Beyond Capitalist Planning

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The International Crisis

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Inflation and Crisis

Inflation has become a problem of dramatic proportions. At the *national* level, it encourages economic speculation, provides some people with unjustified profits, and results in a generally unjust allocation of income, especially when the direct and indirect income of certain social groups (in particular, the non-active sections of the population) are not adjusted in line with increases in the cost of living.

Inflation constantly distorts the assessment of economic performance and frustrates rational calculation in both the public and private sectors. Inflation thus contributes to a less rational distribution of the factors of production. Savings are moved out of long-term investment into forms of 'hedging' against inflation (precious metals, land, etc.) or are kept in liquid form, simply not reinvested. As a result, inflation alters the terms of lending and the criteria for choosing investments, thereby wasting resources or reducing growth potential and creating higher structural unemployment.

Further, the implementation of anti-inflationary measures which concentrate unduly on single aspects of the problem such as reduction of the public sector borrowing requirement have given rise to substantial distortions which have often meant that public authorities have to sacrifice plans for structural reform and public services.

The overall effect of inflation is to jeopardize progress towards a more egalitarian society; to aggravate social tensions and intensify the corporatist reactions of those wanting to safeguard acquired privileges; it thus erodes democracy.

At the European level, the differences between rates of inflation and the specifically national character of anti-inflationary measures face the European Economic Community with real prospects of disintegration, accentuated by the present conditions of international competition and by the 'beggar-my-neighbour' policies of a number of member countries, which prompt others to give priority to their bilateral relations with the United States. Such developments make a Community response to inflation even more unlikely.

The dramatic increase in the pace of inflation in the 1970s was due to a combination of circumstances: namely, a particularly sharp economic upturn in all industrialized countries, accompanied by rapid cost-push and demand-pull inflation; an explosion in raw material prices due partly to overheating and ancillary factors such as the use of oil as a political weapon; and an acute phase in the upheavals besetting the international monetary system.

However, this is only part of the story. These accelerating factors – both cyclical and quasi-accidental – occurred against a background of *structural inflation rooted in profound economic, social, and political changes which have occurred in the last twenty years.*

Forty years ago, Keynes formulated the main elements of a new economic theory based on the principle that, if public authorities intervened to regulate private and public demand, the price mechanism and competition would ensure a supply of goods and services at full employment without inflation.

Since then, there has been a considerable change in the general economic framework. The widespread use of demand management, full employment, and welfare state policies has considerably altered the pattern of both public and private spending.

In the meantime, our economies have been subject to the rapid growth and increasing influence of very powerful large firms described here and elsewhere as the '*meso-economic*' sector, a new phenomenon between micro-economics and macro-economics. This sector does not respond to overall demand management by the public authorities in the same way as an economy based on small firms. The structure of competition itself has been transformed and operates under new 'rules of the game'.

The combination of stagnant investment, rising unemployment, and persistent inflation since the late 1960s indicates that the regulation of overall demand alone as advocated by Keynes is no longer in keeping with meso-economics. To cope with these new factors, the Keynesian approach needs a new and different complement, transcending the orthodox macro-micro dimensions of economic policy and planning. Besides this, several key assumptions on which European integration was based have been profoundly modified.

It frequently is neglected that the report of the Spaak Committee (1956), which preceded the Treaty of Rome, stressed that considerable imbalances and inequalities could *result from* the liberalization of foreign trade, capital and labour, a warning that was reiterated ten years later in the Community's first Medium-Term Economic Policy Programme.

Although the Community has now implemented the main points of its trade liberalization programme and its programme for the free movement of workers, the progress envisaged and achieved in the structural areas of sectoral, regional, and social policy has been limited or insignificant. This is now classically apparent in the failure of a Community response to the structural factors in inflation, which cannot be isolated from economic, social, and political factors. For instance, a number of measures that brought very positive social benefits, such as those for ensuring better job protection, for providing assistance to farmers, and for narrowing income disparities, have played their part in fuelling inflationary pressures, for want of a coherent general framework of policies for coherent development.

