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The Political Economy of Stability in Western Countries

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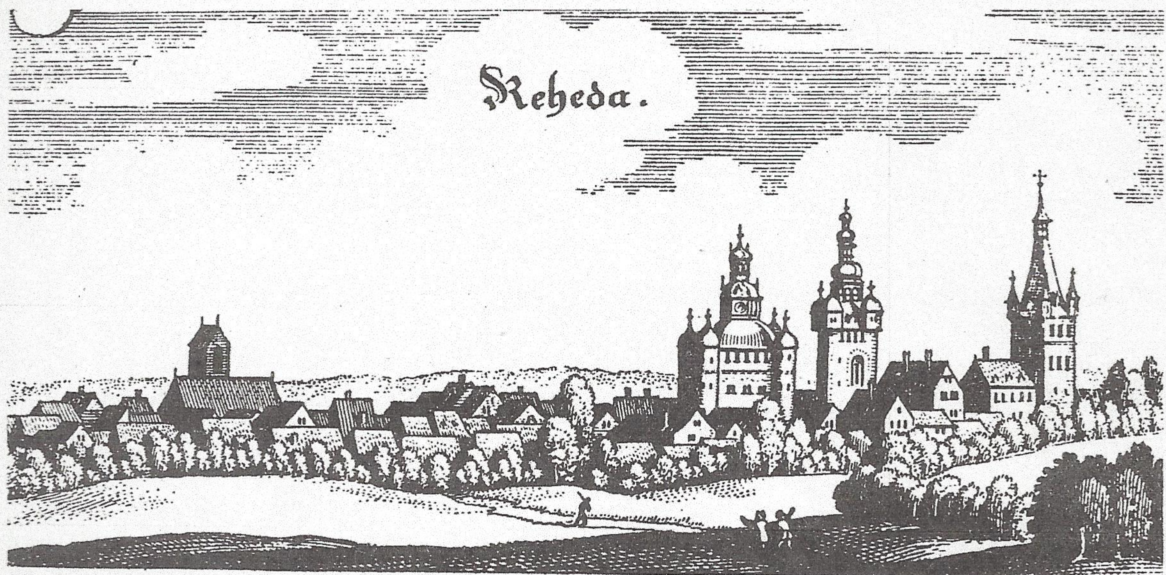

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I

Economic Stability has always been a favourite topic of economists. Knut Wicksell, in whose honour these lectures are given, was very much interested in the problem of economic stability and his contribution to this field of research had a lasting impact on its further development. [1)]
I have called these lectures " Political economy of stability in Western countries. " I want to stress the word "Political Economy", since it will be one of my main points to argue that economic and political conditions can only be properly analysed if one takes into account their mutual interdependence.

Such a proposition is not very original. Thus for example it plays a central role in Marxist doctrine. But whereas Marxism considers the political system to be mainly a function of the economic system and the ensuing class structure of society, I want to take the opposite view point. I want to analyse the economic implications of a political system which we usually call parliamentary democracy, and I should add that I want to limit myself to developed economies. Parliamentary democracy is among other things characterized by the following features: General elections at regular intervals give the voters the chance to decide about the party which forms the government; they have the choice between at least two serious alternatives. There is freedom of speech and there is a large freedom to form coalitions and interest groups. Economic activity in any industrialized country is organized along the principle of division of labour, and hence economic structure already indicates which the pattern of interest groups is that will be present in a democratic system. This basic structure of the political and economic process in a democracy is, I believe, independent of the question whether the means of production are predominantly private property or not. Clearly, the predominance of private property of means of production is a relevant characteristic of the western economic system. And it so happens that no democratic system without a large share of private ownership of means

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1) cf. for example his classic analysis "Geldzins und Güterpreise", Jena 1898

of production exists at present in the real world. But from my analysis I do not see any major conclusion altered, if I assume an economic system without private ownership of means of production as long as its political system is democratic as defined above. Limitations of space do not allow me to elaborate this point here. I shall instead talk about capitalist countries, but I mean to imply that similar results hold in socialist countries as long as they have a democratic political structure.

Whether it is at all possible to have a stable democracy without private ownership of means of production cannot be discussed here. This question is to be distinguished from the question whether a democratic system necessarily implies a market economy. To this latter question I am inclined to say yes. We know three types of mechanisms to coordinate individual actions and decisions (apart from consensus by personal contacts which only is viable where direct personal contacts are viable): bureaucratic-hierachic, democratic and market mechanisms.[2)]
The procedure to arrive at democratic decisions is too clumsy to be applied to day to day production and allocation decisions. The democratic decision making bodies have to delegate the power to make routine decisions. If all day to day decisions are coordinated without the help of the market a very powerful and oppressive central administration will be necessary: it will either seize power from the democratic institution or its oppressiveness will soon cause its abolition in favour of the market, if the voters have their way.

I believe that the central problem of stability in modern economies is identical with the problem of income distribution. There would be no problem of economic stability if the problems of income distribution were settled.
The intricacies of the stability problem are not mainly with us, because governments and economists are technically too incompetent to be able to solve them or because capitalism is bound to break down at some unknown day, but they are due

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2) For a similar argument see Assar Lindbeck, "The Political Economy of the New Left," New York - London 1971, pp 32 - 49

to the fact that there does not exist (and will not exist) a neat formula which tells us how to distribute the national product. Given that this is so, it is still worthwhile to discuss technical problems of stabilization policy, but perhaps with a somewhat more modest attitude towards the political feasibility of our neat little proposals and devices, we economists have been trained to invent. I should stress that by stability of the system I don't merely mean price stability or stability of employment or of any other single variable. I mean by stability the ability of the whole system to avoid such grave inconsistencies of behaviour of the different groups or individuals that the system will break down. A breakdown of the system which I characterized by its democratic political structure logically implies a breakdown of democratic institutions and their replacement by a more authoritarian regime, be it a fascist one or be it a Marxist-Leninist one. The instability may arise in the economic sphere. But if democratic institutions are not able to obtain stability, they will in the long run not be able to survive.At present there is clearly no danger of a breakdown, much less so than, say in the thirties. But I believe it is reasonable to understand the mechanisms of stability or instability in a time of relative stability so that we have a clear view of the problems if they should become more serious.

