor and product markets and confer no long-run benefits in the form of reduced inflation. (See the econometric evidence on the 1971-73 experience in, for example, Gordon 1975, 1977.) Yet the pain associated with the economists' policy of deflation via recession will be enormous. By Hall's (1979) reading of the econometric evidence, the year on year underlying (wage) inflation rate falls one-half a percentage point for every percentage point that the actual unemployment rate stands above the "natural" rate. Hall judges the "natural" rate to be a staggering 6.8%, which, given an underlying inflation rate in the vicinity of 10% per annum, implies that it might take as long as ten years of 8.8% unemployment to restore price stability. By Okun's law this would mean a real GNP loss (gap) of about 5% in *each* year.¹⁸ Of course

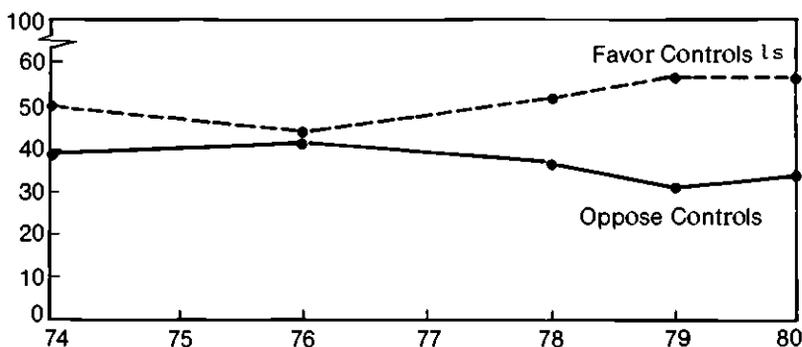


Fig. 10.5

Responses to the question, "Would you favor or oppose having the government bring back wage and price controls?"
Source: Gallup Poll.

inflation might well respond more quickly to economic slack than such simple calculations imply, but there is little doubt that the employment and real output costs of significant disinflation will be high. (See chapter 1, Robert J. Gordon's contribution to this volume.)

The public would not endure the costs and therefore elected, politically accountable officials are unlikely to pursue the necessary draconian policies for any sustained period of time. Instead, unless inflation miraculously abates without policy intervention in the near future, it is quite possible that President Reagan, notwithstanding his ideological inclinations, will yield to political pressures and introduce statutory wage and price controls, or some form of a tax-based incomes policy. Perhaps the preferences of the people (and the possible actions of the politicians) are on sounder ground than the views of most economists. The costs of orthodox disinflationary policies described above justify quite a lot of incomes policy-induced distortion and inefficiency in the marketplace. Moreover, we have no solid empirical evidence that wage-price controls (or tax-based incomes policies) are ineffective *when* accompanied by monetary and fiscal policies consistent with the lower rates of wage and price change encouraged or imposed on the economy by tax incentives or statutory controls.¹⁹ It is at least arguable that the combination of an incomes policy and fiscal and monetary restraint would produce more disinflation per unit of foregone real output and employment than orthodox alternative policies. In other words the politically feasible policy may also be the economically efficient one.

Notes

1. This section updates the introductory part of Hibbs (1979).
 2. The budget figures are based on the Federal Reserve Bank of St. Louis high-employment surplus/deficit series. The real series are nominal data divided by the GNP deflator with a 1972 base year.
 3. "New" M2 deflated by the CPI.
 4. For a detailed empirical analysis of the "electoral business cycle" in general and the 1972 experience in particular, see Tufte (1978).
 5. See *Public Opinion*, December/January 1980, p. 40.
 6. When responding to open-ended survey questions, many people apparently do not differentiate between high and rising prices and use the terms interchangeably (see Kiewiet 1980). The Michigan survey questions described ahead refer explicitly to inflation and therefore are less likely to confuse respondents.
 7. The alternative wording in brackets was used in the 1971:3, 1971:4, and 1972:1 surveys.
- Notice that the question refers to "people" generally (or to the "country") and not to the respondent *personally*. Questions pertaining to *personal* economic concerns invariably yield more mentions of inflation and fewer mentions of unemployment than questions pertaining to respondents' assessment of *national* economic problems.

For example, in February 1980 the Harris survey asked a national cross section: "If you had to choose, which do you think is a more serious problem

- (1) for you and your family today—
- (2) for the country today—

rising prices or high unemployment?"

	<i>Rising Prices</i>	<i>High Unemployment</i>	<i>Both</i>
(1) Problem for you and your family	82%	10%	7%
(2) Problem for the country	46%	44%	17%

Harris Survey, 20 March 1978.

