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Economic Scene | Alfred S. Eichner

New Approach On Inflation

THROUGHOUT his long career as an economic adviser, John Maynard Keynes sought to demonstrate that the government, faced with an economic crisis, need not stand by helplessly. A correct analysis of the problem, he believed, would always suggest some effective course of action the government could take.

Today the crisis is one of double-digit inflation rather than double-digit unemployment. But as in Keynes's day the government seems unable to do anything about it. And the reason, again, is that the majority of economists are unable to provide a correct analysis of the problem.

The consensus among economists is that inflation stems from excess demand, and for this reason they urge policies to curtail the expansion of the economy. However, there is little evidence to support either the diagnosis or the prescription.

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It is against this background that a small but growing minority of economists have offered a different explanation for inflation. The continual rise in prices, these post-Keynesians argue, stems from conflicts over the distribution of a growing social surplus.

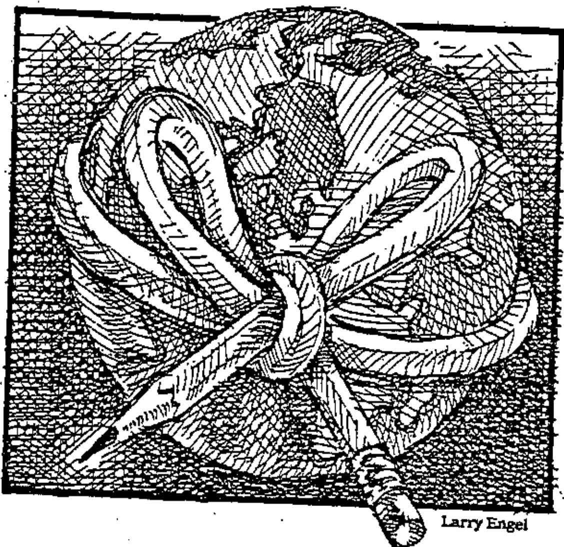
Post-Keynesians emphasize that the distributional issues can be seen in three dynamic processes that, in conjunction with one another, have led to the unprecedented inflation of the past decade. The three processes and associated conflicts are:

¶A domestic wage-price spiral, with labor struggling with capital for a larger share of the internally produced social surplus.

¶An international commodity cost-price spiral, with the Organization of Petroleum Exporting Countries struggling with the United States and the other industrially advanced countries for a larger share of the social surplus generated by the latter.

¶A currency devaluation-domestic price spiral, with one advanced country struggling with another for a larger share of the social surplus produced by all.

It follows from this diagnosis that, if the price level


Larry Engel

is ever to be stabilized, some other way must be found — besides a reliance on the relative market power of the contending groups — to resolve the distributional conflicts inherent in each of the dynamic processes. Herein lies the clue to an effective anti-inflation program.

The fact is that, in each of these distributional conflicts, what appears to be the more aggressive party is unlikely to gain more than a temporary advantage. This is true of union workers. The higher wages they obtain are soon eroded by higher prices.

It is also true of the petroleum exporters. The higher prices they obtain for crude oil are soon offset by the higher prices they must pay for industrial goods from abroad.

It is even true of the countries that, operating within the system of flexible exchange rates, permit their currencies to fall in value. The immediate decline in the price of their exports, as denominated in some other currency, is soon more than matched by the rise in the price of imported raw materials, including foodstuffs, which increases their costs of production and leads eventually to a rise in export prices.

The fact that no party really gains from any of these inflationary spirals suggests the wisdom of finding some other way to resolve the conflicts.

One way is to reach agreement in advance, through a "social contract" at both the domestic and international level, on the rules for distributing the growing social surplus. This approach calls for new institutional arrangements, one for each of the three dynamic processes.

For the domestic wage-price spiral, the arrangement would have to be some type of social and economic council, similar to those in existence in other advanced countries, together with a secretariat to provide technical support. The council's purpose would be to reach a consensus, not only on how the growing social surplus should be distributed but also on how the growth rate itself can be maximized without sacrificing other social objectives.

As the interest groups represented on the council met each year with key government officials to decide on target figures, it would have to be understood that the growth of wages could not, without being inflationary, exceed the growth of output per worker.

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In the case of the international commodity cost-price spiral, the new institutional arrangement would have to be a regular summit conference of OPEC nations and other exporters of basic commodities on the one hand and the industrial countries on the other. The purpose would be to determine the long-term credits that the commodity exporting countries would receive in exchange for holding down prices and which would enable them to continue financing their industrialization even after their raw material supplies had run out.

For the currency devaluation-domestic price spiral, the new institutional arrangement would have to be a system based on a "crawling peg" to replace the anarchy introduced by floating exchange rates. Under the new system, exchange rates would be all but fixed in the short run but would vary over a longer period of time according to a formula that took into account, among other factors, the relative movement of unit labor costs in different countries.

This strategy offers no "quick-fix" solution since it would take some time to get it functioning. Still, if the post-Keynesian analysis of inflation is the correct one, then it or some similar set of measures is the only approach likely to work.

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