II

In proposing that the stability problem is a symptom of the perennial problem of distribution I am arguing against a central proposition of those,whom we have come to call the stagnationist school, who relate stability to the question of equilibrium between aggregate supply and aggregate demand in a capitalist economy. They maintain that the capitalist system has an intrinsic tendency towards insufficient demand, thereby implying that the stability problem is specific to capitalism. The stability problem in Marxist terminology is the realisation problem of surplus value. Using the Keynesian language the problem of insufficient demand is a problem of the relation between total savings

and total net investment. Insufficient demand exists, if at full employment of productive resources investment would be smaller than savings. As was emphasized by Keynes such a situation can only arise if the saving decision and the investment decision are separated. If the only way to save were to invest, no problems of insufficient demand could arise. While this appears to be an almost trivial statement today, it is one which is frequently neglected in particular in the Marxist tradition. For, it implies that an analysis of the problem of stagnation must include an analysis of the relation between savers and investors who have to be distinguished as functionally distinct groups. Such an analysis is conspicuously absent in the work of Baran and Sweezy, "Monopoly Capital", to cite just one example.[3)]

The relation between savers and investors is institutionalized in the capital market where the credit conditions, in particular the rate of interest, are determined. It is a frequent logical fallacy of stagnationist theories not to distinguish between the rate of profit and the rate of interest, i.e. the rate of return on real investment (Keynes' marginal efficiency of capital) and the rate of return on capital lending. The separation of investment decision and saving decision is only possible by the existence of a credit system, i.e. a capital market. The price on this market, the rate of interest, is an additional variable of the system which gives it an additional degree of freedom and thereby under usual conditions enables it to find a full employment equilibrium position. In disregarding this additional degree of freedom stagnationist theories frequently commit a logical error.
Granted that this error is not made by a proponent of the theory of insufficient demand he might argue that the range, within which the rate of interest can vary, is limited. Keynes' liquidity trap is an elaborate argument of this kind. Or one may point out that surely the rate of interest cannot become negative. Full employment might require that the real rate of interest, at which investors can borrow, is negative. It is at this point that the growth rate of the economy becomes of interest.

[3)] Paul Baran and Paul Sweezy, Monopoly Capital, New York 1966

A positive rate of interest presupposes a positive rate of profit, i.e. positive net income of capitalists. It is probable that under such conditions the supply of net savings is positive, since capitalists usually do not consume all their income. But then demand will only be sufficient, if net investment is positive, a condition, which is consistent only with a growing economy.
Growth as a precondition of capitalism may until very recently have sounded as a rather academic proposition, since clearly this precondition was fulfilled and then no worry was necessary about the stability of the system in this respect. But there is a growing number of people who believe that economic growth cannot go on for ever, indeed that it must come to a stop fairly soon, if our planet should remain inhabitable. The problem of global and local environmental pollution have become a concern of first order for many people and thus the attractiveness or rather the further possibility of economic growth is increasingly debated.[4] We are not able to discuss these problems here. But perhaps it is time to start thinking in more detail about modifications in our economic system, if economic growth is no longer possible.

Owners of wealth can hold their wealth either by holding or lending money to others, or by owning producible goods, or by owning nonproducible goods such as land. The minimum rate of interest is the maximum of the minimum own rate of return on these three alternative forms of holding net wealth. Under the usual institutional setup the nominal rate of return for lending money will be positive. Experience tells everybody that the nominal rate of interest is not the real rate of interest. Taking into account the very real possibility of inflation, no lower bound for the real rate of interest on holding or lending money exists. The lower bound of the own rate of return on holding producible commodities can be computed from the storage costs of some of these goods. But, as was pointed out earlier, saving in the form of investment in producible commodities clearly does not create a problem of insufficient demand and it is therefore irrelevant what the minimum rate of return for this

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4) cf. e.g. Jay W. Forrester, World Dynamics, Cambridge,Mass. 1971

form of holding wealth is. Things become a little more complicated by the existence of the third form of wealth: land and other nonproducible commodities. In the long run, the value of land will not fall relative to the average of producible commodities. If the holding of land does not imply any storage costs the rate of return on holding land is therefore at least zero. Given that land receives a positive rent its value approaches infinity as the real rate of interest approaches zero from above. The real rate of interest of the economy cannot become negative. If consumption only depended on current income and if total consumption were lower than income at a zero rate of interest, a real problem of insufficient demand might arise. But consumption also depends on wealth: thus, as the rate of interest approaches zero and total wealth (including land) approaches infinity, consumption will rise above current income and no problem of insufficient demand will arise.

Stagnationist theories often use the increasing sales effort of firms to argue that demand is increasingly insufficient in capitalist systems.[5] This is a typical fallacy of composition. No doubt, a single firm which would stop promoting its sales by advertising or by introducing new models and products,could not survive for long: demand for its products would soon be insufficient. But it does not follow from this that total demand would be insufficient if all firms simultaneously ceased to promote their sales by advertising and other means. An empirical case in point is the fact that cigarette consumption in the U.S. did not decline after cigarette advertising on television was ended recently. If any single cigarette firm would have stopped TV-advertising while its competitors continued, it probably would have been hurt seriously.

This refutation of a stagnationist argument does not say anything about the question whether the sales effort is a good or bad thing. While it is wrong to interprete the sales effort of firms as a sympton of stagnationist tendencies of the capitalist system, the

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5) cf. e.g. Baran and Sweezy, op.cit.ch.5

sales effort is an essential ingredient of a market economy. Any society whose economy is based on the principle of division of labour and specialization is confronted with the central problem of the distribution of the product among its members who perform different partial functions. A market economy - be it capitalist or not - uses the market as one of its most powerful agents of distribution. He who is successful in selling the product of his specialized labour receives a larger share of total product than he who is unsuccessful. The sales effort is an attempt of individuals and groups of individuals to enhance their relative share of national product.

III

The crucial test for the future of the market economy in a democratic environment is not whether there will be sufficient effective demand, it is rather whether it will be able to live with the always difficult problem of distribution of income. If capitalism has lost some of its appeal which it had with many people ten or fifteen years ago, this is particularly related to the increasing difficulties which exists in the field of income distribution. Inflationary trends which have become stronger in recent years and strained labour - management relations in many western countries are symptom of these difficulties to find equitable as well as efficient ways to distribute income.

The classic problem of income distribution in a capitalist system is the distribution of product between wage earners and capitalists. It still dominates substantial parts of the discussion on distribution and is very much in the minds of most participants in wage negotiations. No doubt, employers and employees are the immediate opponents in the labour disputes which have a direct effect on the distribution of product. But it would be naive to infer from this appearance of the problem that this is also its essence. Only by a fallacy of composition similar to the one mentioned above it is possible to fall into this mistake.

It is not really relevant to which specific line of thinking we adhere: every somewhat sophisticated model of income distribution will yield similar results: labour and real capital (Marx would say variable and constant capital) are complementary factors of production. Economic growth in modern economies requires net capital formation. In the simplest model there is a given capital-output ratio x such that each percentage point of annual growth requires x percent of net national product to be available for net investment. Given a certain rate of growth of labour productivity g, and a certain rate of growth of labour supply a, the system must grow at the trend rate g + a, if full employment is to be maintained. But this requires that x times g + a percent of net national product will be reserved for net investment. Usually, the savings ratio of wage earners, s_w, is lower than the required investment ratio, whereas the savings ratio out of profits, s_p, is higher than the required investment ratio. The average savings ratio is given by

$$s_w\ v + s_p\ (1-v)$$

where v is the share of wages in national product. There is exactly one value of v such that the average savings ratio is equal to the required investment ratio.[6] Income distribution between the two classes is already determined by the full employment condition. A more aggressive policy of labour unions does not have any long run effect on distribution in this respect. Higher rates of growth of nominal wages will tend to raise the rate of inflation. If anti-inflationary measures of the government and the central bank prevent this, the rate of investment necessary for full employment cannot be financed : under-employment will ensue. The result would not be much different, if we had applied a somewhat more sophisticated analysis in the spirit of neoclassical theory. Only minor qualifications of the argument become necessary, if we consider explicitly the role of the government budget and of foreign trade. The way a government finances its expenditures by taxes and by incurring public debt has a considerable effect on the long run distribution of income.

