Outline of a research project submitted to Ford Foundation and turned down by them. Unpublished paper 1980

Abstract.

anti inflations-Pol. bygger på forkert opfattelse af økonomien.

The author of this ~~project~~ paper believes that the failure of most anti-"inflation" plans in recent years was mainly due to their being based on traditional monetarist assumptions in a world which is anything but traditional.

Wages are no longer, if ever, determined on the market ~~but~~ otherwise than by collective bargaining, most of the other factor prices are administratively decided upon, and, under inconvertible-money conditions, profits ~~have been~~ are being transformed from a residue into a mark-up. (ikke den traditionelle sammenhæng mellem Løn/profit

As a result, costs are, to-day, exogenous and independent of the quantity of money. An action designed to deflate the latter ~~has~~ no bearish effect on the former and can even have an indirect bullish effect on them, if the break even point is high enough for that. Furthermore, if doles (understøttelse) are taken into account, such action can have an opposite effect even within ~~in~~ its own monetary scope.

Internationally, if autonomous capital movements are allowed for, austerity plans can lead to imported "inflation" (or more properly domestic-price rise) through devaluations and, finally, if low price-elasticities of the demand are assumed too, to a trade deficit, that is, 180° off the goal.

⇒ austerity plan ⇒ devaluering + handelsbalance underskud

Arghiri EMMANUEL

om krise

THE SURPRISES OF "STAGFLATION"

Introduction

Expressing his uneasiness about certain deflationary policies of recent times, Jean DENIZET wrote in LE FIGARO of the 9th January 1977 that he wondered whether present wide spread assent to such devices was not merely due to the fact that very few of the people living to-day were, in the 1930s, of sufficient age to have a full personnal experience of the Depression, the true one, that with a capital D.

inflation / Arbejdsløshed

It is indeed, from the outset, hard to see how the "inflation" problem can be given any priority over employment. One unemployed man means a certain definite deadweight loss for the whole community; one point, up or down, in the price index means but a transfer of wealth from one group to another.

On the most conservative estimates (notably excluding partial unemployment), in the whole area of the developed countries (all the OECD ~~members~~ members except Portugal and Turkey), there were, in 1975, 8 million additional unemployed, as compared with the average for 1960-73.

idag 83 + ca 25 mill.

Since average value-added per active person in these countries was, in the same year, 14,400 dollars, the loss in terms of total output amounted to around 115 billion dollars. In comparison with that, the difference in the Oil bill amounted nominally to 70 billions, but actually (when recycled petro-dollars are subtracted) to about half of this. Yet, it seems that this difference was at least one of the causes of this additional unemployment, via the deflationary action of consumer governments, seeking to get out of the red, at the expense of one another.

Se forord til "Profit og krise".

Now, the only way for OECD countries to pay the extra oil-bill with no setback for their economy would have been to produce about 35 billion dollars more goods and services. Since a certain unemployment of all factors already existed in the "pre-oil" period, all human and material inputs needed for this additional production were right there and by a wide margin. Paradoxically, the individual reactions of these countries against the higher oil-bill resulted in producing 115 billion less. (*)

Yet, this is but a minor recession and the above figures are a mere trifle if compared with those of the 1930s. The latter are so terrific that it is hardly understandable how it is possible to take the slightest chances in that direction. However awkward the social and technical problems arising from price instability as such might be, their solution would scarcely become any easier with a reduced aggregate cake rather than with a maximized one.

It may be argued that "inflation" is not only harmful as such, that is, in the field of the distribution of income. It is principally harmful as the cause of other imbalances transcending this field, namely those affecting the external accounts of the nation.

1) skaber større ulighed
2) dårligere bytteforhold.

Such a statement would only shift the difficulty from one plane onto another without removing it. First, if the ultimate goal is the maximization of social output, all other targets can only be evaluated in relation to their contribution, direct or indirect, to that goal and none of them could ever be an end in itself. This means that no consequence of the "inflation", short of precisely increasing unemployment, could be more harmful than unemployment itself. Second, external accounts can be bad for some nations, never for all of them at the same time.

