Raising the Warranted Rate of Growth

The Redistribution Effects of Inflation on Saving

It was seen in Chapter 2 that there are two broad approaches to the question of the way inflation may promote growth. One is the Keynesian approach which stresses income redistribution between wages and profits. The other is the Quantity Theory approach in which inflation redistributes income from the holders of money balances to the monetary authorities. In the first case what is involved is redistribution within the private sector, and in the second case redistribution between the private and the public sector. The two processes are not mutually exclusive, of course. Demand inflation is likely to involve both forms of redistribution. Rising prices which originate from the desire of government to transfer real resources to itself will also tend to redistribute income within the private sector between wage-earners and profit-earners, creditors and debtors. Similarly, a profit inflation emanating from excess demand in the private sector will involve a tax on money which may or may not redistribute resources to the government sector depending on how the holders of money balances react to the tax.

The way in which a tax on money releases resources for investment is a complex process. On the one hand real purchasing is reduced. Other things remaining the same, saving must increase. This is one interpretation of the term forced saving. The inability to consume as much as before is reinforced by the fact that inflation reduces the real value of money balances. If the public wishes to restore the real value of its money holdings to its previous level, its holding of money must rise. Hence consumption out of real income must fall and saving increase. If the public seeks to avoid the tax on money, however, it will reduce its holdings of real balances which may or may not reduce
saving out of real income depending on which assets are purchased as substitutes for money. If consumption goods are purchased, real saving will fall. At the same time, because the real value of saving is decreasing, the public may decide voluntarily to save less out of current income which could partially or fully offset the positive redistribution effects of inflation on saving.

In the private sector, whether there is redistribution between wages and profits depends exclusively on whether the rate of growth of real wages matches the rate of growth of productivity. If it does not there will be a redistribution of real income in favour of profits because some of the gains of labour productivity will be appropriated by the profit-earners. Given the rate of productivity growth, how much the saving ratio will rise for any given rate of inflation will depend on the precise relationship between the rate of change of wages and prices; by how much the propensity to save out of profits exceeds that out of wages, and on labour's initial share of income. As we have seen in Chapter 2, the relationship between the rate of change of wages and prices depends on two factors: the rate of autonomous wage increases and the wage-price coefficient. It is often asserted that redistribution within the private sector can only generate extra saving in the short run because inflation will ultimately become anticipated by workers who will bargain for wage increases in advance of price increases to ensure a growth of real wages at least equal to the rise in labour productivity. The value of the wage-price coefficient is ultimately an empirical question. Some evidence will be given later. It does seem from case studies in developed countries, however, that people's price expectations cannot be inferred from data on past price movements.¹ People disagree on their perceptions of past price changes. And what is more relevant, people do not necessarily project the recent past into the future. These findings of survey research on consumer reactions to inflation are consistent with the results of econometric research which show that the wage-price coefficient is typically less than unity in both the short and the long run. But as we have seen in Chapter 2, even a wage-price coefficient in excess of unity is not sufficient to guarantee that labour's share will not fall as a result of inflation.

How much aggregate saving increases as a result of inflation will depend on the combined extent of the redistribution effects in the two