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6) The formulation of the model is taken from the wellknown theory of Kaldor, first presented in Nicholas Kaldor, Alternative Theories of Income Distribution, Rev. of Ec.Studies 1956. As I have used it here it is a special case of the more general neoclassical framework, the special case, in which the elasticity of substitution between labour and capital is zero.

But this effect is independent of the collective and individual bargaining processes on the labour market. These bargaining processes do interact with the conditions of foreign trade and the balance of payments in an open economy. A more aggressive wage policy of the labour unions can turn a country with an export surplus and a high share of profits into a country with an import surplus and a high share of wages. But, since one country's export surplus is another country's import surplus, the above argument remains valid, if we consider the system of all countries as a whole.

The formula employed above indicates the role of savings for the distribution of income between those whose income predominantly is revenue from property and those whose income consists mainly of wages. The latter group, called the workers, can raise their share by raising their own supply of savings. Economic policy of those who consider themselves to be political representatives of workers should take measures which encourage the formation of capital in the hands of workers. A more equal distribution of wealth must be a goal with high priority for such politicians and political parties. If we look at the statistics we find that this process is already going on. The supply of savings from wage earning households as a share of total savings has much increased in the last decade in a country like Western Germany. Accordingly, the concentration of wealth has declined, and no doubt this trend will continue. But measures to accelerate this trend are, of course, not identical with wage bargaining.

IV

What is then the function of the bargaining process on the labour market? Or is it completely without effect? I do not think so. I believe that workers of an industry or a specific skill do what is in their selfinterest when they form unions and are tough on the wage bargaining table. While apparently their opponents are their employers, their real opponents are mainly the consumers. If for example steelworkers tend to obtain good results at the wage bargaining table (compared to other workers in other industries) this does not mean that in the long run the rate of

profit in the steel industry is lower than in other industries. It means that the relative price of steel is higher in the long run than it would otherwise be. The high relative wages of steel-workers are paid at the expense of the users of steel, i.e. in the end by all those consumers whose consumption basket directly or indirectly contains steel.

There is no doubt that conflicting long run interests are involved at each wage settlement. But whereas the specific group of employees whose wages are discussed are directly represented at the negotiating table, this is not the case with the consumers, i.e. with all other wage earners whose real wages are affected by the result of these negotiations. The question is, to which extent employers will represent the interests of consumers appropriately at the negotiations. This is mainly a problem of price elasticities of demand for the products of the industry involved. If sufficiently close substitutes for the products of the industry are available and hence price elasticity of demand is high, employers cannot afford to make large concessions in the wage negotiations, since rising prices will reduce market demand and hence profitability of the capital already invested. The interests of employers coincide with the interests of consumers. If price elasticity of demand for the products of the industry in question is low, consumers' interests are not well represented by employers. They can shift a substancial portion of additional wage costs to the consumers and they are, therefore, more likely to yield to demands from the labour union. Considering this situation workers will tend to form coalitions which are broad enough as to encompass all groups producing close substitutes, thereby increasing the joint market power of their employers.Thus there exists a built in tendency in the wage determination process to reduce the common base of interest for employers and consumers to resist the pressure of workers for higher wages. This tendency is reinforced by a tendency towards increasing size of firms in terms of persons employed.

Marx has coined the term "Monopoly Capitalism" as the description of a stage of capitalist development and many of his followers use it frequently to describe the present structure of western economies. Many people, not only Marxists, speak of the tendencies toward increased concentration of sellers on most markets, and

the ensuing increased exploitation of consumers on behalf of the monopolies. While not denying the danger of increased concentration in principle, I believe that a more differentiated analysis would not yield the result that consumers in fact are more exploited by monopolies now than they were in the past. First of all: there is no dramatic rise of the share of profits which could reflect increased monopoly rents. On the contrary: the share of profits has a downward trend. This points to the hypothesis that increased concentration was technologically necessary because economies of scale became more important than they were in the past, and as far as this is the case, this increased concentration is benecicial to the consumer. Secondly: while nationally increased concentration can be observed in many industries, international trade between industrialized countries has developed very impressively in the last twenty years. Just think of the nightmare of many western businessmen: Japanese competition. I have no doubt that the effective degree of concentration on most markets for consumer durables in Europe is lower than it was twenty or forty years ago. The third argument says that the number of markets has increased substantially due to technological progress: in looking at competition, say, in the newspaper sector you must take into account the competition from radio, television and other media. There is no doubt that the freedom of choice of the consumer in most field of consumption - be it food, clothing, shelter,leisure time activity, transportation, education, information, health-care, travel, household equipment, etc. - is much larger than it was a few decades ago. The opposite would be the case if the hypothesis of increased exploitation by monopolies were valid. Without denying the social and economic problems caused by the existence and expansion of very large firms, mergers and cartels, I am somewhat hesitant to call our present age the age of monopoly capitalism.

I am much rather inclined to say that we live in the era of the pressure group economy, i.e. a market economy which deviates from the competitive economy at those points where economic interest groups are strong enough - be it by economic pressure, be it by political pressure in view of election day - to force the system away from competition. Monopolistic or olipolistic power of large firms is just one special case of such efficient pressure.Quite frequently

management and the employee representatives cooperate to obtain common goals - often at the expense of the rest of the population. As an example we may cite protectionism of labour unions in certain industries with the goal to increase the monopoly power of domestic firms which thereby are able (and can be forced) to pay high wages.

This more heuristic description of the pressure group economy should be followed up by more formal theorizing which would start from modern general equilibrium theory. This theory so far analyses the structure of competitive economies, but does already encompass certain game theoretic elements which will become more important in a theory describing an economy where the bargaining table plays such an important role. Such a theory could start from the following considerations: There exist many different mechanisms to solve the problem of coordination and distribution in a society built on the principle of division of labour. The market mechanism is of particular importance due to its high informational efficiency. No doubt, it will therefore remain in extensive use for the foreseeable future. But it implies certain results with respect to the distribution of output which may not be accepted by everybody. Thus there will be a tendency to "correct" the results of the market mechanism by the formation of coalitions and methods of noncompetitive bargaining. Such processes of social interaction are informationally much less efficient than the competitive market mechanism. They therefore will be resticted to areas where it really pays to go to the trouble of correcting the market mechanism. This is the case whenever a group of agents is present whose trade in a particular commodity has a large share in their total trading volume. Such is the case with workers who mainly or exclusively sell their own labour. Such is also the case with firms with respect to the specific outputs they produce. A formal theory should be developed providing insights into the resulting equilibrium between market and nonmarket distributional mechanisms of such a system of the pressure group economy, just as traditional general equilibrium theory gives us insights into the distributional results of competitive capitalism.