Nevertheless, granting that for some undefined reason price stability along with some of its immediate consequences should be sought after for their own sake, we must acknowledge that

(*) In 1974, a spokesman of the French Government declared over the television that to pay the higher oil bill it will be necessary for the French people to work more than in the past, something about equal to a thirteenth month in the year. It is notable, that a set of government actions conceived to make Frenchmen work the equivalent of one month more resulted, in fact, in making them work almost that much less.

most of present-day policies pursuing these aims have missed their own point and turned out to be self-defeating processes.

This phenomenon can be explained if we take into consideration the following circumstances.

1) Stabilization policies, inspired more or less by the old quantitativist precepts, are not only doomed to failure but furthermore likely to have the opposite effect to-day, if only because the free interplay of market forces assumed by the former doctrine no longer works, notably because of compensation payments received by the unemployed which allow them to keep consuming after having ceased to produce.

hvis vi skaver ikke hreflen med Falde Priserne.

2) The disconnection of the currency from any real standard possessing an intrinsic value (predetermined by its own conditions of production), which has taken place lately, far from securing a more adequate framework for the quantitative mechanism, as would have been expected, definitely thwarts its working. For it helps transforming the entrepreneur's profit from a residue into a mark-up, that is, into an exogenous component of the costs along with the other exogenous components, wages, rents, taxes etc. Prices are thus hooked to the sum total of factor remunerations (the latter being predetermined by institutional forces), and become rigid vis-à-vis the supply of money.

Fra guld til ?

Priserne bestemmes ikke længere af efter sp og ud men af en lang række institutionaliserede ar... Løn, rente, Profit skat osv

3) It so happens that price-elasticities of the demand are generally lower than what is necessary for the adjustment to take place between the exchange rates and the relative domestic purchasing powers of floating currencies. As a result, currency depreciations, contrary to all set ideas, tend to enhance the trade balance deficit. For, in terms of foreign exchange, owing to the relative rigidity of the volume of exports and imports, proceeds from the former are reduced instead of being increased, while outlays for the latter remain practically unchanged, instead of being re-

den bedre konkurrence evne – p.g.a med skævningen er ikke tilstrækkelig – p.g.a stived i Imp/Exp-mønst bil al tiden klar i købekraft duced.

4) Autonomous, international capital movements are not necessarily directed from the thriftless countries to the frugal. Certain austerity provisions taken by the latter are, on the contrary, likely to put the national capital to flight. Consequently, the balance of payments can get in the red and the currency can be depreciated prior to prices. In that case, given the rigidities mentioned in (3), it will be the foreign parity of its currency which will determine the price level within a given country and not the other way round. Under these circumstances, the anti-inflation policy will trigger off a cumulative process of more capital outflow, more devaluation and eventually more "inflation" instead of less.

It is these four working hypotheses that the present project will have to test.

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I. The immanent contradictions of current stabilization plans.

Inflation = overstand of rc & be hoyt.

By any past traditional standard, inflation (without quotation marks) used to mean an excess of the nominal purchasing power (and will) over the aggregate output at a given set of prices. The rise of the general level of the latter was but the consequence of this imbalance.

It is therefore necessary to distinguish the rise of prices from inflation, the latter being one of the possible causes of the former. Yet, to-day, more than ever, the term "inflation" is being used as a mere synonym of price rise, whatever the cause.

Now, besides being the effect of inflation, price rise is, in turn, one of the means (procured by free-market forces) to cancel out inflation and re-equilibrate the system, by bringing the nominal value of the supply upwards into line with the demand. Another possibility is state interference, aiming on the contrary, Løsninger på inflation

1) Priserne stiger

2) Købekraft falder

3) Producere mere

at curbing the demand downwards into line with the supply, by siffoning off the excess purchasing power.

It is however clear that these two solutions do not constitute the exclusive horns of a dilemma except in a situation of full employment of the factors of production (the situation of real inflation as Keynes put it). At any lower point, a third possibility of re-equilibrating the system exists, at least technically: to let the supply equalize the demand, not by enhancing its value, the physical volume remaining unchanged, but by enhancing its volume, the unit values (prices) remaining unchanged; in other words, by increasing production.