There are two main ways in which governments could master inflation: either accept recession and depression resulting from over-reliance on traditional instruments of economic policy, i.e. '*stop-go*' *measures*; or undertake a *programme of more fundamental reforms and measures within a new planning framework, designed to achieve a more balanced economic, social and political structure*.

In order to halt inflation, 'stop-go' measures would have to be applied more frequently and on an increasingly wider scale, with intolerable human and economic cost, now less and less acceptable and causing a greater waste of resources. If full employment, a better distribution of resources and the profits for investment cannot be safeguarded, measures which simply restrict demand will increasingly clash with social expectations of improving the quality of life, extending public services, combating inequality, promoting individual liberties, achieving a higher degree of participation and social integration, etc.

The public will not tolerate these contradictions for long. Therefore, unless far-reaching reforms are undertaken, there is a great danger that authoritarian methods – open or concealed – may gradually obtain a hold on our democratic societies.

Meso-Economic Power

Macro-economic demand management policies assume that competition determines price formation at the micro-economic level. In other words, it assumes a price-flexible supply and demand in response to monetary and fiscal policies. This fails to take into account the emergence of a new 'meso-economic' sector between the macro-economic level of public policy and the micro-economic level of small and medium-sized undertakings. (Greek: mesos – intermediate.)

The term 'meso-economic' refers to the *increase and growth of monopolistic, multinational companies*, whose behaviour is totally different from that of small-scale national firms in the micro-economic competitive model, and which constitute a new economic sector between the conventional macro- and micro-economic orthodoxies. The structure of competition itself has thus been transformed. What has emerged is a new dualism between large and small firms (meso-economic and micro-economic undertakings).

The following figures illustrate the size of the meso-economic sector:

In the United Kingdom, less than one per cent of firms

> account for 50 per cent of the country's output and foreign trade. 100 firms control half of industrial output, with 75 firms accounting for half of direct exports and 31 firms for 40 per cent of direct exports.
>
> In France, the top four firms in each of the following industries accounted for over half the total sales in 1969: metal-working (82 per cent), extraction and processing of various metals (80 per cent), steel (77 per cent), aircraft construction (65 per cent), production of non-ferrous metals (60 per cent), oils and fats (54 per cent), rubber and asbestos (52 per cent).
>
> In Germany, about 2·5 per cent of industrial firms accounted for more than half of total sales in 1968.
>
> More dramatically, in the EEC Nine as a whole, some 332 companies now account for half of industrial sales. Moreover, while Britain shows a more concentrated industrial structure than other Community economies, the rest of the EEC are 'catching up' in terms of both monopoly market structures and multinational spread of capital.[1]

There is every indication that meso-economic firms are continually increasing their share of the market despite the policies attempted at national and Community levels to maintain plural market structures of the old-style competitive model.

The growth of this powerful new meso-economic sector is not a conspiracy against the public interest; it is the natural outcome of economies of scale and the need for specialization. Its monopoly trend is a consequence of competition, not simply an abuse of the competitive process through collusion.

However, the inflationary power to raise prices is in part a direct result of the rise of meso-economic power: there is a significant correlation between the size of a firm and its ability to set its prices at a relatively high level, thereby earning super-normal profits.[2]

In the new meso-economic sector, consumer sovereignty has been replaced by a producer sovereignty, by which the new big business can 'impose' prices. Large firms generally set their prices in relation to the costs and prices of smaller marginal firms. This provides a kind of *price umbrella* for those small firms which large firms, or public authorities, want to keep in business.[3] This policy enables competing firms of very different sizes to remain on the market and offeres the more viable firms super-normal profits which, in turn, makes possible their further expansion and unequal strength relative to 'micro'-economic competitors.

The price umbrella technique now has been extended to trade between subsidiaries of multinational companies in different countries, i.e., using the *transfer pricing* technique. These companies can thus promote inflation by raising the prices of imports from their foreign subsidiaries virtually with impunity.

