CHAPTER TWENTY

Unions, Inflation and Profits[*]

Tendencies are observable in the field of labour economics which most seriously threaten our future prosperity. The developments which are bringing this about are not of recent date. They extend at least over the last twenty-five years. But for most of that time, and particularly during the long period of great prosperity through which we have recently passed, it may have seemed as if the United States could take in its stride even those new hurdles which only a few alarmists regarded as serious. But there are strong reasons for thinking that things will soon be coming to a head. It may be that already those new demands of labour which I want later to examine in some detail will prove to be the critical point. Or Walter Reuther may decide that this is not a favourable moment for a decisive test of strength and the fatal struggle will be deferred a little further. Whichever it will be, I have little doubt that we shall soon have to face fundamental issues which we have managed to avoid for so long and which have not become easier to solve because the practices and institutions which raise them have been allowed to continue for such a long time.

Before turning to the more specific problems which the new union demands raise, I must explain how I see the more general problem of policy which the powers of modern labour unions create, and describe the character of the particular phase of business fluctuations in which it seems those problems will now have to be decided.

The first of these tasks divides itself into two distinct yet closely connected ones: the character which labour organizations have gradually assumed, and the new powers they have obtained, not as a result of any-

* Reprinted from *The Public Stake in Union Power*, edited by Philip D. Bradley, New York, 1959.

thing *they* can do, but as a result of the new conceptions of the tasks of credit and fiscal policy. With regard to the first, though it contains the crux of the union problem, I can be very brief. The essential facts are here so well known that I need merely mention the chief points. Unions have not achieved their present magnitude and power by merely achieving the right of association. They have become what they are largely in consequence of the grant, by legislation and jurisdiction, of unique privileges which no other associations or individuals enjoy. They are the one institution where government has signally failed in its first task, that of preventing coercion of men by other men—and by coercion I do not mean primarily the coercion of employers but the coercion of workers by their fellow workers. It is only because of the coercive powers unions have been allowed to exercise over those willing to work at terms not approved by the union, that the latter has become able to exercise harmful coercion of the employer. All this has become possible because in the field of labour relations it has come to be accepted belief that the ends justify the means, and that, because of the public approval of the aims of union effort, they ought to be exempted from the ordinary rules of law. The whole modern development of unionism has been made possible mainly by the fact that public policy was guided by the belief that it was in the public interest that labour should be as comprehensively and completely organized as possible, and that in the pursuit of this aim the unions should be as little restricted as possible. This is certainly not in the public interest. But all this has been so admirably treated by Professor Sylvester Petro of New York University in his recent book *The Labor Policy of the Free Society*[1] that I need merely refer to that work.

I must take a little longer in discussing the particular circumstances which have made the power of unions over wages so especially dangerous in the present world. It is often said that successful general union pressure for higher wages necessarily produces inflation. This is not correct as a general proposition. It is, however, only too true under the particular conditions under which we now live. Since it has become the generally accepted doctrine that it is the duty of the monetary authorities to provide enough credit to secure full employment, whatever the wage level, and this duty has in fact been imposed upon the monetary authorities by statute, the power of the unions to push up money wages cannot but lead to continuous, progressive inflation. It is the blessing that J. M. Keynes has showered on us which we enjoy in this respect.

We are not concerned here with the niceties of his theory. What we are

[1] New York, 1957.

concerned with is the factual assumption on which his whole argument rests: that it is easier to cheat workers out of a gain in real wages by a reduction in the value of money than to reduce money wages; and his contention that this method ought to be employed every time real wages have become too high to allow of 'full employment'. Where Lord Keynes went wrong was in the naïve belief that workers would let themselves be deceived by this for any length of time, and that the lowering of the purchasing power of wages would not at once produce new demands for higher wages—demands which would be even more irresistible when it was recognized that they would not be allowed to have any effect on employment.

What we have achieved is a division of responsibilities under which one group can enforce a wage level without regard to the effects on employment, and another agency is responsible for providing whatever amount of money is needed to secure full employment at that wage level. So long as this is the accepted principle, it is true that the monetary authorities have no choice but to pursue a policy resulting in continuous inflation, however little they may like it. But the fact that in the existing state of opinion they cannot do anything else does not alter the fact that, as always, it is monetary policy and nothing else which is the cause of inflation.

