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Toward A National Policy On Inflation

by

D. I. Padberg

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TOWARD A NATIONAL POLICY ON INFLATION

By
D. I. Padberg

Economics professionals attracted to the matters of inflation and inflation policy usually represent the "Monetary economist" ghetto of the profession. As such, their sensitivities are particularly developed in macro economics in general, the interactions between monetary policy and economic behaviour, as well as the various skills and arts german to quantitative analysis of such systems of variables. The work of these specialists proceeds quite independently from the work of economists in other ghettos of the profession. Flowing from this work is a series of hypotheses and empirical results.

I am probably among the least qualified to offer any appraisal of these results. It is not my purpose to offer any appraisal of the current direction or nature of inflation oriented economic analysis. What I propose to do is identify the direction and nature of hypotheses one might develop looking at inflation from a different point of view. If one started with the skills from the "marketing economist" ghetto of the profession, what kinds of questions and hypotheses would come to mind?

Since communication between the ghettos is near zero, it may be useful to mention the nature of the skills of the marketing economist. Consumer behavior must be high on the list of subject matter priorities of the marketing economist. In western economies, the sharp rise in income since World War II and rapid changes in the organisation of society (autos, hypermarkets, women working etc.) have precipitated marked changes in consumer goals and behavior. A marketing economist must be prepared to work with large international firms. The high cost of T.V. advertising and the high risk of product innovation and introduction (among other influences) have led to remarkable changes in firm structure and behavior. These changes affect the firm's sensitivity to "market forces".

Consumers and the very large firms manufacturing and distributing consumer goods are only two groups or types of actors on the economic stage. The government, service institutions (hospitals, schools etc.), professions (solicitors, psychiatrists, etc.), auto and gadget repair men and many other types of economic initiative or activity are increasingly a part of the affluent economy. But, the consumer and consumer goods industries must represent a very important component of economic behavior. If the fine tuning of monetary variables is to lead to desired macro economic results, it must be largely through its influence on consumers and consumer goods industries.

My objective in this paper is to set out some general hypotheses or assumptions relating to inflation and social or national goals for inflation policy. Against this background, some observations concerning trends in behavior patterns, goals and structure within the consumer goods industries and consumer behavior will be presented. Implications for an enlightened inflation policy will then be considered. Longer run or strategic policy alternatives will not be excluded.

A Broad View of Inflation Policy.

Economic reality of the postwar period has centered on change. Changed economic structures, changed co-efficients of technical or physical transformations and even changes in motives. Of course, this is an exciting time for the economist - it makes him an analyst rather than an historian. On the other hand, it makes many traditional tools obsolete. In the postwar period, dynamic influences have come to represent the dominant influence in firm and household behavior and have replaced the equilibrating "competitive market" forces in this regard.

The flowering of mass production and mass distribution, the emergence of large middle classes, the explosion of higher education have unravelled the meaning of economic equilibrium. Goals for policy must accept this reality and must be framed in dynamic terms. In this context, "the inflation problem" is one of worker productivity rising more slowly than worker aspiration expressed in wage claims. One approach to studying this matter is to see these variables in a system of interconnections - linked together by some market mechanism - which has a tendency to find equilibrium conditions. There are two problems with this approach:-

- 1) we measure past behaviour which is often a poor guide to future behavior.
- 2) there is a tendency for the primary economic actors (firms and households) to behave more spontaneously and autonomously and insulate themselves from the interconnecting links

Another approach to this matter could be to address the key variables directly. What might be done to "manage" the rate of escalation of worker aspiration as expressed in wage claims? What might be done to hasten the rate of increase in worker productivity? One might address policy directly at price levels. So doing, however, requires dealing in an immediate fiction if price goals are inconsistent with wages and productivity.

Policy objectives may not be the keeping of wage claims and worker productivity exactly in step. There seems to be advantages in some non-zero level of price inflation. We may assume here then an "optimum" relationship would have wages increasing two percent faster than productivity resulting in consumer price index rising two points a year. Some people think that a

positive rate of inflation encourages investment. In addition, the two percent annual rise in prices is not discernable to consumers and, when added to productivity gains may make wage increases large enough to be observed by laymen.