The price umbrella practice is substantially the perverse result of competition policies which encourage price increases instead of curbing them. Large firms set their prices at a level which permits a number of competing firms to remain on the market (an objective of competition policy).

This practice is inflationary in that: it makes for a constant upward alignment of prices; it slows down the process of modernizing equipment and thus narrows the scope for subsequent price cuts. This does not mean that competition no longer exists. In fact, meso-economic firms both continue to compete for a larger share of national or world markets, and at the same time enter into various types of agreement designed to limit other effects of competition and strengthen their own position as firms. In short, large firms are motivated in different and more complex ways than conventional economic theories suggest: they aim as much to expand their activities and supplies and markets, as to raise the profitability of their operations; the ultimate aim, in terms of power, is survival and relative autonomy. But, in this battle, *price* competition has increasingly been suspended – both between big business in the meso-economic sector, and indirectly between it and the micro-economic enterprise of the conventional model. *This has affected the relationship between productivity, returns, and prices in different sectors*. Industrial growth has been rapid but unequal both among sectors and regions. Productivity, therefore, varies considerably between sectors and among regions. The fact that increases in productivity differ from sector to sector is not in itself inflationary, provided that the most productive sectors pass on to their customers a considerable share of their gains in the form of lower prices.

However, the sectors in which productivity gains are the most rapid rarely reduce their prices: high-productivity sectors, which are dominated by a few leading firms, can conduct virtually independent pricing policies regardless of their productivity. As a result, profits and wages in these sectors will rise sharply. Given the general tendency to pay equal wages for the same type of work, higher wages quickly spread to other sectors of the economy. Sectors in which productivity increases at a relatively slow rate raise their prices even more sharply in order to be able to pay the higher wage rates and ensure their survival. In brief, *the greater the productivity differences, the greater the increase they now can entail in the general level of prices.*

Besides which, the structure of profit margins in the distributive trades is generally such that measures taken to hold back prices, particularly in industry, often do not work through to consumer prices. There are a number of reasons for this, including: traditional and outdated structures in part of the distributive trades; the gradual replacement of price competition by a form of competition which tends, on the contrary, to raise costs and prices and involves in particular artificial differences in products, markets, prices, and related services; massive, insistent, and largely emotive advertising; prestige goods and items 'for show'; the 'middle class' bias policy pursued by many governments; the low price elasticity of demand on many markets (inadequate market transparency, lack of time available to consumers, particularly as a result of the increase in the number of women who go out to work); growing consumer expectations regarding choice of varieties available, presentation of products, product specialization, etc. Also, more generally, in the new consumer society there is a tendency for prices to be related to the satisfaction *expected* from the purchase or possession of an object, or from the use of a service – social prestige, attempts to imitate or to be different from others, etc.

This is very much related to the middle-class bias of government policies, or general concern to placate professional and managerial élites by allowing them income levels which cannot be achieved by the working class.[4]

The size of the distributive trade's profit margins in terms of consumer prices can be illustrated by the following statistic: the gross trading surplus of the distributive trades alone is equivalent to about half of the gross trading surplus of industry as a whole.[5] In a number of countries, the distributive trades' surplus is even larger than that of industry.[6]

Among other factors, the main reason for this is that traders often calculate their selling prices by adding a fixed percentage to their cost prices. Wherever demand is relatively inelastic, this is tantamount to indexing profits to cost prices. This triggers primarily an upward pressure on prices. A downward movement in producer or import prices is rarely passed on to the consumer Moreover, the development of integrated retail outlets often has little beneficial effect on consumer prices. Although, at the outset, supermarkets and the like frequently apply a policy of low prices in order to attract customers and to drive small competing traders out of business, they then often raise their prices, thereby making considerable and unwarranted profits. In addition, their advertising and promotion techniques frequently disguise long-term price increases.