V

If our design for a theoretical analysis and our heuristic argument elaborated above are correct, pressure groups are to a large extent combinations of sellers of a particular commodity. Pressure groups are so called because it is their purpose to exert pressure. Here pressure is a word, drawn from everyday life or perhaps the natural sciences, covering a large variety of complex social phenomena. We do not have time to analyze these phenomena more thoroughly; instead we will use this word "pressure" to indicate what we mean. If pressure is a phenomenon of particular importance among sellers (or groups of sellers) we should expect that one of the main results of large pressure in an economy is a rising price level. In formulating this, we are close to wellknown concepts such as cost push inflation. Such increasing inflationary tendencies are an outlet for this additional pressure put on the system as long as they are not anticipated.

But experience of inflation soon conditions people to expect inflation to continue with the consequence that the average rate of growth of wages and prices will again increase. The wage price spiral will lead the system towards explosion in a process similar to the Wicksell process if such an accelerating inflation is financed by the central banks.
If such an explosion is prevented, the moment arrives when the real rate of inflation and the expected rate of inflation are the same, i.e. when inflationary expectations are fulfilled. Then the system does not provide any outlet for increased pressure coming from the pressure groups of sellers. The system approximately behaves as if the price level were stable. But stability of the price level is only consistent with a certain general level of pressure from sellers, in particular from labour unions. The higher the propensity to exert pressure is, the stronger the countervailing forces which work against this pressure have to be. One of the most important forces working against sellers' pressure to raise prices is low demand for the commodity they sell, i.e. in the case of labour a high rate of unemployment. Thus the higher the pressure of labour unions to raise wages, the higher is the rate of unemployment which is necessary for the long run stability of the system. Friedman calls this rate of unemployment the "natural rate of unemployment." One of his main points is that this natural rate of unemployment is independent of the rate of inflation in the long

run and thus cannot be influenced by monetary or fiscal policy.[7)] There is possibly a certain payoff between inflation and unemployment even in the long run[8)], but it clearly cannot be very substantial. For expository simplicity we will neglect it here altogether, its existence would not change the substance of the argument.

The important conclusion is that in the long run full employment is not consistent with a high propensity of sellers to exert pressure. This conclusion is not only in accordance with theoretical considerations[9)],it is also, as we all know, in accordance with the empirical evidence of recent years. I believe that it is time to reconsider the full employment policies as they have been pursued in western countries in the years since the second world war.

VI

It is perhaps worthwile to have a look at the development of full employment policy and its theory. This development shows that history seems to have more imagination than the economists. At any rate, the prescriptions of economists after a while became obsolete because history had invented new problems to which the old solutions of economists and economic policymakers no longer applied. Theory follows history and not vice versa.

Originally, orthodox economic theory assumed that there was an automatic tendency towards full employment in a market economy. A specific policy of full employment seemed not to be necessary. Then came the Great Depression which probably was the greatest crisis the capitalist system has had so far. It showed clearly that governments could no longer neglect the goal of full employment. The Keynesian Revolution provided the theoretical foundation

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[7)] Milton Friedman, The Role of Monetary Policy, American Economic Review, March 1968.

[8)] For example Tobin has argued recently that this is the case: James Tobin, Inflation and Unemployment, American Economic Review, March 72.

[9)] The following mathematical theorem remains to be proved: "A general equilibrium in a pressure group economy exists only if effective pressure of sellers does not exceed a certain level" All the concepts used still have to be made precise.

for a policy of full employment. The problem of unemployment was mainly seen as a problem of insufficient demand which could be cured by a fiscal policy providing sufficient demand. After the war economists and politicians increasingly became **aware** of the fact that full employment may not be consistent with price stability and there was a widespread view that some inflation would be necessary, if full employment was to be maintained. Only fairly recently, under the impression of rising inflationary pressures without more employment did not only a few economists but the majority of the profession and economic policymakers understand that in the long run inflation was not an outlet, which would allow full employment. Only fairly recently do economic policymakers realize that unemployment under present day conditions (this was different in the Great Depression) is not so much a problem of insufficient demand, but of pressure from the supply side. Of course, in the short run, given this pressure, unemployment can be reduced by increasing demand and at the same time increasing inflation, but almost everybody agrees nowadays that this is not a long run solution.

Attemps to find remedies for such a situation such as wage guidelines, incomes policy "konzertierte Aktion" or the new economic policy of the Nixon administration have so far only been partially successful. Invariably, they have been rather popular at the beginning, but well organized sectors of the working class always had strong reservations. The inability to keep the demands of strong labour unions within the framework of the guidelines and the inability of the governments to pursue a policy of full employment and at the same time to stabilize prices invariably has led to a breadkown of these attempts of governments, popular as they may have been. No wonder: such policies benefited the majority of the population at the expense of a minority of well organized union members who could not fully use their pressure power in such a situation. The policies were not, to use a technical term, Pareto superior compared to the anticipated situation prevailing in absence of such policies.

To be sure, such policies have been completely without effect. In particular, the final outcome of Nixon's new economic policy

cannot yet clearly be seen. But if such policies for a while have been successful the reason may have been that those workers who were prepared to relinquish a substantial part of their pressure power felt uneasy to use this power fully at the expense of the majority of the working class. Solidarity with a larger group, be it class solidarity or national solidarity, made the beginning of such policies possible. The inability of governments to stabilize consumer prices sufficiently reduced the credibility of the incomes policy which so far invariably has led to their collapse.

A different story is the experiment of a solidaric wage policy of the Swedish labour unions. Until now it was successful in avoiding large nonsolidaric wage settlements which might have hurt those segments of the working population not being part of the settlements. But it did not solve the problem of inflation and unemployment. Also it came under increasing strain in recent years, perhaps among other things, because it did not solve the problem of unemployment and inflation.[10)]

VII

If our analysis is correct, the goal of full employment is feasible only if certain conditions are fulfilled. Indeed, an unconditional policy of full employment of a government may be selfdefeating: the unconditional guarantee of full employment increases the bargaining power of pressure groups, among them labour unions substantially, so that the propensity to exert and yield to pressure may be fostered up to and above the point where it is yet consistent with long run full employment.

The consequence must be that the government can only pursue a policy of conditional full employment. The government must declare that full employment can only be guaranteed if wage rates do not grow more than a certain percentage fraction per year.

