

February 10, 1975

Dr. Robert M. Solow
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Dear Dr. Solow,

I just wanted to pass on how much I enjoyed reading your article on inflation in the Public Interest No. 38. There was more wisdom packed in a few words, and highly intelligible ones at that, than I have seen in a long time.

On page 65 you refer to a few partial remedies which are very much in line with my own thinking of the past several years. In particular, why haven't more economists pressed more strongly for the government issue of indexed bonds along the lines of your own suggestion! It seems to me that the wider availability of such instruments would greatly lessen the dead weight costs of inflation and insofar as these were oriented to small savers would help mitigate some of the redistributive inequities of the process. It seems to me this also has political implications in that the frenzy that many people experience in trying to hang on to their savings (1) frustrates reasonable efforts at dealing with the recession problem and (2) imposes rather more of a cost than the rest of your discussion implies on the application of their energies towards more economically productive ends. By providing a more secure place for funds seeking such a haven I think that some of the side-effects of inflation like hoarding of commodities and driving up their price might be mitigated and these have further ripples in the economic structure. Look at the contortions that we have to go through when the price of copper exceeds the threshold for its monetary use.

but You very rightly point out the difficulty of dissection the adverse consequences of inflation from the accompanying snarl in economic activity - our depression - ~~and~~ I wonder if you really did give adequate weight to the impact of inflation on venture capital. Perhaps this can also be put down to an inappropriate psychological stance, but it seems to me that during a time that money can earn 5% (which implies a rather low rate of progressive inflation), a risk enterprise that promises to yield 30% will seem very attractive; when money costs 15%, even an anticipated 40% return on the same basis is not going to seem nearly as attractive since I think that investors are going to look for some multiplier rather than additive factor in what they look for from risk capital. I may be making the mistake of blurring the two underlying phenomena but I do think that inflation really

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does intrinsically make it very difficult for a young firm to be able to achieve the level of economic return that will keep investors interested in potential technological innovation.

But perhaps you will answer that the disease was not inflation itself but efforts to control it by clamping down on the money supply. Have you given any further thought to this particular question?

As to the indexing of tax rates, that does not seem like a very probable event - look what happened to Ford's proposal which began with a flat 10% rebate (then dropped to a more sharply progressive incidence, and is still in serious trouble!) Perhaps even more to the point from the standpoint of some sort of equity would be the indexing of capital values invested before so-called capital gains are calculated for tax purposes. But I wondered whether this was not in fact such a great incentive to the treasury that it might be one of the underlying motives for a global and perpetual inflationary policy. I suppose that is not very distant from the debasement of the currency which I guess must be one of the first laws of historical economics. The state having to worry about the management of its debt and having access to the principal tools of managing the value of money obviously has inexorable pressure in just one direction. You refer to the interplay of wage and price pushes and I wonder whether taxes have been adequately thought of in the same general connection.

Anyhow, I do not want to lose sight of my main point which was to ask you to put more political heft behind the idea of indexed savings bonds which I think could do a great deal to take the sting out of inflation for a great many people.

Sincerely yours,

Joshua Lederberg
Professor of Genetics

JL/rr