Grandpa's Neighbor

by Robert F. Graboyes
Federal Reserve Bank of Richmond
***Equilibria* #4, 1997/98**

Inflation strikes many a wicked pose. He is a thief in the night, silently snatching away the value of bank accounts and pensions. He is a taskmaster, forcing grocers to run up and down their aisles, changing the price tags on merchandise. He is a con artist, tricking businesses into investing in questionable schemes, and then running off with the proceeds. He is the grasshopper that begs you to fiddle rather than to save.

But the worst of all his poses is this: Inflation is the meddlesome neighbor who interrupts and confounds every conversation you ever have with your Grandpa. Just when you and Grandpa start to have a serious heart-to-heart conversation about how your life differs from his early life, Inflation barges through the door and tells you that Grandpa had to walk 5 miles to school each morning (and 10 miles back each afternoon), uphill in both directions, and always in the snow, even in summer when the school was shut. Once Inflation joins the conversation, forget about winning any arguments with Grandpa.

Inflation confounds conversation by muddling comparisons across time. It does so by forcing us to make several comparisons at once. Afterwards, it's difficult to sort out our emotional responses to each comparison and deal with them separately.

You can see the same sort of thing happen when your friend asks you, "Isn't it amazing? My little car got 36 miles per gallon on our trip, and your big one only got 12." You point out that you were also lugging a heavily loaded trailer behind your car. "It's still amazing," your friend responds.

It's not clear, though, what he expects should amaze you. Is it how much more fuel-efficient his car is? Or is it how much more gasoline it takes to drag a trailer? Or does he expect you to apportion your amazement—say 60% to 40%—between the fuel-efficiency of his car and the fuel-inefficiency of dragging a trailer? A meaningful comparison would be to compare the two cars' mileage when neither is pulling a trailer or when both are. Alternatively, you could compare the mileage obtained by one car, first with a trailer and then without.

Inflation twists conversations in the same way. Suppose your friend (the annoying one with the small car) says, "Isn't it amazing? My annual income has gone from $30,000 to $90,000 in the past ten years!" Again, what does he think should amaze you? If your friend can now buy three times as much as he used to, then perhaps he expects you to marvel at how successful he has been. But if his $90,000 income buys exactly what his $30,000 did ten years ago, then perhaps his point is that the monetary authorities have done a terrible job of maintaining the value of the dollar. If his $90,000 today buys 40% more than $30,000 did ten years ago, then once again, it's hard to decide how to apportion your amazement between his success and the monetary authorities' failure.

Now you're talking with Grandpa who wants to make the point that, "Young people today spend too darned much on everything." His neighbor, Inflation, comes through the door and says, "Your Grandpa's right. This *Titanic* movie cost $200 million to make—the most expensive movie in history. The directors in our day didn't need to spend that much to make a movie. Why, says right here in the book that they made *Ben Hur* back in 1959 for only $15 million. Now you tell me how *Titanic* is 13 times better than *Ben Hur*! And in 1956, they made *The Ten Commandments* for only $13 million, and there's no way *Titanic* is any 15 times better than *The Ten Commandments*!"

You answer, "If you compare the costs in 1998 dollars, the numbers aren't so striking. In today's dollars, *Ben Hur* cost $84 million—not $15 million. And *The Ten Commandments* really cost $81 million. The most expensive movie in history wasn't *Titanic*; it was really *Cleopatra*. In 1963, they made it for $44 million; in today's dollars, that would be $235 million."

Grandpa thinks for a minute and says, "Well ... maybe there's something to what you're saying, I mean ..." Inflation cuts him off with, "Don't listen to the boy. Look what he paid for his house."

Then Grandpa, Inflation nodding behind him, chimes back in. "He's right. You paid $100,000 so you could live in some palace. I was thankful in 1951 to get a house for $17,000—thankful!" ("Okay," you say, "but that's $107,000 in today's dollars.") "And another thing," says Grandpa, rolling right along, "every burger-flipping teenager expects $5.15 an hour. In 1950, the minimum wage was only 75¢ an hour, and when your own father worked at the grocery he was darned glad to get that. ("But that's $5.09 in today's dollars." you say. "Dad could buy about as much with his hourly wage as today's burger-flippers can with theirs.")

In desperation, you pull out your economics textbook and show Grandpa how his friend Inflation distorts perceptions. He looks over at Inflation and then looks you square in the eye and says, "Yeah? Well you try sticking that kid from *Titanic* in a chariot and see how he does against Charlton Heston."

Afterthought: Grandpa might argue—and perhaps just as plausibly—that inflation favors his spendthrift grandson's side of every argument. But we'll let Grandpa make that argument himself.