In earlier free-market economies, where there were no compensation payments to the unemployed, but where, nevertheless, wage rates were more or less rigid, this third way of re-equilibration was hardly practicable. Because the additional production would have created additional equivalent purchasing power and the assumed initial excess of purchasing power - whatever its origin - would not have been compensated for.

Før og efter understøttelse

This is no longer so, as soon as unemployment doles are distributed. The additional production, while adding to the side of supply the total additional value-added, would only add to the side of demand the difference between wages and doles, plus, of course, the remunerations of those other factors which are paid only in proportion to actual production.

(Moreover, in a situation where the general standard of living is as high as in modern industrialized countries, the sensitiveness of total household consumption to the fluctuations of employment is considerably less than proportional to the latter. Factor owners are sticking as much as they can to their usual mode of life. They are compensating for the lack of remuneration, or the difference between remuneration and dole, by dissaving and borrowing. This, in turn, is, in modern capitalist economies, one of the most important antidotes against the chain-reaction process that formerly was leading to major crises. To-day, one sacked man is one sacked man. He is not likely to make another worker redundant by simply withdrawing from the market. In return, the greatest part of additional production is, under the circumstances, being made with no creation of new purchasing power.)

This means that under contemporary conditions the Phillips relation is reversed. Far from enhancing inflation, the increase of employment offsets the excess demand and far from deflating the market, unemployment tends to inflate it. The main vice of actual anti-inflation policies is that they make no allowance for this would-be paradox.

To be sure, there are discontinuity thresholds. Beyond a certain point, the inner contradiction of the process will blow up. Neither doles nor saving and borrowing could finance an ever increasing unemployment. But this is precisely the danger of the enterprise: that it is always possible to make the prices tumble down by continuously squeezing the demand. It only needs to go on far enough to provoke chain bankruptcies and, eventually a major crisis.

In the early stages of an austerity plan, when the results are contrary to expectations, inflation being aggravated instead of being checked, there are two possible reactions: 1) acknowledge the inadequacy of the policy and stop it, 2) conclude that the restrictions so far have not been drastic enough and strengthen them. For various reasons, mainly connected with political benefit and credibility, governments greatly prefer, all other things being equal, the second attitude. Thus, the deflation devices become in some way a self-substantiating process, producing the very situation which renders them necessary.

In some way, austerity plans attempt to deal in a Cartesian way with a system which is anything but Cartesian. Their implicit afterthought or explicit purpose is to reduce final consumption, by deflating consumable nominal income, and so curing inflation, while, at the same time, stimulating investment by direct ad-hoc incentives, and so avoiding depression.

This is simply logical. The less we consume, the more do we save and invest. Investment and consumption or, what amounts to the same thing, productive and unproductive consumption are the two components of a given aggregate; the social output. As such, they are, by their nature, inversely proportionate to each other?

The trouble is that in the capitalist system, contrary to any other known or merely conceivable system, the decision makers are unable to treat these magnitudes otherwise than as directly proportionate to each other.

In all other systems, accumulation, i.e. investment, is a decreasing function of unproductive consumption. In the capitalist system, investment, that is, productive consumption is an increasing function of unproductive consumption.

Under the circumstances, attempting to stimulate investment or just to keep it going, in the very moment that final consumption is declining or just stagnating, is, whatever the direct incentives, as utopian as trying to square the circle.

In the last analysis, it seems that it is this basic contradiction between investment power and investment will (or between potential and actual investment), inherent to market economies, that most austerity plans came up against.

hu's Lörner Solde
Expat. vil blastel

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II. Inconvertible monetary systems and "stagflation".

On the basis of the classical definition of inflation - excess of the demand over the supply at the existing prices, whatever the level of the latter - "stagflation" would have been not only an inconceivable phenomenon but a mere contradiction in terms, since it would have coupled two notions that are mutually exclusive: overproduction on the one hand and overtrading on the other.