[10)] My visit to Stockholm on occasion of giving the Wicksell lectures was a good opportunity to learn about Swedish economic policy. I would like to thank Erik Lundberg as well as Karl Olof Faxén, Assar Lindbeck, Rudolf Meidner, Clas Erik Odhner, Olof Sundström and Lars Wohlin for introducing me into Swedish economic policy problems.

Such a full employment policy can,of course,be only part of a greater concept of economic policy. Otherwise there is no chance to obtain sufficient popular support. In particular,price stability must be granted by the government. This guarantee of price stability should be unconditional as long as it only applies to the long run trend of the price level. It is, of course, not possible to guarantee price stability in the short run. Progressive people may consider it a rather conservative advice to pursue an unconditional policy of price stability,but only a conditional policy of full employment . But this interpretation is false: this advice only tries to formulate goals of economic policy which are feasible. It is the consequence of the result that a policy of unconditional full employment is selfdefeating, whereas a policy of unconditional long run price stability is not. Indeed, the latter is a help towards achieving stable (if not full) employment.

As already indicated, our instruments of macroeconomic policy are not sufficient to stabilize the price level from one quarter to the next. But our instruments are sufficient to influence the trend of the price level which prevails over the period of a few years. A policy of trend price stability means that the government tries to stabilize an appropriately chosen price index around some fixed number, say 100. If now the price index moves from 100 to 102 this means that the goal of the government will be to reduce the price index again. Thus,past failures to achieve the goal of price stability will be stored in the memory of the system and must be compensated by an overachievment of this goal in the future. There is a sharp contrast of such a criterion of price stability and the criteria usually applied in present day economic policy. If a certain rate of inflation of, say 5 percent, prevails then the next rate of inflation is compared to these 5 percent, and it is considered a move towards price stability if the next rate of inflation is only 4 1/2 percent. The criterion for price stability then is the rate of change of the price level and not the price level itself.
While this latter criterion has its advantages for a government which is not too successful in pursuing the goal of price stability it has its disadvantage from the point of view of the structure of expectations.

Economists know that expectations can have a stabilizing or a destabilizing effect. One of the great problems economic policy-makers are confronted with at present is the destabilizing effect of expectations with respect to the price level. Since everybody is used to argue about the price level in terms of percentage rates of change, economic agents have become used to extrapolate past rates of inflation. Thus in wage negotiations labour unions ask for a compensation of anticipated losses of purchasing power calculated at the going rate of inflation, thereby promoting further inflation. In other words: rising prices cause the anticipation of further price rises. Any loss in purchasing power is considered a loss forever and is considered a signal for further losses in the future.

If the declared goal of the government is to stabilize the price level around the index value 100 and if people believe that this goal will be achieved, then any rise in the price level will cause the anticipation of a fall of the price level in the future. Such an expectational structure will make it much easier to be successful in stabilizing the price level.

I should point out that only for reasons of expository simplicity I have talked of a policy of absolute price stability. Similar arguments apply, if one would decide to follow a trend rate of inflation of x percent. Inflation in itself only hurts if it is not anticipated. If everybody anticipates the rate of inflation correctly, this is almost just as well as price stability. This is well understood among economists. It may have certain advantages to have a positive planned rate of inflation. In particular it is easier to switch to such a policy than to a policy of absolute price stability from a situation of substantial unplanned inflation. A third possibility would be a planned and declining rate of inflation. The only important thing is that an excess of the actual over the planned rate of inflation will be planned to be compensated in the future so that there is a negative feedback from the experienced rate of inflation to the planned and expected rate of inflation and not, as is the case at the moment, a positive one with its destabilizing effect on the structure of expectations.

There is some similarity between the proposal presented here and Friedman's proposal of a steady rate of growth of the money supply. If Friedman's proposal would be followed and if Friedman is correct in his analysis of the role of money in a market economy, then there would also exist a negative feedback between past and future inflation rates. But I should like to stress the differences to the Friedman proposal. I believe that the role of the government must be much more active than Friedman proposes. The experience of the first years of the Nixon administration cast doubt on the political feasability of Friedman's proposals. And, if our analysis of the pressure group economy is correct, government intervention in the distributional process seems to be important.

We will not say very much about the conventional monetary and fiscal instruments to obtain price stability. We only should keep in mind that these instruments are characterized by rather substantial time lags between cause and effect, which may imply substantial technical and above all political difficulties unless additional, perhaps nonconventional instruments of intervention, enrich the arsenal of the government. This, of course, does not mean that the conventional instruments should not be used. The other instruments to be discussed can never by themselves obtain price stability.

At the end of this section, I want to emphasize again that this unconditional policy of price stability must be seen as a politically necessary support for the policy which has the goal to keep the pressure in the system below the level which is critical for the stability of the system as a whole. Only by convincing the people that the government is able to stabilize prices will it have a chance to obtain support for a policy of full employment conditioal on an average rise of wages not greater than x percent. Apart from being a political necessity in this context price stability has, of course, a great value in itself, which has frequently been pointed out by economists. Wicksell was particularly prominent among them.

It is perhaps worthwile to add a theoretical remark at this point which may cast some additional light on our proposals with respect to full employment policy. Tobin has recently argued[11] convin-

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[11] op.cit.

cingly that Friedman's natural rate of unemployment will in all likelihood be characterized by the existence of involuntary unemployment as defined by Keynes. This means that it is a disequilibrium situation in the sense that there exist people who at the going wage rate supply more of the commodity labour than there is demand for it. This is an argument for him to take measures which would reduce the rate of unemployment below the "natural" level. I am not sure that in the long run his policy would succeed. To make this clear it is perhaps useful to discuss briefly the nature of an equilibrium in a pressure group economy. It is probably characterized by the existense of many oligopolistic markets. These markets, as well as purely monopolistic ones, have often one thing in common with a labour market under conditions of involuntary unemployment. The supply side is willing to sell more than is actually purchased at the price ruling in the market (which usually is set by the supplier). Indeed, only under conditions of an excessive boom (which surely is not what one usually calls an economic equilibrium condition) are most suppliers no longer prepared to sell more than they actually sell at the going price. Thus equilibrium - in some meaningful sense of the word - in a pressure group economy may show on many markets a willingness of suppliers to sell more than is actually sold at the prevailing price. Yet it would be wrong to speak of an equilibrium with insufficient demand. If demand were higher the system would exhibit a change of prices not consistent with a reasonable definition of equilibrium. The willingness to sell more than expected at the given price is not inconsistent with a tendency to change the price if more than expected has been sold. To the extent that labour markets have a structure similar to oligopolistic markets we should expect that involuntary unemployment as defined by Keynes is a characteristic of equilibrium in a pressure group economy.