Labour, Capital, and Crisis

The Treaty of Rome provides for the free movement of workers within the Community. However, it has now been widely shown and recognized that imbalanced geographical migration is extemely costly in social and economic terms and thus fuels inflation.

Generally speaking, *the factors making for an inflexible supply of manpower are not dealt with rationally*. This is a matter of fundamental importance. It goes a long way towards explaining shortcomings in public policies. Inflexibility is often the result of undeniable social progress which no one would think of reversing, e.g., laws and agreements on job security (length of notice of termination of employment, accident prevention, redundancy payments), improved benefits for the wholly unemployed, the creation of opportunities for promotion within firms, etc. There also is increasing attention to demands that a certain level of employment be guaranteed in the less favoured regions of the Community when the major employer in a town or locality announces a cutback in production.

However, granted the social and economic aims of modern society, it would be a mistake to reject the aim of achieving improved allocation of manpower. In this respect, although the active employment policy pursued since the last war has produced very positive results, its limitations have, since 1965–8, become apparent to differing degrees in the countries concerned.

One of the main new problems, of which governments have taken little or no account, is the long-term trend to structural or technological unemployment in the main economies of the Nine. The postwar boom into the mid 1960s was sustained by the absorption in entirely new industries of labour displaced by technical progress in traditional industries. But since the mid-1960s, increased product and productivity in even modern sectors of industry has been matched by a falling rate of growth of employment. Without a new generation of job-creating industries on the horizon, and with a trend for technical progress (e.g. in micro-electronics) to substitute machines for labour in the service sector, classic full employment policies are thrown into crisis.

Related to this is the *inability of certain groups to obtain worthwhile employment*. This is the case for handicapped workers or foreign workers who have lost their previous jobs, but there is also an increasingly serious problem for the elederly, the ever-growing number of women seeking their first jobs or wishing to return to work after raising their children, and school-leavers either with qualifications for which there is no demand or with no real vocational qualifications. This has led to an increase in structural unemployment, even during phases of rapid growth.

Even when a large number of young people and women were registering with employment exchanges, firms were complaining of the shortage of skilled labour, which led to outbidding on the wages front between firms in need of such labour. The steps being taken to extend adult training schemes are not an adequate answer to such problems posed by shortage of skilled workers. It also should be stressed how difficult it is for some employees to move to a new region: the arduous business of selling their homes, which they often own, and of buying another in a new locality; the fact that such a move does not always fit in with the occupation of the spouse, who cannot always move as well; the loss of certain indirect wages or work advantages, although here collective agreements have resolved a number of difficulties; the inadequacy of the social infrastructure (schools, hospitals, transport facilities, etc.).

All things considered, even under conditions of overall job expansion, employment policy has failed to create the conditions necessary for a voluntary mobility that is satisfactory from both a social and an economic viewpoint. There are other causes such as the lack of a genuine market for part-time employment, which clearly would help adjust labour supply and demand in particular areas.

This criticism in no way implies that an attempt should be made to reverse the gains already made by trade unions which are, in any case, irreversible. However, *a comprehensive review of employment policies* that also makes allowance for the limitations of medium-term and long-term forecasting in this field is called for. Only a radical *redistribution* of the structure of employment, between firms and industries, regions and cities, and different social classes, will be able to fulfill the classic ends of postwar full employment policy in the remaining decades of this century.

The allocation of capital is also subject to considerable rigidities, although financial capital is much more mobile than individuals.

Leading firms (meso-economic firms) – through price-making power – have more scope today for maintaining their profit margins and sales in periods of depressed activity; as a result, a key feature of the conventional price and profit mechanism is no longer functioning. But, for the same reason, self-financing now is a regular feature of their capital-raising. Therefore, leading firms have relatively less recourse to the capital market. This is one of the causes of fluctuations in capital markets in recent years, but is a main cause of the declining role of stock markets.