We have behind us the first long period of such cost-push inflation, as it has come to be called. It has been one of the longest periods of high prosperity on record. But, though the upward trend of wages has not yet stopped, the forces which have been making for prosperity have been flagging for some time. We have probably reached the point when we must reap the inevitable harvest of a period of inflation. Nobody can be certain about this. It may well be that another massive dose of inflation may once more get us rapidly out of the recession. But that, in my opinion, would merely postpone the evil day—and make the ultimate result much worse. Inflation-born prosperity has never been and never will be lasting prosperity. It depends on factors which are nourished, not simply by inflation, but by an increase in the rate of inflation. And though we may have permanent inflation, we clearly cannot for very long have inflation at a progressive rate.

Such inflation-fed prosperity neither comes to an end because final demand becomes insufficient to take the whole product off the market, nor can be perpetuated by simply keeping final demand at a sufficiently high level. The decline always begins, and did begin this time, in the field of investment, and it is only as a consequence of the decline of incomes in the investment goods industries that final demand is later

affected. It is true that this secondary shrinkage in final demand may become cumulative and tend to become the controlling factor; it may then turn what would otherwise be merely a period of recession and readjustment into a major depression. There is, therefore, every reason to counteract these tendencies and to prevent them from setting up a deflationary spiral. But this does not mean that by merely maintaining final demand at a sufficiently high level we can secure continued full employment and avoid the readjustment and incidental unemployment made necessary by the transition from inflationary to stable monetary conditions. The reason for this is that investment is not, as is often naïvely believed, coupled in any simple manner with final demand; a given volume of final demand does not always evoke a proportional, or perhaps even more than proportional, change in investment in the same direction. There are other factors operating within the whole price-cost structure which determine what rate of investment will be evoked by a given level of demand. It is a change in these factors which brings about the primary decline in investment and incomes which then produces a decline of final demand.

I cannot here examine this highly complex and very controversial mechanism in detail. I will confine myself to two considerations which seem to me to prove that the predominant 'lack of buying power' theory of depression is just wrong. One is the empirical fact that not only have declines of investment often started when final demand and prices are rising rapidly, but also that attempts to revive investment by stimulating final demand have almost invariably failed. The great depression of the 'thirties was indeed the first occasion when, under the influence of such 'purchasing power theories', deliberate efforts were made from the very beginning to maintain wages and purchasing power; and we managed to turn it into the longest and most severe depression on record. The second point is that the whole argument on which the purchasing power view rests suffers from an inherent contradiction. It proceeds as if, even under conditions of full or nearly full employment, an increase in the demand for final products would lead to a switching of resources from producing final goods to producing investment goods. Indeed, it suggests that if at any one time the demand for consumers' goods should become very urgent, the immediate effect would be that fewer consumers' goods and more investment goods would be produced. I suppose it means that in the extreme case, because people want more consumers' goods very urgently, no consumers' goods and only investment goods would be produced. Clearly there must be a mechanism which will bring it about that the opposite happens. But unless we understand that mechanism, we cannot be sure that it may not also operate under conditions of less than full employment. We evidently cannot accept the current popular view on these matters, which not only offers no answer to that crucial problem, but which, if consistently pursued, leads into absurdities.

I now come to my main subject. The reason why I have spent so much time in diagnosing the economic situation in which the new demands of labour are presented is partly that they are presented both as non-inflationary and as a safeguard against (or a remedy for) depression, but mainly because in the present situation the greatest pressure will be brought on the employers to avoid a labour dispute, which at this juncture may have very serious consequences. But the decisions which the corporations facing the new demands will have to make are decisions of principle which may have tremendous long-term effects, indeed, may do much to shape the future of our society. They should be made entirely in consideration of their long-run significance and not be affected by the desire to get out of our momentary difficulties. But with the power the unions have acquired, the capacity of the corporations to resist any harmful demands depends on what support they get from public opinion. It is therefore of the greatest importance that we clearly understand what these demands really imply, what their satisfaction and the general acceptance of the principle underlying them would mean for the future character of our economy.

As will be remembered, Mr. Reuther has presented the demands of the United Automobile Workers for 1958 as a 'two-package' programme, consisting of a set of 'minimum basic demands which will be common for all employers' and of supplementary demands 'in addition to the minimum for those corporations or companies in a more favoured economic position'—or, in other words, one set of demands applying to the automobile industry generally, and further demands directed to the Big Three. The first package constitutes in general only 'more of the same as before'—although we have been told that it will be the biggest wage increase demanded in the history of the automobile industry—and I shall consider it only briefly as an illustration of what I have already said about the inflationary character of these demands and especially about their significance in the present phase of business conditions. It is the second package which raises the interesting new problems and, I believe, constitutes a real threat to the future of our economy.