VIII

I believe that some kind of price control cannot be avoided. Everybody concerned with these questions is well aware of the fact that in very many instances quantities produced react much faster on changed demand conditions than prices do. Thus the main primary effect of antiinflationary policies is a reduction of output and a deteriorated utilization of existing capacities. This is particularly the case

with the large majority of goods and services purchased by households which are relevant for the general public and which constitute the basis for measuring the consumer price index.
Firms often calculate prices using costs at normal capacity.
Thus price dampening effects can only be felt after cost, in particular wage costs, have been affected by antiinflationary measures.
But wages will only be affected after employment has been reduced.
Thus there is a long and, indeed, unpopular and perhaps inefficient way from antiinflationary measures towards antiinflationary effects.
Experience shows that democratic governments often fail to have the time and the nerves to wait for such a long period if this, in the meantime, implies slow economic growth, unemployment and hence a drastic decline in popularity.

Direct price controls can have a more immediate effect on prices if they are administered properly. Of course, price controls must break down or lead to great inefficiencies if they work against market forces over extended periods of time. They are then not a substitute, rather a complement of orthodox monetary measures with the goal to obtain the results more quickly and perhaps by less severe side effects on growth and employment.

But there is another reason for price controls. This is a distributional one. We have argued above that the stability problem mainly is caused by the problems of income distribution. However, there is a trend towards a situation in which employers are less and less willing to incur substantial sacrifices by resisting the demands from the labour unions, since they are more and more able to shift additional costs on to the consumers. If the government allows this additional pressure to develop it will result in a higher natural rate of unemployment. It will also have negative effects on what we may call the equity of the wage structure. Both aspects cannot be tolerated by a conscientious government or even by a government which simply tries to keep the majority of voters on its side. Price controls can be an effective instrument to raise the resistance of employers against excessive demands of strong labour unions. They are probably more effective and politically feasible than direct wage controls. The latter can easily be misinterpreted by the unions and their members as being an illegitimate assistance

of the employers and capitalists in their dispute with the employees, and in imposing constraints on wage settlements it is, indeed, very difficult for the government to differentiate between short run interests of employers and the interests of the community at large. Experience shows that labour unions and workers resent such government intervention.

If the government applies price controls to contain the effect of monopolistic practices of employers or of labour unions such anticapitalist emotions can be neutralized. The government does not interfere directly in the labour-management dispute about the appropriate wage level in this firm or industry. At the same time, its influence on the wage level can be substantial. This is not only important because it will have an influence on the general wage level and hence on the political feasibility of the conditional full employment policy. It is also important because it is an instrument which can be used to check the power of strong unions and of oligopolistic firms to obtain a larger share of national income by exerting pressure. This is a necessary complement of the acknowledgement that workers have the right to exert such pressure. For, whereas this right is accepted in principle by the large majority of the people, some of the results in the wage structure of a strong bargaining position of certain sectors of the working population are not accepted as being legitimate or just. The government thus is forced to take an active role - if an indirect one - in the determination of the wage structure in order to correct the results of excessive pressure of parts of the wage earners. But for its credibility it is important that this activity never be used to interfere directly in the disputes between private employers and labour unions. This, of course, does not mean that the government should refrain from legislation forbidding certain excessive monopolistic practices of labour unions. On the contrary, such legislation may be necessary for the stability of the system and the equity of the wage structure.

The art and the science of price control in a market economy are still underdeveloped. Economists in their large majority have taken the attitude that, perhaps with the exception of war-times, price controls are against the spirit of a market economy and

inhibits its proper functioning and its allocative efficiency.[12)]
These arguments against price control have to be taken very seriously. They should serve as guideposts in order to avoid certain mistakes which easily can be made and have been made when price controls are used as an instrument of economic policy.

A few suggestions, which I want to make, cannot be taken as a fully developed theory of price control. Price control has to serve two distinct proposals: stabilization of the price level and influence on relative prices for distributional purposes. For the first goal every price is of interest in a similar way as any other price. Thus a general procedure of price control seems to be appropriate. For the latter goal, prices which directly or indirectly have large "monopolistic" or "pressure" components will have to be treated differently than other prices.

If the goal is stability of the price index at the level 100 and if the actual price index is above 100, say at 102, then any price rise is socially disadvantageous - apart from the allocational functions of the price - and any fall of prices is socially beneficial, again apart from allocational functions of this price. It would therefore be natural to subsidise price reductions and to tax price rises in such a situation. A possible proposal would therefore be to establish a (positive or negative) tax on price changes which would be proportional to the magnitude of the change, proportional to some measure of the "weight" of the commodity in question and proportional to, say, the difference between the actual price index and 100.[13)]

Such a proposal is guided by one of the good rules of economic policy according to which one should try to apply general operational principles and avoid as much as possible rulings in special cases.

[12)] A well known dissenting voice on these matters is Galbraith's. cf. e.g. his "New Industrial State" ch. XVI, XVII and XXII.

[13)] The mathematically trained readers will have no difficulty to see that such a tax would correspond to a social welfare function in which the sqare of the deviation of the actual from the "ideal" price level enters with a negative coefficient.

Since the price structure will have to change over time the simple general rule of keeping prices constant would be disastrous in the long run. The principle of using costs as a guide line for prices can also turn out to be counterproductive: in particular, if price ceilings are an important constraint, this principle would work against the important incentives to reduce costs. It would also burden the price control office with detailed cost accounting paper work, moreover collusion of firms and employees to raise wages above competitive market levels would be encouraged.

Of course, the administration of the proposed tax would not be easy. Exceptions for certain markets with volatile prices are clearly necessary. New commodities and quality changes have to be taken care of, etc. The problem of new commodities and quality changes is not too difficult in principle, for the same problem arises in the definition of the price index. It would thus be advisable to levy a tax zero on a price of a new product, if and only if this price would be neutral in its influence on an appropriate price index.

Another problem with such a proposal is that it may have a long run distorting effect on the price structure. If on average the price index is above 100, it essentially increases production costs of any commodity whose relative price has a rising trend due to below average productivity gains in its production and it correspondingly subsidises commodities with above average productivity gains. But, I believe that the welfare losses of this distortion of the price structure are small as long as on average this tax is not a very heavy one; this again will not be the case as long as the government and the central bank use the conventional instruments of monetary and fiscal policy in accordance with the goal of price stability. Moreover, apart from contributing to a successful policy of price stability the proposal may also contribute towards allocational efficiency. If, on average price rises are taxed and price reductions are subsidised such a tax works against the common phenomenon of pricing above marginal cost due to oligopolistic or monopolistic market structure. Price competition is encouraged, as are efforts to reduce unit costs,

full utilization of existing capacity, etc. The distortion of the price structure can also be reduced, if the tax is imposed on price changes relative to an "ideal" price index of a commodity group whith similar trends in production costs. This "ideal" price index of the commodity group reflects the hypothetical prices of the commodities in this group if the global price index is 100.