In this view, with price increases of about eight percent annually, policy to increase growth in productivity and/or reduce the rate of increase of wage claims is in order. Most of the weight of this discussion will concern the productivity side of the matter. Primary reasons are:

- 1) there is the potential of rapid productivity gains (it is claimed that worker productivity in Japan increased 12% annually for the 1967-71 period.)
- 2) the presence of rising living standards in other countries leaves little hope for suppressing worker aspiration locally. Workers tend to take the viewpoint that rising income is the natural right accruing to 20th century life. I cannot disagree. The goal of policy, then, is to harness 20th century technology so that it yields rising worker productivity and rising real income.

Worker Productivity

Probably the best way to give systematic consideration to the genesis of changes in productivity is through the study of the "Galbraithian Firm". While this approach certainly does not exhaust the subject (publically planned economies will have a different structure but probably similar functions), it is useful. The effort here is to identify the kind of agency most instrumental in the genesis of increases in productivity, then study its behaviour - what motivates it and what external conditions stimulate which actions.

The Galbraithian Firm has two major and distinct components of activity and organisation. These may be represented schematically as in Figure I.

Part A.	Part B
1. Consumer attitude Research.	
2. New Product Research.	Repetitive
3. Advertising & Promotion.	production
4. Supervision of distribution.	operation
5. Production methods Research.	
6. Financial planning.	

Figure 1 - The Galbraithian Firm

This firm is engaged in the manufacture and distribution of consumer goods although its structure may be analagous to many other types of firms. Part B is simply the Marshallian Firm. It flourishes alone under the direction of the "market" where the state of the arts moves slowly. This isn't to imply that the Marshallian Firm is immune to technical change. The Marshallian Firm sees technical change as an external influence. It adjusts to a change in the arts according to the dictates of its principal co-ordinating mechanism - the market.

The Galbraithian Firm has internalized technical change. In fact, the care and feeding of technical change is its central focus of behavior. Its organisation and incentives are accordingly arranged. The primary manifestation of this arrangement is in the organisation and function of Part A, but Part B is made subservient to Part A in this firm. For example, most food manufacturers specialising in product innovation will not pack under retailers labels despite a clear "market" incentive. It is disadvantageous because it hampers their availability for responding to the highly unpredictable production requirements of new and innovative products.

When the Galbraithian Firm takes on extra-market activities such as product innovation, its incentives and structure must depart dramatically from those of the Marshallian Firm. The departure is the greater as the level of technical complexity increases. A successful product innovation may rest on years of investment in Part A activities I through 5. How are those activities to be financed? Since these activities are experimental in nature, their failure rate must be high. This means that a totally new procedure for financial planning must emerge. It also means that returns above costs on successful products must be the order of the day rather than an aberation from the norm. In addition, A type activities are more spreadable over many different products and types of products than B type activities. This leads to conglomerate firm growth and multi-national firm organisation. This large size gives the Galbraithian Firm the market power it must have to support A type overheads and spreads its risk.

Worker productivity increases emerge from two sources. It can be obtained by substituting capital for labour in a given production function or by finding a new production function which is more efficient as regards the labour input. Often these two influences are inextricably mixed. The new production function is often more capital intensive. Although worker productivity improved steadily under the auspices of the Marshallian Firm for centuries, such an organisation is much less likely to be associated with either capital intensification or new production function today. The first airplane was developed and flown by bicycle mechanics, but such talent would be of little value on the Corcorde project. There is no reason to expect the market co-ordinated Marshallian Firm to endow workers with steadily increasing capital because the market returns to the capital owner are only sufficient to replace equipment.

The Galbraithian Firm is usually seen more as an influence on product innovation than as the discoverer of new production functions. While this is a valid observation, new products often provide the stimulus for increased

worker productivity. In the construction industry, for example, today's worker is equipped with better tools and materials, such as precast concrete, which make his productivity much greater. New products and new production methods are often mixed in the same event. The change to a new product also may afford a discontinuity in the production process which becomes a natural opportunity to upgrade production technology.

While the Galbraithian Firm concept will describe only a relatively small number of total firms in any free enterprise economy, it is the part of the structure most important in achieving increases in worker productivity. The Marshallian Firm waits for the market to tell it of a change in the arts. The Galbraithian Firm insulates itself from the market so that it can explore and exploit technical possibilities.

Consumer Behavior

Consumer economics has been an interesting topic for the past few years. "Consumerism" has come to describe a new focus of concern, study and action. Ralph Nader and other freelance activists have been instrumental in this field. Consumer advocates have been established and dis-established in important governments. Since consumer behavior is at least interdisciplinary in nature, it is very difficult to capsulize what is happening, yet something is happening and it needs to be understood.