Of the first part of the demands, I want to examine only the claims that wage increases proportional to the increase in average output per head of the employed are non-inflationary, and that 'increasing mass purchasing

power' through wage increases is an effective means of combating depression. They are easy to dispose of. Changes in output per head are, of course, not the same as changes in the productivity of labour. To see this clearly we need merely consider an extreme but by no means impracticable case, such as the replacement of present power stations by highly automatized atomic energy stations. Once one of these modern stations is erected, a handful of men would appear to be the sole producers of a colossal amount of electric energy and their output per head may have increased hundreds of times. But that does not mean that the productivity of labour in that industry has significantly increased in any sense relevant to our problem, or that in that industry the marginal product of a given number of workers has increased at all. The increase in average productivity of labour in the industry is the result of the investment made and in no way reflects the value which a man's work contributes to its product. To raise wages in proportion to the increase in average productivity in that industry would raise them to many times their marginal product in other industries of the economy. Unless we assume that the particular men employed in that industry acquire a vested right in a share of the product of that investment and are entitled to earn much more than exactly similar labour earns elsewhere, it will mean a general rise in money wages far in excess of what can be paid without a general rise in money incomes, that is, without inflation.

This does not mean, of course, that labour may not succeed in pushing up money wages to that level, but it means that this would be highly inflationary and could not mean a significant increase of the real wages for the workers of this kind as a whole. Since the illustration just given throws much light on one of the crucial aspects of the power of modern labour monopoly, I will dwell on it just a little longer. Where very large and very durable investments have once been made, it is today the owner of these investments who is almost completely at the mercy of an effective monopoly of the supply of labour. Once such plants have been created, and so long as they can be kept going without substantial renewal or re-investment, labour is in a position to appropriate almost any share of the returns due to the investment of the capital. The demand for a definite share in the increase in the average productivity of labour due to the investment of capital amounts, in fact, to nothing less than an attempt to expropriate that capital. There is no reason why a really powerful union monopoly should not succeed in this to a large extent so far as investments irrevocably committed to a particular purpose are concerned.

This, however, is only a relatively short-run effect and the advantages that labour as a whole can derive from such policies look very different when we consider what effects such policies must have on the attractiveness of new investment once they come to be anticipated. Personally, I am convinced that this power of union monopolies is, together with contemporary methods of taxation, the chief deterrent to private investment in productive equipment which we have allowed to grow up. We must not be surprised that private investment dries up as soon as uncertainty about the future increases after we have created a situation in which most of the gain of a large, risky and successful investment goes to the unions and the government, while any loss has to be borne by the investor. Man is so made that in times of great prosperity he still tends to forget about these deterrents. But we must not be surprised that as soon as prospects darken a little, these reasonable fears revive in full strength and we face another apparent 'exhaustion of investment opportunities' which is entirely the result of our own follies.

This brings me to the second aspect of the general demands of the U.A.W.: their significance at a time of threatening depression. It is contended that an increase of wages at this juncture will result in an overall increase in purchasing power and thereby reverse the tendency towards a shrinkage of incomes. I do not wish to deny that, at a time when there is danger that we may be entering a deflationary spiral, it is desirable that aggregate spending power should be prevented from falling further. What I question is that raising wages is a sensible or effective method of achieving this. What we need in the first instance is not that some people should earn more, but that more people should earn an income, and particularly that employment should revive in the capital goods industries. There is every likelihood that in the present phase of business an increase of wages will lead immediately to a decrease of employment in the industries concerned—even if it is not achieved through a labour dispute and work stoppage which, at present, would react even more rapidly on employment. And it seems certain to have even more harmful indirect effects on employment in the investment industries. I believe that under conditions of more or less full employment an increase of real wages of the final producers may act as an incentive to investment—crudely speaking because it induces the producer to substitute machinery for labour. But this is certainly *not* true in a situation where a large part of the capacity of the existing equipment is unused. In such a situation, investment does depend solely on how much of the final product can be sold at a profit, and that prospect can only be worsened by raising money costs first.

I must not enlarge any further, however, on the first part of Mr.

Reuther's 'packages' since, after all, they do not raise any problems with which we have not been long familiar. Even if some of the considerations I have mentioned cannot be stated often enough, or emphasized strongly enough, there is nothing new in them.

The interesting part of the proposals is the second 'package', the special discriminatory terms for the more successful enterprises in the automobile industry. It is not quite easy to say what their aim is or what Mr. Reuther expects to achieve by them. But it is well worth while to ask what the consequences would be if they were successful.