The role of such a price stabilization tax in obtaining price stability can be outlined as follows. A democratic government which cannot afford the immediate consequences of strong anti-inflationary policies is probably still able and willing to pursue a policy of trend price stability if only small doses of restrictive actions are required at any given time. But such small doses, even though their cumulative effect will be sufficient to obtain price stability in the long run, my not give the results soon, unless some further mechanisms are employed. If these results do not come soon, the credibility of the government's antiinflationary policy will be undermined. This means first a direct danger for the survival of the government. It also implies that inflation is expected in the future so that wage settlements and other contracts already contain further inflationary effects. On the other hand, if by the existence of such a price stabilization tax prices remain stable for a while, the government can hope for success for an antiinflationary monetary policy of small doses and will then go this road. The price stabilization tax has a strong stabiliting effect on the price level, if firms expect the price level to remain stable in the future. To see this take the following example. Assume that most firms expect that in the future the price level will be 102. Thus then the rate of the price stabilization tax will correspond to the price level 102, which is, say, 2a per "unit" price change. If now at present the price level is at 104, the present tax rate is 4a per "unit" price change. These are very favourable conditions for reducing prices or for postponing price increases. Thus the price level will have a strong downward trend. Indeed, under normal circumstances with respect to total demand the "speculative motive" of firms will drive the price level close to some kind of average expected price level of the future. We are here, of course, using the other side of

the coin of the phenomenon of sticky prices: discretion of the firms with respect to the timing of prices changes. The very same phenomenon which causes so much trouble for stabilization with monetary means - independence of prices from demand conditions in the short run - is used to obtain price stability in the short run. It is, of course, clear from our argument, why such a price stabilization tax only makes sense, if everybody can rely on the government's strong determination to pursue a monetary policy which will stabilize the price level in the long run.[14)]

The government should have the power to prohibit price increases where it suspects that these increases are the result of excessive pressure of well organized minorities which try to get a larger share of national product and if this larger share seems to be unjustified on general equity grounds. It is very likely that such price control decisions have to be made by a procedure involving arbitration schemes. Arbitrators may better be able to represent with authority principles of equity and impartiality than democratic governments which have the short term goal of winning the next election and which are confronted with parliamentary opposition with no interest to support the image of an impartial government. There is no space to discuss questions of a theory of arbitration. It only appears plausible that a pressure group economy in which systematic deviations from the outcomes of competition exist is more in need of arbitration processes than a competive economy. But an elaborated theory of arbitration so far clearly does not exist.

IX

I have said in the introduction that I do not see any significant difference in our context between a capitalist economy and a noncapi-

14) I had the opportunity to discuss the proposal of the price stabilization tax in the Political Economy Club in Stockholm. This discussion helped me very much in clarifying my own thinking on this proposal. It also made me even more aware of the weaknesses of any system of price control than I already was before. I want to thank the participants in the discussion for this opportunity. I hope that my proposal is not completely against the spirit of Wicksell who, as I am told, was one of the founders of the Club, as its aim is to make stability of purchasing power politically viable.

talist democratic market economy. I believe that this point is of some political importance. It basically implies that it would be wrong to hope that the problems which we have discussed will disappear if private property of means of production is abolished. The economic and political problems which for example Yugoslavia faces at present are an empirical corroboration of this hypothesis.[15] On the other hand, I do not see why we should not incorporate elements of a noncapitalist market economy into our system as long as this has a beneficiary and stabilizing effect.Comparability of "capitalist" and worker management in the same economy may also provide a more realistic appreciation of alternatives to capitalism.

We can distinguish at least four functions which have to be provided for any production process:
1) provision of labour, 2) provision of capital, since inputs on average accrue earlier than outputs, 3) provision of management and entrepreneurship, 4) bearing the primary risk (the persons on whose account the whole operation is performed and who receive a residual, not a contractual income).
Traditionally the entrepreneur-capitalist class provided the three latter functions, whereas the working class provided the first function. From the very beginning of industrialization the credit market allowed a differentiation of function 2) from function 3) and 4), so that in principle a member of the working class could also become a capitalist. But this became important only in the twentieth century. The joint stock limited liability company allowed a differentiation between function 3) and 4).But until fairly recently someone on whose account the production process was performed was performing this function by providing at least some of the capital necessary for the operation. Only in recent time has profit sharing with employees become more widespread, so that now employees in many firms participate in function 4).

The function of bearing the primary risk - secondary risk is also borne by employees if there is job insecurity, and by lenders

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15) Yugoslavia is of course not exactly what I would call a democratic country.

of capital if bankruptcy of the borrower is possible - is indispensible in a market economy, and there are good reasons why this function usually is combined with one of the other three functions. The traditional combination with the entrepreneurial-managerial function is still important, but there are many reasons, among them size of operations, which make it necessary to use the bearers of function 1) or function 2) as at least auxiliary bearers of function 4). Mainly reasons which have lost importance in the process of further economic development have made the lenders of capital the main additional bearers of primary risk - by means of the limited liability company with or without public shares. Formal control in the last resort lies with those on whose account operations are performed and it is therefore the prevalent situation in western countries that the representatives of shareholders appoint the managers. But in many cases this formal control in the last resort is no longer a real control in the sense that shareholders really have very much to say. There is, of course, always the control of the market in the sense that low profits and the ensuing drop in the price of the shares in the stock market usually leads to a replacement of the top management.

Whatever the historical reasons were for the predominance of the combination of the capital providing function and the risk bearing function there are good reasons for the trend to let employees participate in the primary risk-bearing function. This also implies that they will have a share in the formal control of top management. One of the reasons for profit sharing is that it can be an effective incentive for efficiency and profitability of operations. A different reason is that in this way the base for bearing the primary risk can be considerably broadened which makes it possible for the firms to incur larger risks. Of particular interest in the context of the problem of stability is the following reasoning: if workers receive a substantial part of their income as residual income directly depending on profitability, cyclical fluctuations of demand will have a smaller impact on employment. Since then the proportion of residual income to contractual

income (which is a part of production costs) is much larger than it would otherwise be, the normal profit cushion lying above costs is larger and hence makes it much easier for firms to reduce prices if demand declines instead of reducing production and laying off employees. This would make it easier to dampen demand by restrictive government policy for the purpose of stabilizing prices. To put it differently: if stabilization of the price level requires a reduction of incomes (or the rate of growth of incomes) this reduction will take the form of reduced employment if the ratio residual income: contractual income is low, and it will take the form of reduced earnings per manhour if this ratio is high.

Another reason for profit sharing from the point of view of stability is that excessive wage demands are less likely to occur, if the short run effect of large wage increases is a sharp reduction of profits shared by employees.