Within that framework, if inflation was expected to lead to a price rise - at any rate it was through that manifestation that inflation has always been perceived - any price rise was not necessarily of inflationary origin, no more than ~~any price~~ any ~~[illegible]~~ price fall of a deflationary one. Inflation and deflation were _a priori_ consistent with any price-level and any _autonomous_ movement of prices in either direction.

To be sure, in a closed system, with a metallic standard and fixed parities, such autonomous movements of the _general_ level are impossible, indeed meaningless in the long run, barring a change in the technical conditions of production of the standard itself.

But the system was never integrated enough to be closed. We had to deal with national economies each of which was an open system as regards the rest of the world. Exchange rates, even if not freely floating, were not fixed for ever. Consequently, autonomous movements of the general level of prices, particularly short-term ones, were, in fact, frequent even under the most ~~thorough~~ perfect monetary fixity. This is, certainly, more so under present conditions of worldwide absence of any standard, possessing its proper cost of production, along with conditions of generalized rate flexibility.

1) The most important single factor for an autonomous rise of the general level of prices is, of course, the rise of wage rates. Here is also the point "par excellence" where the sort of monetary system we are in makes a tremendous difference.

Reasoning on the basis of the existence of a numéraire-commodity (that is, on the assumption that the monetary standard possesses an intrinsic value, based on its own production costs), and on that of perfect convertibility, Ricardo, Marx and all those who explicitly or implicitly accepted the exogenous determination of wages, have been demonstrating that a general variation of their rate affected only relative prices. On the social scale, it was countervailed by an inverse variation of profit rates.

These demonstrations are no longer valid when the gold or silver standard is abolished and all prices, including that of labor power, become nominal (expressed in terms of some paper-money, thoroughly inconvertible and floating without limit in relation to other currencies), that is when money becomes a mere unit of account.

In that case, entrepreneurs can quietly incorporate wage increases in their cost of production while maintaining their usual mark-up. Both variables - wage and profit - then become independent.

The mathematic form will perhaps more clearly show the difference between the two cases.

In the usual Sraffa-type paradigm a k-process closed system would be symbolized as follows:

$$\begin{aligned}
(A_a p_a + B_a p_b + \dots + K_a p_k)(1+r) + L_a w &= A p_a \\
(A_b p_a + B_b p_b + \dots + K_b p_k)(1+r) + L_b w &= B p_b \\
&\vdots \\
(A_k p_a + B_k p_b + \dots + K_k p_k)(1+r) + L_k w &= K p_k
\end{aligned}$$

If we assume a real standard and full convertibility of the currency, we must take one commodity (k) as the numéraire-commodity of the system and this will oblige us to add: $p_k = 1$. In that case, all p's will have to be expressed in terms of k, which means that all our prices are relative prices and there is no such thing as a price-level.

Our variables being the k-1 price-ratios plus a unique w and a unique r, we have but one degree of freedom and as soon as w is given our system becomes perfectly determined. Since r is then endogenously fixed, no possibility exists for a mark-up whatsoever. Any variation of w will entail an inverse variation of r. Løn og profit er omvendt proportionale

Things are thoroughly changed if the monetary standard is not "produced" within the system but is a costless thing in unlimited supply. Prices expressed in terms of such a token-money become <u>absolute</u> prices and a general price-level acquires a definite meaning. We then have k+2 variables (k prices plus one r plus one w), that is two degrees of freedom. Not only w, but r itself has also to be given; which means that nothing prevents the entrepreneurs from adding to their cost price any mark-up they wish.

men så er der jo ikke tale om en real løns stigning.

In other words, under the actual monetary system, as it has evolved after the transformation of the gold exchange standard into a more or less pure <u>dollar</u> standard, employers have the possibility to pass on to prices, and so cancel <u>ex post</u>

Hvis der tale om en real løn er
Pr. og Løn stadig 2 dele af et hele og
dermed omvendt proportionale

in real terms the wage increases they have been compelled to grant <u>ex ante</u> in nominal terms. It is in that sense that wages to-day can constitute an independent factor of inflation or, more properly speaking, of a rise in the level of prices.

