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In This Issue

Flatliners

The monetary policy goal of the Federal Reserve System should be zero inflation: over time, the price level should follow a more-or-less straight, flat line. So say some people, including academics and prominent government officials. In fact, legislation compelling the Fed to adopt a version of this position was recently proposed in the U.S. Congress. What do current economic theory and evidence have to say about such a move? S. Rao Aiyagari answers that question in "Deflating the Case for Zero Inflation" (p. 2).

Aiyagari concludes that the economic support for the flatliners' position is weak. He reaches this conclusion after examining the costs and benefits associated with the proposed legislation's instructions to the Fed to bring inflation down from roughly 5 percent to zero in five years. His analysis is based on a survey of economic studies. The analysis suggests that a better policy goal could well be an upward-sloping price line, essentially a continuation of the U.S. inflation experience of the middle- and late-1980s.

Aiyagari's conclusion assumes, however, that fiscal policy can be changed to neutralize inflation's effect on taxes. If politics preclude fiscal policy changes, then the flatliners' case is stronger.

Back to the Futures

A long-debated issue among economists and economic policymakers is whether futures markets make commodity prices fluctuate less than they would otherwise. Those on both sides of the debate generally believe that futures markets are good if they do help stabilize prices and bad if they don't. V. V. Chari and Ravi Jagannathan carefully re-examine this issue—and also take a look at the belief behind it—in "The Simple Analytics of Commodity Futures Markets: Do They Stabilize Prices? Do They Raise Welfare?" (p. 12).

The conclusions: Futures markets could plausibly either increase or decrease price volatility, but whatever they do to prices is not obviously related to what happens to economic welfare. Chari and Jagannathan reach these conclusions using a series of models which differ in their assumptions about the primary function of futures markets, the structure of the industries involved, and the tastes and technologies of the market participants. In these different models, the introduction of futures markets has different effects both on the prices of the commodities and on the welfare of their buyers and sellers.

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