Profit sharing does not necessarily imply the ownership of shares in the company, i.e. the ownership of wealth. But with certain schemes of profit sharing it does, and there are good reasons to opt for such schemes. One such proposal would be : x percent of total profit will be distributed among employees. There exist employee shares which cannot be sold except in special circumstances, but they must be sold, if the employee leaves the company. Every newly issued share gives its owner a share in the profits of the company over the next 10 years. New shares are issued to all employees in proportion to their wages. If 20 percent of the income of employees takes on the form of profits then such a scheme implies that the capital value of employee shares outstanding is approximately equal to the wage bill of the firm for a whole year. Such a scheme probably also implies a more appropriate incentive structure than immediate payment of profits. Employees become more interested in the long run profitability of the company.

I think the government has every reason to encourage bold profit sharing schemes. This implies in particular that tax

laws will have to be changed in many countries.

X

Profit sharing between providers of risk capital and employees is a compromise solution between two extremes: one extreme is traditional capitalism where all residual income accrues to capitalist-shareholders the other extreme is complete worker ownership, as it is practiced in Yugoslavia, where all residual income goes to the workers. My personal opinion is that this compromise is better than both extremes. Why it is superior to traditional capitalism from the point of view of stability and efficiency I have tried to indicate in the last section. This is not the place to discuss in detail the other extreme, i.e. a Yugoslavian type model, which I would consider a less efficient, less stable and, above all, less equitable system than a mixed system as proposed in the last section.[16)]

On the other hand, I find a model of complete worker management sufficiently interesting to propose that one should try more experiments in this direction in western countries. Indeed, every person should be able to have an effective choice between employment in "capitalist" firms and employment in worker managed firms. This does not mean that he has the right to work in a worker managed firm at the same pay that he receives in a "capitalist" firm. If worker managed firms are less efficient due to inferior management or if they sacrifice efficiency for what they consider more human working conditions, workers probably will have to accept lower wages than in "capitalist" firms.

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16) Problems of economies with labour managed firms are discussed in a systematic way in J. Vanek, The General Theory of Labor-Managed Market Economies, Ithaka and London, 1970. I should also like to mention the recent article by J.E.Meade, The Theory of Labour Managed Firms and of Profit Sharing, Economic Journal, March 1972 (Supplement in honour of E.A.G. Robinson). Yugoslavian experience as well as these theoretical considerations make it very clear that it is not only capitalism which has to deal with classic problems of efficiency versus equality.

But even those people who would be prepared to accept these wage reductions for the possibility to participate in worker managed firms usually at present cannot do so in their own country. Thus the idea of worker management so far cannot be tested empirically under conditions comparable with those of "capitalist" firms. The government should subsidize experiments in worker management so as to make them viable and sufficiently attractive to appear as a real alternative. The subsidies should be given in such a way that at least 2 - 3 percent of the privately employed labour force work in worker managed firms. If the idea catches on and more such firms are established the subsidies can be reduced until at the 5 percent mark the subsidies phase out completely. If more than 5 percent of the privately employed labour force work in worker managed firms the worker managed and the "capitalist" sector will have to compete under equal terms. If there is sufficient diversification in both sectors every person in the economy has the free choice to work in one of these two sectors and it is the sum of the free choices of all individuals which determines in the long run to which degree the economy is " capitalist" or worker managed.

This is not the place to discuss difficulties of implementation of such a proposal. Apart from political difficulties of gaining sufficient support there are substantial practical difficulties which would have to be analyzed in a detailed feasibility study. But there are in addition certain limits to the kinds of experiment in a "capitalist" environment. For example, experiments with egalitarian pay structures - following Cuban or Chinese models - may encounter special problems in a society with comparatively large pay differentials as is the case in most of western societies. Yet they should not be impossible. Considering the fact that enthusiasm for such models as Cuba or China mainly exists among young, well trained people with a middle class background who frequently consider their parents' material well being corrupt and detestable, there should be a sufficient reservoir of skilled volunteers working for the wage of unskilled workers.

Variety is a source of stability and adaptability . Economists can confirm this for individual portfolios, individual firms, regions, etc., sociologists and psychologists confirm this for large organisations or small groups with strong interaction, biologists confirm this for ecological systems or for the genetic basis of individual species. The same is probably true for forms of management.

A philosophy of pragmatic experimentation thus is likely to be better suited to combine the goals of stability and of progress than dogmatic rhetoric and uniformity. This philosophy of experimentation should also be applied to other fields of social life. It contradicts to a certain extent the principle of uniformity which so frequently is applied in modern social and political life.

In the context which is discussed here I am rather skeptical about the attempt of labour unions and political parties to find a uniformly applicable regulation for codetermination of firms by shareholders and employees. Such a regulation, which has to be applied to any single firm of a certain size, no matter what the specific wishes of employers and employees are, forces everybody into rather dull compromises and tends to preclude any bold and really interesting experiments.

XI

In discussing the political economy of stability I have so far completely ignored, among other things, the fact that our economies all have borders and there exist other economies beyond these borders.
This is of particular interest for the European countries which are in a situation where foreign trade constitutes a large share of gross national product . Thus our analysis of stability problems may be much more applicable to a country like the United States than any European country. The situation does not change in principle for a country with a large foreign

trade sector, if its own currency has sufficiently flexible exchange rates against those of its trade partners. Due to foreign trade competitive forces maybe stronger so that domestic pressure groups may not be able to accumulate so much pressure power. Thus in a country like West Germany with a relatively rational system of union organisation and of employer - employee cooperation and with an electorate that puts a high priority value on price stability, full employment and price stability could be achieved under a regime of sufficiently flexible exchange rates. The depreciations of purchasing power of the D Mark which West Germany experienced were all either directly induced to excess employment and excessively high profits in consequence of export booms. There never existed a genuine cost push inflationary situation as it undoubtedly prevailed in other countries over longer perions.[17)]

Space does not allow me to draw specific conclusions from our analysis for the process of European monetary integration. Stability requires that there exists a stable European unit of account to which national currencies could be pegged. So it would be good, if first such a stable unit of account were established before the different countries use it to regulate the exchange rates between their currencies.
At the moment, the governments of the EEC are trying to obtain monetary integration the other way round. They first decided to fix the mutual exchange rates of their currencies, thereby implicitly creating a European unit of account. But there is no guarantee whatsoever that this implicit unit of account will be stable in terms of purchasing power.

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17) Even the very large wage increases in recent years, which clearly were not consistent with price stability, evidently were justified in view of general economic conditions. Otherwise they would have led to unemployment and a reduction of the employment of foreign workers, which they did not. It is thus misleading to call the present inflation in Germany a cost-induced inflation. If costs had not risen, the inflation would have taken place anyway, via another export led boom. Profits would not be higher under such conditions. Of course, disappointment with the results of economic policy provide the psychological climate which may in the long run cause supply (including labour supply) pressure to rise in Germany.

Everybody with some understanding of monetary systems will, I think, agree with me that such a setup is very likely to cause strong inflationary effects. I hope I am wrong and I hope our statesmen will have the wisdom to proceed steadily towards the common goal of increased European integration and stability in spite of all difficulties which others and they themselves have created.