We can put it otherwise. A rise in the absolute value of commodities can mean nothing else than a fall of the relative value of one of them: money. When the latter is a real commodity (e.g. gold), for such a fall to happen (following a general increase of the quantity of it delivered to the workers), it would need a labor intensity in the gold mines lower than the average in all other branches, and by as much as the proportion of wage increase. There is no reason to suppose such a peculiar combination. It follows that capitalists have, in that case, no means to take back from their employees in real terms what they have yielded them in nominal ones. But when the employees receive paper dollars or francs, there is no predetermined ratio linking these things with the contents of the housewife's basket. Capitalists have therefore - at least under certain social-political conditions - the possibility of themselves fixing this ratio by manipulating their selling prices.

2) Besides the wages, all other exogeneously priced factors, rents, interest, taxes etc., can equally generate an autonomous general price rise. As in the case of wages, this price rise, improperly called "inflation" - sometimes "cost inflation" - has nothing to do with inflation <u>stricto sensu</u> and may perfectly be consistent and coexist with its contrary. It is this last combination (with its contrary), that precisely constitutes the so-called "stagflation".

The major reason of the negative results of most of the austerity plans seems to be that some of their provisions designed to deflate the demand, as, for example, increases of taxes and interest rates, have the unwanted effect of "inflating" the costs, and through them the prices themselves.

This is why the distinction between real inflation and mere cost rise, emphasized above, is not a mere theoretical subtlety but a substantial point. The matter is not to merely distinguish, as it is usually stated, between two parallel causes of the same phenomenon: demand-pull and cost-push factors of "inflation". Nor is it enough to realize that in a situation in which there is simply no excess but lack of demand (as the first component of "stagflation" indicates), fighting imaginary demand-pull factors leads to real cost-push effects. The bearing of the distinction goes further than that. It reaches the background question of whether the ultimate determinant of the equilibrium prices is the market or the production.

Without re-entering this endless debate, it would perhaps be sufficient to point out that, whatever the ~~viewpoints~~ viewpoints regarding a pure model of market economy, actual social reality has deprived the market of this attribute, if only because the price of the most important factor of production, the labor power, is no longer part of its agenda. In addition to that, the very implements of the austerity plans, credit restrictions, taxes etc., deprive the market of any determining force on the other inputs.

Now, whatever the doctrine, the state of the demand could influence equilibrium prices of final goods only if the latter could, in turn, influence the prices of their inputs. It is therefore of the utmost absurdity to try to bear on the demand lever with a view to modifying prices of final goods, when our deliberate action consists in fixing the prices of inputs <u>prior</u> to those of final goods.

3) Lastly, it seems that all these rigidities have the side effect of reversing the law of decreasing returns, at least within the limits of certain discontinuity thresholds.

In modern economies, the proportion of more or less irremovable white-collar staff, as well as of other invariable overall expenses (e.g. time depreciation of fixed capital), is so high that the fall of production as such and independently of any variation of the rates of factors remuneration, entails a rise of the unit cost price. This is another causal link between the first and the second component of "stagflation".

It is noteworthy that in the background of such good performances in the field of price stability, as those of Germany and Switzerland, what can be traced is not some anti-inflation plan more drastic or more efficient than those of inflation-stricken countries, but rather the absence of any real "plan", if compared with these same countries. In the case of Italy, it is even remarkable that an acceleration of "inflation" coincided closely with the reinforcement of the Andreotti austerity plan.

4) Another link between the two components of "stagflation" is that the existence of the second, "inflation", prevents the first, stagnation from developing into depression and crisis. This is because, despite the sluggishness of sales, the anticipation of further rise in prices induces entrepreneurs to dissave and invest for fear of losing more by holding monetary assets than by keeping the production going.

This is a very important point. When analyzing the present minor recession we can scarcely discover any definite particularity warranting the hope that it will not degenerate into some sort of pre-war hurricane but the fact that, contrary to past conditions, to-day, when all other incentives to buy have disappeared, there still remains one: the belief that the longer one puts off one's purchases the higher the price will be.

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III. Domestic prices and trade balance.