If we look at changes in the condition in which consumers find themselves, we may find some explanation of the current consumer mood and behavior. Consumer real income has about doubled in most developed economies in the space of a generation. Higher education enrollments (in degree granting institutions) rose in the U.S. from 15 percent to almost 50 percent of college age youth between 1940 and 1970. The participation of women in the labour force has increased rapidly. Today one half of British women are employed compared to about one third in 1950. The automobile has vastly increased the mobility of the modern consumer. Mass distributors have rationalized distribution functions leading to more standardized products and services and lessened the incentive for comparison shopping. Interests of women (the primary consumer) in matters beyond the household, such as humanitarian, creative, leisure, employment etc., activities have lessened the time for comparison shopping.

This modern richer and more outgoing consumer is quite different from her mother as concerns her performance as a consumer in the market. Performing the traditional role of consumer in a market is not an insignificant task. It requires knowledge, analysis and often a good bit of walking. All of these things take time. A generation ago the housewife saw her performance in these dimensions as rather central to her value to the household and to society in general. Today they are mere maintenance activities to be performed as efficiently as possible to leave her time for more creative, rewarding and fulfilling activities. One cannot say that the modern consumer is irrational. When her objectives and means change markedly, it is not

surprising that her rational behavior may also undergo some changes.

The general result of this change is that she becomes less sensitive to the market and more dependent on the Galbraithian Firm. She is more sensitive to time saving gadgets and alternatives than to "economy in the money dimension". Of course, science offers a horn of plenty in this regard. Convenience foods and household gadgets are examples. Her outgoing lifestyle makes her more style conscious. In both respects she is dependent on the Galbraithian Firm. Her preferred role as a consumer is better described as spontaneous, creative and style conscious than frugal and economy oriented. Often our public policies concerning consumer protection do not take these changes into account. The current interest in consumerism may bring them up to date.

Economic Behavior and Inflation Policy

Observations concerning the emerging behaviour patterns of consumers and firms leads to some skepticism about the extent of influence of monetary policy in affecting their activities. This is particularly true as far as worker productivity is concerned. The type of firm most instrumental in increasing worker productivity generates most of its capital internally. It must take policies to protect itself from unpredictable disturbance in the form of financial availability. Its long term plans can't be disrupted by the caprice of some economist in Washington or some other national capital. The notion that its behaviour is a function of the money markets is credible only among a minority of economists. Monetary policy has a much greater influence on the Marshallian Firm, of which there are many. This may affect many things but will have little to do with worker productivity.

Merely noting that both consumers and the larger firms are tending toward a behaviour pattern less sensitive to the market is not very helpful in establishing a national inflation policy. Much more useful would be the identification of policy variables through which behavior could be altered or influenced. This is inherently difficult because both units (consumers and firms) are becoming more autonomous and spontaneous. That is not to say they are independent. Consumer behaviour is increasingly dependent upon the Galbraithian Firm. The dependencies of the large firm form a basis for policy, although these dependencies are more long run or strategic in nature.

If we look at the new functions which separate the Galbraithian Firm from the Marshallian Firm (Figure 1), we find a list of activities requiring large numbers of scientists in several disciplines. This need places a heavy requirement upon the educational resources of the economy. These capabilities require higher education of a scope and type not at all anticipated by the British University system. British Universities produce excellent government officials and academics, but they give the business community very little. The "Polys" are geared to create technicians for the Marshallian Firm. The needs of the Galbraithian Firm are for educated workers not just educated leaders and the nature of education needed is more

inter-disciplinary than conceived by either the Universities or polys. Since the universities are bursting at the seams and yet only accommodate something like ten percent of the student age population, it seems unlikely that they can meet the needs of mass-education. More importantly, teaching methods currently associated with universities are not adaptable to the numbers which must move through a mass-education system. Nor does there seem to be any desire or capability to adapt the universities to meet mass-education needs. Such policy would probably be ill advised because the present role performed by universities is essential - particularly their work at the postgraduate level.

It seems to me that some policy to evolve a set of multi-discipline institutions of higher education could make a vital contribution to the business sector. Without it, the ability of the firm to successfully internalize the process of technical change will be hampered. Consequently, worker productivity will lag well behind its potential rate of growth. It might also be mentioned in passing that the availability of institutions of mass higher education has a great influence on the opportunity threshold available to the individual in modern society.

