CASE STUDY

Stagflation of the 1970s

Background Readings

Investopedia

"Stagflation"
A general summary of the concept of stagflation

"Stagflation, 1970s Style"
An in-depth look at how the stagflation impacted the economy in the 1970s

Canadian Business

"The Stagnant 70s"
How Canadian federal and provincial governments had responded to the 1970s stagflation

Khan Academy

"Stagflation and the Oil Crisis"
The relationship between the oil crisis and the stagflation of the 1970s

Background

The stagflation of the 1970s was a period in which a multitude of countries experienced high inflation as well as high unemployment. The word roots from "stagnant" and "inflation," as there was high inflation alongside stagnant economic growth. This can be outlined by the high growth in Consumer Price Index and the slow growth of Gross Domestic Product. The stagflation of the 1970s was caused by a multitude of factors, however, poor monetary policies, and the rapid increase of oil prices were the main contributing factors.

Firms and Other Stakeholders

The oil embargo placed by the Organization of the Petroleum Exporting Countries (OPEC) was one of the biggest factors that created these harsh economic conditions, causing global economic impacts. These harsh conditions were caused in part to the oligopolistic market structure of the petroleum industry which allowed petroleum producing firms to have great influence on price. This rise in the price of oil also affected related industries such as the automotive industry.

Globalization & International Impact

Stagflation had impacted numerous nations across the western hemisphere, specifically in North America and Western Europe. The rising inflation and low economic growth had required government intervention from each country affected. Canada had implemented rebates, wage rollbacks, and price increases. The United States introduced price and wage controls along with contractionary monetary policies. The United Kingdom carried out contractionary monetary policies through immense spending cuts as well. Nations generally saw an increase in welfare spending due to the high unemployment rates of the time period.

Microeconomic Analysis

There were a multitude of factors that contributed to stagflation on a microeconomic scale. Price controls by Richard Nixon were a huge contributing factor as they prevented the market from reaching equilibrium. Another major factor that contributed to stagflation was the multiple oil crises of the 1970s. In 1973, OPEC took control of oil prices and placed an embargo on the United States, which led to enormous increases in the price of oil for Americans alongside a shortage from the reduced supply. The 1979 energy crisis also played a major role in stagflation, along with poor monetary policy and failure to stop growing interest rates.

Macroeconomic Analysis

Stagflation in the 1970s can be better understood using macroeconomic indicators such as GDP, unemployment, and inflation. During stagflation, the United States saw a sharp decrease in the growth of the GDP per capita compared to both the previous and following decades. The unemployment rate for Americans also saw a huge increase, with the nation going from over full employment to being three percentage points below it within a span of five years. Macroeconomic models such as aggregate supply and demand curves also show the effect stagflation had on the American economy.

Guiding Questions to Consider

1. Explain, using supply and demand theory, why oil embargoes impact the overall economy.
2. How do you believe economic thinkers, such as Keynes and Friedman, influenced the issue at hand?
3. Using an understanding of fiscal and monetary policy, what do you believe would have been the most effective solution to solving this economic crisis?
4. How do you think governments and economists have changed their thinking to prevent futures crises of such nature? What macroeconomic indicators could be utilized to foresee such economic crises in their early stages?