

## *The Economy in Perspective*

*Once upon a time* ... there was a land filled with hard-working, creative people. Most often, economic conditions were good, but even in the best of times some companies went out of business and people changed jobs. These comings and goings might disrupt lives and cause hardship, but the people recognized that the great majority were well served by their economic system. When inefficient businesses failed, more productive ones took their places and provided new jobs. Living standards rose from generation to generation.

But their were hard times, too. During the 1970s, economic activity contracted twice, unemployment escalated, and inflation soared. Political thinking at the time favored using monetary and fiscal policies to vigorously stimulate business activity and create jobs. Prevailing economic doctrine underestimated the negative consequences of higher inflation. So, when the actions of an oil-producing cartel sent energy prices skyrocketing, the nation's leaders initially feared that the cost of aggressively combating inflation might exceed the benefit. But accelerating inflation proved so destructive that by decade's end the public was clamoring for a change in economic strategy.

In the 1980s, the nation acclimated itself to lower inflation. The government lowered several key tax rates, reduced regulations affecting many industries, and dropped trade barriers. The economy expanded without interruption for most of the decade, while inflation declined and became more stable. Economic conditions improved on average, but regional and industrial circumstances still differed widely.

As the 1980s progressed, people saw that the previous decade's inflation had distorted the economy in more complex, profound ways than they had realized. Not surprisingly, many companies were struggling because when inflation collapsed, they could no longer survive merely by raising their prices. Financial institutions were burdened with nonperforming loans made to energy and real estate development companies at a time when it seemed that energy and property prices would rise forever. Manufacturing firms still had trouble competing with foreign-based rivals. Productivity growth remained rather sluggish. Nevertheless, as the decade evolved,

economic conditions gradually strengthened. When inflation threatened to accelerate more than moderately, the nation's monetary authorities acted swiftly and surely to keep it in check. No longer did they discount the consequences of high or accelerating inflation.

The 1990s proved to be a remarkably favorable decade for this land. Previously devastated industries had already closed old plants and taken steps to become more productive. The financial system regained solid footing and once again could channel funds to growing businesses and families. Inflation remained low, and people expected it to continue so. Promising new technologies, ever-growing world markets, and favorable financing conditions triggered an investment boom. When production expanded and people became wealthier, consumer spending boomed as well. As the decade advanced, the nation's productivity growth trend began to accelerate. Times were undeniably good.

Curiously, the threat of accelerating inflation rarely materialized during this long and vigorous expansion. When it did, the nation's monetary authorities provided a measured response to anticipated inflation. They were willing to adjust their policy instruments continuously to economic circumstances rather than taking strong actions, after excessive delay, in the face of imminent danger. As a result, the people never expected inflation to get out of hand, and interest rate movements (which are strongly affected by inflation expectations) fluctuated in a correspondingly narrower range. The county's unemployment and inflation rates simultaneously trended down throughout the decade, falling to lows not seen for nearly 30 years.

A new decade draws near. Interested citizens, second-guessing the monetary authorities, consider the same policy options debated a generation ago: Should monetary conditions be tightened or left alone? But experience has left no illusions about economic growth and inflation. Growth comes from innovation, competition, and productivity; inflation gets in their way. In this enlightened land, even if today's monetary policy vote is cast for the status quo, it is cast by a knowing hand.