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LETTERS TO THE EDITOR

Inflated Economic Claims

Edward Luttwak's lament about central banks ["The Real Masters of the Universe," Outlook, Feb. 2] exacerbates the very problem that he decries, for he joins in inflating the image of an essentially powerless institution.

Fed Chairman Alan Greenspan is America's Wizard of Oz—his power stems entirely from the widely held but mistaken belief that the Fed actually controls interest rates and therefore the rate of inflation. In fact, the Fed cannot enforce its interest-rate signal, the so-called Federal Funds Rate Target. This is so because the net effect of the Fed's open-market operations on interest rates is minuscule.

Increasingly, the financial markets ignore the Fed's often misleading rate signals, as debtors (who like inflation) and creditors (who like deflation) negotiate interest rates that are neither highly inflationary nor deflationary. Instead, their bargaining is setting interest rates that are steadily reducing inflation in a manner that will produce stable economic growth and low unemployment.

Mr. Luttwak argues that moderate inflation (8 percent is moderate?) will reduce real wages in less productive industries, inducing workers to move to new, more productive industries. This is fallacious reasoning, for if employers in less productive industries do not keep their wage costs in line with productivity at any level of inflation, they will soon go bankrupt, leaving their workers with no choice but to move to the new industries.

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