Inflation is accentuating the tendency among firms to raise capital by issuing bonds rather than shares. This is an important aspect of the general trend away from share issues, prompted, in particular, by the systematic extension of interest rate subsidies offered by central or local authorities and by the desire of firms to avoid control by institutional investors (banks, insurance companies, etc.) in countries where these have large shareholdings.

This increasing recourse to bonds for raising capital creates another inflationary factor, since it leads firms to maintain or even raise price levels in a recession in order to meet their fixed interest payments, and cover their higher unit costs (with spare capacity) through inflation rather than increased sales. This has transformed the price sequence of the conventional trade cycle. Previously, prices rose during the upswing of trade and fell in the recession. Nowadays, prices rise in *both* the upswing *and* the recession.

Moreover, this tendency is aggravated by government stop-go policies. The more a government relies on a policy of restricting demand, the more firms tend to raise prices in order to compensate for the drop in turnover resulting from the fall in sales. Thus deflation can *cause* inflationary pressure.

Such factors are not unique in the current inflation in the EEC. Nevertheless, it is notable that the average rate of price inflation in the Nine effectively doubled in the decade 1964–74, i.e., before the major increase in commodity and oil prices caused governments to impose deflationary domestic policies to make room for higher raw material and fuel costs.

It is in the post-1974 situation that the new deflation-inflation syndrome has become critical. Overall, inflation rates have decreased in some countries, such as Britain and France, as the main initial impact of OPEC and other price rises have diminished. These dis-inflationary effects have been reinforced in an economy such as Britain's by wage restraint policies accepted by trades unions. But, over the longer term, only a comprehensive reflation of demand, related to public policies for effective price control in the meso-economic sector, can ensure that leading firms decrease prices in line with the reduction of their unit costs of output through higher sales.

Moreover, there is no guarantee that such policies will prove effective if governments attempt to reflate demand without a fundamental change in its structure and distribution, essentially moving public expenditure from a secondary and passive role to a *primary* and *active* position in the socially planned allocation of resources. This is partly because of the psychological shock of the crisis of the seventies to management confidence that further major investment projects could be covered by sustained private demand, and partly from increasingly apparent limits in a mode of development based primarily on private consumption and investment.

Private versus Social Consumption

Spurred on by advertising, consumption in our society tends towards a model which includes a large measure of frivolous, ostentatious or, at the very least, non-essential consumption. There are several factors behind this: anarchical advertising; artificial differentiation of markets, models, prices, and related services (guarantees, after-sales service, etc.); unnecessary changing of models; production of over-sophisticated and expensive items in place of simple, more efficient and cheaper goods; insufficient consumer information (comparison of prices, technical characteristics and durability of products, etc.). Tied to this pattern of consumption, a society based essentially on private consumption tends to consume too much too quickly. This generates heavy pressure for increases in direct and indirect income, while demand, despite the prices charged, expands too rapidly, spurred on by a supply of goods and services which are of increasingly questionable utility and novelty.

None the less, consumer demand today also is increasingly concerned with the 'quality of life and working conditions': it concerns needs, some of which could be organized or provided publicly (housing, public transport, cultural and social services, etc.) and others privately (organization and content of work, desire to keep occupational expertise up to date, greater worker participation, and increased industrial democracy). In general, these problems are poorly perceived both by public authorities and employers. Both prefer to try to solve disputes and ease tension through traditional negotiations on wages and working hours. Such an approach fails to solve the problems involved, and at the same time boosts inflation in the following respects. Increased wage costs are passed on by firms in the form of price increases. The unduly heavy pressure of consumption (resulting from the increase in direct or indirect incomes) limits the resources available for 'social investments', which do not receive the necessary priority. Production costs are aggravated by absenteeism, high staff turnover, and poor quality work, all of which reflect wage earners' frustration with their working conditions.

Public policy in this connection shows four main expenditure trends:

An increase in subsidies to meso-economic firms rebating and negating nominal corporation tax.

A growing share of tax transfers or social subsidy in the structure of household incomes.

An increase in goods and services acquired with public subsidy (direct or indirect) in traditional private consumption.