Another look at the functions of the Galbraithian Firm shows the importance of consumer communication in the process of technical change. This process must have an input from the consumer (1. consumer attitude research) and it must have communication the other way (3. advertising and promotion). Debriefing the consumer is not a simple process, but it is relatively inexpensive. Samples can be used to reduce cost. No institutional arrangements or public auspices are needed in the carrying out of this function.

Communication from firm to consumer, however, is much more complicated. Consumers are many and busy. Effective communication requires powerful media. Since powerful media are very involved in the "public interest," it is most appropriate that they be under public surveillance. If, however, worker productivity assumes any position of importance in public policy goals, radio and T.V. must be made more available to the Galbraithian Firm.

This matter deserves much more attention than it gets. The American experience is one of too little public surveillance and policy in public media while the British experience is one of too little availability to the business sector. A compromise between the two would benefit both societies. It should be noted that the media do not have a neutral influence. We certainly do not know enough to present entertainment, news and an interpretation of current events independent of some ideology. Probably we don't want to anyway. By completely suppressing the commercial aspect of life (quite an important component of the common man's world), the transmitted programming is far too heavily balanced to the ideology of the "haves". This results in a protection of the status quo or traditional order. It retards the transition necessary to fit the 20th century.

If growth of worker productivity becomes more important in national policy, it may be worthwhile to consider which sectors of the economy have

the best chances to make gains. The greatest opportunity for increases seems to be associated with supplying the worker with more and better capital equipment. This type of scientific application is certainly easiest in the controlled environment of the factory or assembly line - although it is going on in the office and on the farm as well. If one wanted maximum growth of productivity, however, it might be appropriate to stimulate the factory - assembly line types of industries. Subsidies might not be appropriate, but the purchase tax ranging as high as 75 percent on this sector must have had a growth retarding effect. The effect of such policy is likely very regressive as well.

Increases in worker productivity have a side effect which must be taken into account. As the production of the present goods and services becomes more efficient, less workers are needed to create them. The higher real income of employed workers, on the other hand, establishes the potential demand for a new set of goods and services. If the economy and the society are able to make the transition, the released workers become available to move into the new industries. The ability to make such transitions is a requisite for taking advantage of worker productivity gains and translating them into a higher living standard. Here again, the educated worker and the conglomerate structure of the Galbraithian Firm are much more able to make the transition than the combination of the Marshallian Firm and the uneducated worker.

If one places concern for unemployment higher than concern for worker productivity (a quite natural and humanitarian posture), it is possible to justify a case against progress and the transition to "new industries". While this might be a viable choice in a closed economy, it is not workable in a trading economy. If a trading economy lags in the transition to "new industries" it acquires a trade problem. If a trading economy leads in the transition to new industries, this leadership has positive implications for both worker productivity and trade balance.

Since trade in the "new industries" is more pivotal on the blandishments of the Galbraithian Firm than price competition, establishing foreign markets requires heavy investment in advertising and distribution costs. Most firms successful at this game have a protected home market as a base for subsidising this expansion. A Japanese T.V. set costs less in America than in Japan. The difference widens when distribution costs are considered. The overwhelming purchase tax has denied British "new industry" firms this operating base and put them at an international competitive disadvantage. Restricted promotion opportunities and educational resources have the same effect.

Summary

Western economies are caught up in a spiral of changes in technology, market structure and consumer behavior. Devising sane policy in such

circumstances is most difficult. Many traditional positions are in need of rethinking or replacement. A rather casual view of the inflation problem as framed in the perspective of a marketing specialist leads to the following observations:

1. Equilibrating processes have been replaced by a process of creating and responding to basic changes in parameters. It therefore may be more useful to conceptualize economic activity and formulate policy goals in terms of rates of change rather than in relation to a concept of equilibrium.
2. There is a tendency among firms and consumers toward behavior patterns increasingly insensitive to the market. This is particularly true in relation to the money market. For this reason, monetary policy although necessary is increasingly insufficient as an inflation policy instrument.
3. Keeping worker productivity in some acceptable relationship with rising wage claims may be the most operational and strategic focus of the inflation problem.
4. Long term increases in worker productivity requires widespread deployment of science and transition to new consumer products. These, in turn, place a heavy requirement upon the communities educational resources and require the communication lines between business firms and consumer to remain open.

My experience suggests that it is very unusual for a non-specialist to make much of a contribution to a topic of any scientific complexity. Just as the current level of scientific application is beyond the capabilities of the Marshallian Firm, the matter of macro-economic policy is beyond the grasp of the non-specialist. The best I can possibly achieve is to present observations from a different point of view which may be of some use to the experts.