Research shows that *national* economic concerns have far greater influence on political behavior than *personal* economic concerns (see, for example, Kiewiet 1980 and Kinder and Kiewiet 1979, 1981), and therefore the former are more useful for my purposes.

8. See Sunley and Peckman (1976) on the stability of effective federal tax rates.

9. For a broader view of the strain and personal dissatisfaction produced by unemployment experience, see Schlozman and Verba (1979).

10. Gramlich (1974) provides estimates of unemployment-induced earnings losses of various demographic groups.

11. The conclusions are based on the following regression results from available data over the period 1971:3–1980:4:

$$\begin{aligned}
 Y_t = & 38.5 - 12.3(U_t - U_{t-1}) + 1.38P_t, \\
 & (3.9) \quad (3.1) \quad (0.37) \\
 & + 11.1(P_t - P_{t-1}) + 2.01R_t - 0.72(P_t R_t^*), \\
 & (1.2) \quad (0.75) \quad (0.24) \\
 R^2 = & 0.89 \quad DW(2) = 1.61, \quad SER = 4.27,
 \end{aligned}$$

where Y = percentage of the public more concerned about inflation than unemployment (graphed in figure 10.2a); P = rate of inflation of consumer prices; U = rate of unemployment; R = growth rate of per capita real personal disposable income (nominal income deflated by the personal consumption deflator); $R^* = R$ if $R < 0$ and $R^* = 0$ otherwise; standard errors are in parentheses; and all rates of change are formed $\ln(X_t/X_{t-4}) \cdot 100$.

The level of the unemployment rate has a small, statistically insignificant effect on public opinion as the following regression results indicate:

$$\begin{aligned}
 Y_t = & 40.2 - 0.25U_t - 12.3(U_t - U_{t-1}) + 1.39P_t, \\
 & (9.9) \quad (1.3) \quad (3.2) \quad (0.38) \\
 & + 10.8(P_t - P_{t-1}) + 1.99R_t - 0.71(P_t R_t^*), \\
 & (1.8) \quad (0.78) \quad (0.25) \\
 R^2 = & 0.89, \quad DW(2) = 1.57, \quad SER = 4.37.
 \end{aligned}$$

The aggregate results above and the discussion in the text are broadly consistent with the nonlinear, disaggregated analyses reported in Hibbs (1979).

12. This estimate is based on limited experience and therefore should be interpreted cautiously.

Surprisingly, in all statistical analyses the consumer prices inflation rate performed better than the inflation rate of the personal consumption deflator, even though the latter probably has measured the actual inflation experience of consumers more accurately in recent periods. This implies either that people use a "fixed basket/fixed weight" standard in developing opinions about the relative importance of the inflation issue or, more likely, that opinions are to some extent affected by the media, since media coverage focuses heavily on movements of the Consumer Price Index.

13. Cf. the earlier discussion. Over the period 1971:1–1980:4 the best autoregressive equation for the CPI inflation rate is

$$P_t = 0.52 + 1.69P_{t-1} - 0.76P_{t-2},$$

(0.23) (0.11) (0.12)

$$R^2 = 0.97, \quad DW = 1.97, \quad SER = 0.57,$$

where $P_t = \ln(CPI_t/CPI_{t-4}) \cdot 100$.

14. The results in figures 10.3 and 10.4 are based on Hibbs (1982).

15. Since the elasticities are a nonlinear function of all variables driving political support (see the model in Hibbs 1982), they do not necessarily track closely their associated economic variables. As it turns out, the inflation and real income growth rate elasticities have high shared variation with the rate of inflation and real income growth respectively (the r^2 through 1980:1 are 0.91 and 0.86), whereas the shared variation between the unemployment elasticity and the unemployment rate is a more modest $r^2 = 0.41$.

16. For evidence showing that the 1980 election outcome represented a repudiation of the Carter administration's macroeconomic performance rather than a fundamental "shift to the right" of the electorate's preferences on domestic social issues, see Hibbs 1982a.

17. For example, in an April 1980 *New York Times/CBS News Poll* 69% of the public opposed "letting unemployment rise to try to fight inflation" (34% were in favor) and in the January 1980 poll 56% opposed "letting interest rates go up."

18. Here I have accepted Hall's very high estimate of the "natural" unemployment rate, and I have assumed that $(Y^* - Y)/Y = 2.5(U - U^*)$, where U and U^* are the actual and "natural" rates of unemployment, and Y and Y^* are actual and "natural" levels of real output, respectively. For recent estimates of Okun's law coefficient, see Perry (1977) and the comments and discussion of that paper.

19. Virtually all the evidence relevant to a peacetime United States economy is from 1971 to 1973 when fiscal and monetary policy was excessively expansionary. Consequently, the inflation rate increased sharply when the Nixon controls were lifted.

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