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## Division of responsibilities

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## Division of Responsibilities

In spite of two world wars, the deep crisis of the 30s and some other economic setbacks, this century has brought an unprecedented improvement in welfare of the broad population in the free world. In the 1970s, however, the economic outlook for the rest of this century has seemingly become much less promising. Rates of inflation and rates of unemployment have become distinctly higher than they used to be, and this was accompanied by a slowdown of economic growth.

Without underestimating the challenge which such events as the quadrupling of oil prices posed for the structural adaptability of the advanced market economies, they do not sufficiently explain the poor performance with regard to real growth, employment, and price-level stability. Nor could they justify the pessimistic expectations for the decades to come.

To give an explanation one has to recognize the strong presumption developed after World War II that government economic policy is capable of managing almost any situation, and by skilfully handling its instruments producing desirable results with regard to the main economic objectives. This belief, fostered by economic wizardry, has easily found widespread consent among all socially relevant groups, because it seemed to suit everybody.

As a result, the world experienced in the 1970s "a significantly greater degree of government direct involvement than ever before in individual markets and in the decisions of enterprises and groups. The last decade has been a period of unparalleled expansion in the scope and detail of government penetration into private decisions", as John T. Dunlop had put it at last year's Conference of the International Chamber of Commerce in Orlando.

But many of the measures undertaken and the likelihood of more to come have increased the uncertainty as to the chances of future private investment. Diminishing confidence in economic policy in general and lack of control of inflation in particular with resulting hectic developments in the foreign exchange markets and other events on the international scene have led in the same direction. In many countries cost pressure from aggressive wage policies have eroded profits and lowered the prospects of future profitability. Repeated attempts to get the economies going again by additional government spending programs and by cutting taxes have either failed or have shown little and only temporary success. This disappointing experience has greatly contributed to the widespread pessimism.

In this situation we should remind ourselves of the basic economic principles of a free market economy and should try to achieve widespread social consensus that there is a strong case for a clear-cut division of responsibilities, that is how the responsibilities for different policy objectives should be divided among the groups. One prerequisite for this is to disabuse all groups concerned of the misconceptions regarding the relationships between price inflation, unemployment and real growth.

First of all, experience, particularly of the 1970s, has shown that there is no trade-off between inflation and employment in the long run. Even if in the short run an unexpected and, therefore, unanticipated increase in the rate of inflation does lead to a decrease of unemployment, employment will fall back to its former level as soon as the reduction of real wages has been realized by organized labour.

A certain rise in the price level can be helpful in reaching higher employment only, as Keynes pointed out, if employees are willing to accept the implied reduction of real wages imposed upon them.

Employment is, at least to a substantial extent, a function of the level of real wages. With free collective bargaining, unemployment is, therefore, dependent on the course of action taken by the unions. Government cannot assume responsibility for full employment unless it is willing to resort to wage and price controls, subsidies, trade restrictions and other measures with detrimental effects on the allocation of resources and growth. On these grounds it should be possible to achieve consensus that government is not to be held responsible for unemployment. This is not to say that government could not do anything with respect to employment. It should remove the obstacles to structural change, improve the conditions for structural change by taking measures to enhance mobility of employees between locations as well as between jobs requiring different skills, and reduce uncertainty as to future tax loads, other impositions and, not the least, the future rate of inflation. But this could not relieve the unions of their responsibility for unemployment, which remains dependent on the relative level of real wages, whatever governments do to improve the general conditions for employment.

Inflation is, at least in the medium run, a function of money supply. With flexible exchange rates, in principle, money supply can be controlled by the national monetary authorities. Since accelerating inflation does not generally reduce unemployment, there is no good reason for letting it happen. Consequently, monetary authorities alone should be held responsible for the desirable degree of price-level stability.

By analogous reasoning, supported by similar empirical evidence, it can be shown that there is no trade-off between inflation and growth of productive capacities, at least not in the longer run, and that for extended periods of time accelerating inflation is likely to be accompanied by a slowing down of growth. This strengthens the case against inflation.

There is no clearcut relation between employment and growth of productive capacities. In principle, full employment is compatible with quite different rates of growth and a particular rate of growth is compatible with quite different rates of unemployment. The rate of growth simply results from the economic process. It depends on the numerous decisions of individuals on how they want to divide the spending of their incomes between the present and the future, on the one hand, and on technical progress, on the other, which is partly autonomous and partly dependent on the risk-taking behaviour of entrepreneurs and on the incentives built into the legal and social framework to invent, to innovate, and to invest. This is not to say that the rate of growth would not be influenced by group decisions in several ways. Particularly, changes in the legal and social framework by passing laws and by introducing administrative regulations for all sorts of reasons have — often unintended — sometimes stimulating but often adverse effects on economic growth. It is most important that legislatures become better aware of this in order to avoid contradictory decisions. Legislators, and that means society itself, are responsible for a better or worse climate for economic growth.

In the present situation almost any effort to improve the conditions for investment and growth would be most helpful. But in many a country real wages have been pushed to a level which is not compatible with full employment and efficient production at the same time. Therefore, the unions' part would be played best if they, for a while, did not insist on real wage increases as high as the increase of productivity. What is to be feared, however, is a tacit agreement of government, unions, and employers to accept wage demands which correspond to the rise of productivity and to let the government try to restore a high level of employment by continuously buying a greater share of total output. In this case, private enterprises might well invest to supply the capacities and create the jobs necessary to meet the additional demand. But the price to be paid by society would consist in accepting a greater share of public goods which are produced at social costs much higher than people would be willing to pay if they were allowed to spend their income according to their preferences. This would be an inferior solution if it is one at all, and could, in the end, ruin our economic system to which we owe our present wealth.

*Armin Gutowski*