An increase in goods and services provided 'free of charge' in enlarged private consumption.[7]

Public transfers, and in particular social security transfers, are obviously an integral part of the policies aimed at achieving a fairer distribution of national wealth and income and attaining the fundamental objectives of improving social welfare and cohesion.

In most cases, direct income demands are formulated in such a way as to take account of the transfers which must be made to the state, but do not allow for cash payments or public services provided by the public authorities. A substantial inflationary pressure begins to weigh on costs, especially during wage negotiations. This is one of the conclusions to emerge from an OECD study of expenditure:[8]

. . . it seems clear that the rising tax burden stimulated

> income claims . . . and was thus one factor tending to keep up the household sector's share in 'primary' incomes. How far, on the other side, the rising volume of transfer payments (many of which go mainly to the aged, sick or unemployed) helped to mitigate claims for higher money incomes is an open question. . . . These questions . . . lie at the centre of the process by which resistance to attempts to shift the distribution of expenditure away from 'pure' private consumption generates inflationary pressures. . . .[9]

Secondly, the Community countries do not yet have a breakdown showing to what extent national product is used for meeting the various needs of society (education, health, social security, research, law and order, housing, recreation, etc.) and to what extent the various sectors (public authorities, firms, households) contribute to meeting these needs.[10]

In the absence of such an overall survey, it is impossible to evaluate fully how growth contributes to meeting these needs. Endless political discussions take place without a sufficiently extensive and coherent statistical base. In such circumstances, it is very difficult for the public authorities to make rational choices and to fomulate coherent policies.

While the public authorities can allocate part of new resources to new objectives, it is extremely difficult for them to cut back previous allocations. This therefore results in *a highly rigid structure of public expenditure*. Thus, the utilization of the national product has not been sufficiently adapted to the changing needs of society. The inadequacies of social infrastructure in general and of public transport in particular are striking examples.

As has been seen, these inadequacies give rise to 'qualitative' demands for which satisfaction is sought – with little success – in conventional wage concessions (direct and indirect) and which, in their turn, fuel inflation. These contradictions will become even more marked if, as everything would tend to suggest, growth over the coming years stays below the rate of the immediate postwar decades.

All in all, the present, conventional economic model leads to clear dilemmas. Having failed to make the necessary policy choices, policy-makers continue to maintain personal taxes and equivalent charges in order to be able to step up transfers, subsidies, social welfare schemes, etc., neglecting the effective corporate taxation which would become possible through a reflation of demand and a change in the model of consumption. This then creates tax-push inflation, the various aspects of which have been studied in depth by the OECD. Moreover, the level of personal taxation in several member states is reaching the bounds of what will be tolerated with impunity. If the option is made for a lower level of taxation, a choice also must be made between the following alternatives:

to slow down the development of public services, thereby increasing the sense of frustration in society in the short-term;
to finance it peversely (i.e. expenditure not covered by taxation);
to introduce or increase direct contributions to the cost of the services by those using them;
to stimulate savings so as to increase financial resources;
to cut 'welfare state' services and reverse the social advance which they have represented in the postwar period.

Crisis in Policy Formulation

After the Second World War, growth was a prime objective of economic and social policy. It was unquestionably instrumental in recovering employment and raising living standards. But it also promoted the internal strains in the economic and social systems of our countries. Since these strains were not in due course eliminated, they produced inflationary effects.

Inflation is therefore not only a source of increased distortions, but a sort of flight away from present realities. It masks certain structural problems and temporarily eases certain strains, but at the same time lays the foundation for even more serious tensions leading to social and political crisis.