It will doubtless be remembered that before the U.A.W. put forward this demand they had asked that the Big Three reduce the price of their cars by $100.00 and promised that if this were done, the U.A.W. would take this into account in formulating their new demands. The fact that this suggestion has not been acted upon is now advanced as a justification for the new demands. I do not believe that that demand for price reduction ought to be taken very seriously, and it is probably more correctly seen as a public relations job—intended to prepare public opinion for the demands subsequently to be put forward. The union had, in fact, used exactly the same tactics twelve years earlier. But it will help to understand the present issue if we examine for a moment the significance of that demand.

For the purposes of the argument, let us assume that General Motors and perhaps also the two other big automobile manufacturers could, in fact, profitably sell their cars at the reduced price, and that perhaps over a limited period this would even turn out to their advantage. There seems very little question but that this would rapidly mean the end of the remaining independent producers and leave the Big Three alone in the field. If that is so, the first question on which we must form an opinion is why they do not go ahead and reduce their prices. One obvious answer is, of course, that such action would probably bring them soon into conflict with the anti-trust authorities. We have reached the ridiculous position where an attempt to act competitively will lay a particularly efficient organization open to the charge of aiming at monopoly. I do not know what advantages Mr. Reuther imagines his workers would reap from this result, if he really wanted it. I merely mention this to point out that it would almost certainly bring about results which are contrary to one of the accepted objects of public policy.

In fact, it seems very doubtful whether the Big Three regard it as really in their interest that the independent producers should be eliminated. If any one of them did think it desirable, he could quickly force the others into a course of action which would have that result. But it seems to me much more likely that a concern like General Motors, which takes such pains to preserve active competition between its divisions, would for the same reasons regard it in its long-run interest to preserve the independent experimentation of the smaller producers. After all, the men inside the big corporations probably understand better than many outside observers that the exceptional efficiency of a particular organization is not the necessary result of size, but rather that size is the result of the exceptional efficiency of a particular organization. They doubtless know also that such exceptional efficiency does not only not follow automatically from size, or from any device or design which can be established once and for all, but only from a constant and ever-renewed effort to do better than can be done by any other known method. I feel very strongly that in this sphere the simplified schemes which the economic theorist legitimately uses as a first approach, which treat costs as a function of size and approach the problem in terms of economics of scale, have become an obstacle to a realistic understanding of the important factors. Many of the individual and unique features of a particular corporation which make for its success are of the same character as the similar features of an individual person; they exist largely as an intangible tradition of an approach to problems, based on a tradition which is handed on but ever changing, and which, though it may secure superiority for long periods, may be challenged at any time by a new and even more effective corporate personality. I must say that if I were responsible for the fate of one of these corporations, I would not only feel that I was acting in the best interest of the corporation if I sacrificed the temporary gain from the control of an even larger share of the market in order to preserve the stimulus which has kept the organization on tiptoe so long; I should also feel that, in my efforts to prolong this leadership as long as possible, and use for this purpose part of the differential profits which this greater efficiency allowed my corporation to earn, I was acting in the interest of the community at large. An advantage of an individual or a corporation which cannot be duplicated remains an advantage to society even though nobody else has it; it ought to be made full use of, so long as nobody else is prevented from bettering the result by different and even greater advantages. To think of such positions in terms which are appropriate to monopolies based on obstacles to entry into an industry leads to an altogether distorted approach to the problems of policy.

It will be useful to remember this when we now turn to the specific demand of the automobile workers directed only to the three dominant corporations. I am not a little puzzled to understand what Mr. Reuther

really expects to achieve by them, and from what parts of them he expects to derive any real benefit for the employees, and what part has been put in rather for its optical effect, that is, to gain the support of public opinion. The result of the acceptance of these demands would depend on certain decisions on the part of the management of the corporations, the character of which is by no means obvious. I shall, therefore, have to consider the consequences of these demands being accepted on the basis of alternative assumptions concerning how the corporations respond to the new conditions.

The 'supplementary economic demands' directed to the Big Three are that one half of all profits in excess of 10 per cent on what is called 'net capital' should be divided equally between employees and the consumers so that one quarter of these 'excess profits' during any one year should be given as a rebate to the buyers of cars, while another quarter should be handed over *to the unions* to do with it as they please. It is this last feature which distinguishes the proposal from all other profit-sharing plans and particularly from the profit-sharing plan which was offered by some automobile manufacturers to the workers and was turned down by them. It is not a plan to give the individual worker a determinable share in the ownership of the enterprise and therefore in its profits, but rather a plan to give the union, or the representatives of the workers employed in the corporation at a given time, control over, in the first instance, one quarter of the profits in excess of 10 per cent on net capital.

