6 Conclusions for Policy

This chapter summarises the macroeconomic conclusions of the foregoing chapters, and then sets their policy implications against the context of economic policy generally.

Consideration is given to the question whether the less inflationary mixes might ever all have such adverse effects on the allocation of resources that it could even be worth tolerating temporarily high unemployment rather than employing one of the anti-inflationary mixes. Although such a situation might conceivably arise at near to full employment, it seems virtually certain that when there are high levels of macroeconomic unemployment there will be anti-inflationary mixes that will tend to reduce the rate of inflation over the period in question without any risk that they may have adverse resource allocation effects sufficient to outweigh their macroeconomic benefits. At the same time, it is possible to conceive of particular anti-inflationary mixes that might have seriously adverse resource allocation effects, and a government would naturally have to weigh these possible effects before choosing an appropriate mix.

The main arguments of this book have been as follows:

(1) The problem of stagflation, which surfaced in the later 1960s, became much worse in the later 1970s and early 1980s. The attempt to deal with the inflation by accepting high and rising levels of unemployment left the problem essentially unresolved, as governments remained reluctant to adopt policies that would restore full employment – in the expectation that to do so would increase inflation again to unacceptable rates.

(2) Part of the problem was itself the result of the combinations of taxation, government outlays and monetary policy employed from the later 1960s onwards, when there was a sharp rise in the ratios to GDP of government receipts and outlays; and from the early 1970s onwards monetary policy, as indicated by the rate of growth of monetary aggregates (relative to the growth of real output) and by real interest rates (especially after tax), also...
moved in a direction that could have been expected to increase
the upward pressure on the price level at any given level of
unemployment. Groups of countries that had especially rapid
monetary growth and large rises in their budgetary ratios tended
to have higher rates of inflation. But there is no such evidence of
any clear relationship between unemployment and relative rates
of inflation, or between budget deficits and inflation.

(3) An important part of the solution must therefore lie in choosing
more appropriate combinations of macroeconomic measures.
Indeed, provided that there is even one macroeconomic stimulus
that is less inflationary than some other there is in principle a
combination of the two that will exert a downward pressure on
the price level comparable to that which governments are presum­
ably hoping to achieve by their current policies of temporarily
high unemployment. It is therefore not justifiable to tolerate the
high unemployment if a change of the mix – coupled with
appropriately more expansionary policies – can reduce the rise in
the price level without having to accept the high unemployment.

(4) A change in the mix towards a lower ratio to GDP of govern­
ment receipts and of the more inflationary forms of government
outlay, coupled with a reasonably tight monetary policy, needs
to be coupled with a sufficiently expansionary overall policy to
restore full employment. The greater the extent to which higher
levels of activity are thought likely to increase inflation, the
greater the change of mix (in an appropriate direction) that
would need to accompany the recovery.

(5) In certain respects, however, the high levels of unemployment
(and the associated below-capacity operation of firms) may have
been tending to increase the upward pressure on the price level;
and, to that extent, recovery could be accompanied by a reduc­
tion in unit costs (which would tend to have some downward
impact on prices). At the level of the firm, operating below
capacity raises unit costs, and to that extent the incentive for
manufacturers to charge higher prices. Moreover, the financing
of the government sector at a time when the economy is operat­
ing well below capacity necessitates governments raising their
charges and tax rates (per unit of service provided, and per unit
of output produced in the economy), in order to finance the
overhead costs of government, including those government out­
lays (such as defence and most of the public service) that do not
vary much, if at all, with the level of economic activity.