Foremost among these problems and strains is the persistence of *considerable inequalities of income and wealth.* The differences between per capita income in the various regions of the Community have not appreciably narrowed in the sixties, and widened in the seventies.[11] Certain groups of workers have further consolidated their direct and indirect advantages, while others (small and medium-scale farmers, small traders, certain categories of wage earners) have seen their relative situation deteriorate. Economically unwarranted gains have become larger and more common (property speculation, earnings of certain professions, investment income, and middle-class hedges against inflation). Certain new forms of unjustified profits have developed (dividends received by the shareholders in large meso-economic firms who make little, if any, contribution to financing investments and who do not incur significant risk, even in periods of marked recession). At the same time, conspicuous consumption has become increasingly common, highlighting these inequalities and reinforcing the general desire for parity.

Even in countries with a strong trade union structure and a relatively high social consensus, there is a marked tendency to decentralize the decisions in which trade union organizations are involved. This tendency is reflected in the greater strength wielded by both management and unions in business, and in a greater awareness and often even greater willingness at grass roots level to take steps on matters which concern them directly.

Decentralization is not a bad thing in itself – quite the contrary – but its success depends on the ability to combine greater initiative at the base with a necessary minimum of coherence of action at the top. However, this is occurring less and less, in some countries not at all. Consequently, employer-employee relations become more and more uncertain, agreements and contracts are drained of their value, and the only possible solution to the problems of industrial bargaining is to be found increasingly in inflation.

Besides individual trade unions, some countries have for a long time had organizations representing particular groups of the working population (farmers, small traders, craftsmen, civil servants). In recent years these groups have also adopted new, much more aggressive attitudes. In most countries, specific groups have recently set up their own representative organizations and are resolutely applying all the means of pressure at their disposal. This is a new and complex form of corporatism operating at all levels of society.

These two tendencies (decentralization and corporatism) have led to social groups competing more keenly between themselves. This competitiveness is becoming more and more compartmentalized. This makes it virtually impossible to carry out the redistribution effort on a general basis. The danger of this corporatist tendency is all the more serious since it is not countervailed by policy-makers, who should be the guardians of the general public interest. In some countries, renewed awareness of the cultural and linguistic identities of regions is further tending to compartmentalize decisions.

Given these tendencies, political decision-making has never been so necessary. But, substantially through a crisis in ideology, based on the attempt today to recreate the conditions of yesteryear, it lacks either intellectual credibility or political force.

The fundamental principles underlying most political institutions and procedures were conceived years ago in very different economic, social, and political circumstances. These circumstances have altered profoundly. Institutions and procedures have not adapted to these changes.

Social and political objectives have become many and varied. Their relative importance varies considerably from country to country and from one interest group to the next. The hierarchy of objectives is vague and their interrelationships not at all well understood.

False Relationships

Thus, many discussions on economic policy are still dominated by the explicit or implicit assumption that close relationships exist between several objectives, particularly between prices and costs on the one hand, and unemployment and the balance of payments on the other. These relationships are in general much more flexible than is supposed. Where they exist and hamper the fight against inflation, they can often be loosened by a change in the behaviour of the main power groups in economic activity.

The relationship between prices and employment, which even in the past presented different characteristics in different countries, has changed appreciably in recent years; the slower creation of new jobs has led to an increase in the 'structural' aspect of unemployment. In addition, structural factors – including the rise of meso-economic price-making power in big business – have had an ever greater effect on price trends. It now should be obvious that the conventional 'cyclical' relationship between prices and unemployment has virtually been reversed. If governments stick to conventional policies in order to curb inflation, they will vainly apply increasingly rigorous restrictive measures. Because of the ability of large firms to set their own prices, deflationary measures can actually reinforce inflation, as firms increase prices to offset a fall in demand and thereby maintain or increase cash-flow. The resulting social costs result in increased social tension which is the more serious precisely because governments appear to misunderstand its basic causes and fall victim to secondary mythologized explanations of crisis such as monetarism.

The situation is aggravated when it comes to the relationship between prices and the balance of payments. According to conventional theory, a balance of payments deficit should prompt governments to implement a restrictive monetary and fiscal policy (and vice versa). But when a currency is allowed to float without any state intervention, a balance of payments deficit no longer necessarily has the same restrictive effects on overall demand. Responsibility for managing the foreign exchange position passes from the central bank to private finance. The system becomes increasingly unstable as it is taken out of the hands of the authorities. Consequently, the deflationary and reflationary relationships between prices and the balance of payments are undermined, thus encouraging inflation.