The need of a positive or equilibrated trade balance is one of the last-resort arguments of the upholders of austerity plans. It is grounded on the postulate that not only the volume, but even the value of a country's exports is a decreasing function, and the value of its imports an increasing function, of the level of prices in that country.

In other words the trade-balance argument is grounded on the assumption of a price-elasticity of the demand greater than unity. This is one of the most stubborn set ideas of Political Economy. However, here again, contemporary reality, namely that of OECD countries during recent years, seems to invalidate old "obfiousnesses".

In order to calculate these elasticities on the international market, we should reduce national differentials of "inflation" to a common denominator, that is, we should take into account devaluations and/or revaluations of respective national currencies. It is senseless to compare, as is often done, the evolution of English prices in terms of pounds sterling with that of German in terms of DM.

If this reduction were made, the comparison would probably turn out to show that as far as the foreign customer is concerned English prices have risen less than German. Reciprocally, as far as consumers in both countries are concerned, it would be discovered that import prices compete better with local products in Germany than in England. Yet trade balance has been impsoving in Germany, deteriorating in England.

There is some evidence that price-elasticities of demand - quite high for standard commodities - fall off considerably for the sophisticated products of the advanced industrialized countries, whose specificity is, moreover, strongly enhanced by modern advertizing methods.

If it were found out that these phenomena are not just erratic "perversities" but the outcome of structural features of contemporary, imperfectly competitive, market economies of the advanced countries, it would become obvious that some of the policies, lately implemented in OECD countries, run 180° off their goals, in so far as these countries strived to become more competitive on the international market by both enacting "austerity" plans at home and letting their currency slacken abroad.

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IV. Exchange rates and capital movements.

It could be argued that modifications of exchange parities are but the effect of the differentials in the movements of domestic prices. Therefore, if devaluating countries, Italy, the U.K., France, have a negative trade balance, this must ultimately be attributed to domestic inflation.

The argument would be valid, if depreciation of the currency abroad followed in time and equalled in degree the loss of purchasing power at home, if, in other words, it merely cancelled out the gap between the two values of the currency, within and outside the country.

These last years, however, more and more empirical evidence has been accumulated showing that the wdakness of certain currencies certainly overrated and probably preceded the trends of "inflation" within respective countries.

In fact, what the above argument overlooked was the existence of autonomous movements of capital, unrelated to trade balances, draining Central Banks of their reserves and resulting in devaluations, whether formal or informal. These movements are not necessarily linked with the evolution of domestic prices. Following immediately the capital gains taxation in France, early in 1976, an important outflow of capital took place. The drain was more than the Bank of France could afford and the latter let the Franc out of the "snake".

After several ups and downs, the latter lost, within a few months, about 10% of its value against the average of the main OECD currencies. This devaluation has nothing to do with prices, as regards its origin. As regards, however, its effects, it automatically puts up the prices of imported goods by the same percentage. Even if we dismiss the alleged existence of further "spread" effects, it remains the direct impact on the index in strict proportion to the Imports/GNP ratio, which is far from being negligible.

Now, in this particular case, the main aim of the French Government in introducing the tax was social equity. But similar measures are sometimes geing taken in the wake of an anti- "inflation" policy. We have ~~another~~ then another case where acts and doings designed to relieve the market of an imaginary excess demand may result in burdening the costs with a real extra charge and so have a diametrically opposite effect on domestic prices. This reversal is linked with an equally unexpected opposite effect of the same acts and doings on external accounts and foreign trade.

An outstanding example of an imported and, at the same time, two-way distortion is the "oil" operation. On the one hand, of course, we have the direct upward effect on prices in the oil-consuming countries; but, on the other hand, to the extent that Arab countries had been unable to really "collect" their dollars, that is to transform them into real values, they provoked a trade defficit in the area of consuming countries as a whole, and this had undoubtedly a deflationary effect. It is the same effect as if an equivalent tax had been levied without a corresponding outlay.

Now, if we assimilated price rise to inflation, we should say that oil increases had a joint, deflationary and inflationary, effect, which is absurd; if we distinguish them properly, we must say that it just had a "stagflationist" effect, that is, deflationary though price raising effect, which makes sense.

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