In many cases, the phenomena previously described have led to decentralization of public decision-making and a diversification of social structures. But this tendency towards more direct democracy has not been accompanied by adjustments of socio-political structures sufficient to offset the neutralization or negation of central state power.

Consultation and negotiation procedures between interest groups in society are proliferating, overlapping, and being drained of much of their value. In many cases, the very object of consultation has been defeated by the *multiplication of procedures*, unrelated to a central strategy for the use of economic resources.

In addition, several old-style rules and constraints have, in reality, disappeared: wage-productivity alignment, the balance of payments constraint on domestic expenditure, and other international monetary 'norms'.

These difficulties are further aggravated by the *weakness of political decision-making*. This is partly due to the narrow margin between majority and opposition parties or defensive government effort to achieve consensus within majority parties. These are factors which reduce the room for manœuvre available to parties in office, since they tend to result in lowest-common-denominator tactics rather than a strategy for basic change, including a change in the mode of development. Such factors partly explain the weakness of the political parties, the instability of governments, and the difficulty governments have in taking major economic and social decisions. This is in addition to the divergent economic interests previously described which weigh more and more heavily on processes of political decision-making, to the point of paralysing them.

These phenomena are the outward manifestations of a profound transformation in the way democracy works in our countries. Some of them are positive; but the institutions have not been adapted to new ideas or new realities, with the result that increasing difficulties are encountered in coordination and decision-making.

Under these conditions, inflation substitutes for the failure of other instruments to mediate and adapt claims to real and objective possibilities.

Chapter 9 The International Crisis

1. See further EEC Commission, *Sixth Report on Competition Policy*, 1976, and L. G. Franko, *The European Multinationals*, Harper and Row, 1976.
2. See further EEC Commission, *Fifth Report on Competition Policy*, 1975 (Introduction and summary of the research programme on concentration).
3. For the 'price umbrella' concept see Edith Penrose, *The Theory of the Growth of the Firm*, Basil Blackwell, 1959.
4. Such a situation relates very much to what the late Professor Fred Hirsch called 'positional goods', in *The Social Limits to Growth*, Routledge, 1977.
5. In 1970, the figure for Germany was 41 per cent, for the Netherlands 51 per cent, and the United Kingdom 58 per cent.
6. In Italy, the percentage was 109 per cent.
7. Traditional private consumption plus goods and services provided free of charge to households by the public authorities.
8. *Expenditure Trends in OECD Countries, 1960–1980*; OECD, July 1972.
9. 'Pure' private consumption is defined as follows by OECD: 'Consumption not paid for out of transfers received from the public sector in connection with social security and other welfare schemes.' *ibid.*, p. 11.
10. The national accounts of the member countries that have adopted the new conventions of the European System of Integrated Economic Accounts (ESA) contain two distinct and uncoordinated functional classifications based on the United Nations' System of National Accounts (1970):

    one showing general government expenditure (see Table 12 of the SOEC National Accounts Yearbook 1973) (breakdown to one digit of the United Nations classification);
    the other showing final consumption of households (see Table 7 of the SOEC National Accounts Yearbook 1973).

    Apart from the national accounts, work on functional breakdowns has been carried out or is still going on in two other fields:

    social accounts: a functional breakdown of social security expenditure (*cf.* SOEC publications);

public finance: a functional breakdown of public expenditure beyond the second digit of the United Nations classification (*cf.* OECD works).

In September 1973 OECD attempted, unsuccessfully, to establish a combined functional classification of public and private expenditure.

11. See further EEC Commission, *European Regional Development Fund*, (First Annual Report), 1976, which admitted that GDP per head increased from five to one to six to one in favour of Hamburg and against South Italy between 1970 and 1975.