There are various grounds why the idea seems attractive that the workers in a corporation should be given a favoured opportunity to invest their savings in the corporation, and there are also good reasons why the great hopes which some people have set on such plans have scarcely ever been borne out by the result. Though the worker may find greater satisfaction in working for a corporation where he has a share in the profits, however small, and may take a greater interest in the prosperity of the corporation, it is also natural that, if he has any savings to invest, he will normally prefer not to stake them on the same enterprise on the prosperity of which all the rest of his income depends.

It is, however, an entirely different matter if it is demanded that the body of workers employed by a firm at any one time, without having contributed to its capital, be given a share in the profits. The effect will in part depend on how this share is to be distributed among the workers or otherwise used for their benefit. On this the proposal, as published, leaves us largely in the dark. It merely tells us that the workers of any company 'would determine democratically how they chose to allocate the money available from their companies through this supplementary package', and adds a list of purposes for which they may be used which ends with 'any other purpose which they deem advisable'. I sometimes wonder whether this is not the most ominous sentence in the whole document, since it leaves open the possibility that the individual worker may get little, if anything, for his free disposal, and that the money will be used mainly for the collective purposes of the union, i.e., further to increase its power.

So far as the effects on the position of the companies affected are concerned, we must distinguish between the short- and the long-run effects. In the relatively short run, the companies would have the choice between absorbing the loss of net profits and continuing essentially the same price policies as before, or at once trying to recoup themselves by an adjustment of prices. The former would mean that they would both be in a stronger position in the labour market compared with their weaker competitors, and would also offer the consumers what amounts to a lower price—though how significant the expectation of an uncertain and at best small rebate at the end of the year would be in affecting the choice of the purchaser seems doubtful. At any rate, so long as they followed this policy, the tendency would necessarily be to strengthen their superiority over the less successful companies and to increase the likelihood of the elimination of the latter. If, on the other hand, the companies concerned decided that they could not afford the reduction of profits but that it was expedient to raise prices sufficiently so as to restore them (so far as practicable), the car buyers would not only have no advantage at all—they would have to pay more than before, because they would have to provide the additional profits which would have to be obtained to satisfy the demands of labour.

In the long run, however, the managements of the corporations would have no such choice. Mr. Reuther is here obscuring the main issue by calling all profits in excess of 10 per cent on 'net capital' before taxation (i.e., 4.8 per cent after taxation) 'excess profits'. I will not examine here the difficulties which the vague concept of 'net capital' raises in this connection but, for the purposes of the argument, shall assume that it can be given a sufficiently definite meaning. Whatever this basis of calculation, it is difficult to see in what sense the profits actually earned by the successful industries can be called 'excessive'. It is true they are high in comparison with those companies in the industry that are struggling for survival, but hardly in any other sense. The commonly accepted measures of profitability scarcely suggest that the profits earned by the three companies are more than is necessary in such a highly risky

field to make the investment of new capital attractive: at the end of last year the value of the shares of both Ford and Chrysler was below the book value of the assets of these companies, and only the price of General Motors shares exceeded the book value of the assets by more than the average for all the companies included in the Dow-Jones index number of the prices of industrial stocks.[2] But even if it could be seriously maintained that the profits of these companies were in some meaningful sense 'excessive', surely this would only constitute a case that, in the general interest, more capital should be invested in the companies concerned, and not a case for making investment in them less profitable. Or, assuming there were any grounds on which it could be contended that the big firms in the automobile industry were making 'monopoly profits', this would seem to me the strongest possible case against giving the workers a vested interest in the preservation of such monopoly profits.

This brings me at last to the general principle involved in those demands, the question of what would be the significance for the character of our whole economic system if the principle underlying them were applied generally. This is a question which must be examined without any regard to the particular figures mentioned in Mr. Reuther's 'packages'. If it is in any sense right that the employees of a particular firm should get one quarter of the profits in excess of 10 per cent, it would seem equally right that next time they should demand one half, or that they should claim some even larger percentage of all profits. It is, of course, a familiar and an only too often successful practice to establish a new principle by putting forward at first what may quantitatively seem a not very important demand, and only when the principle has been established to push its application further and further. It may be that Mr. Reuther was not very wise in asking in the first instance as much as one quarter of what he calls excess profits. The danger that he would gain his point would probably be much greater if in the first instance he had asked a modest 10 per cent and only after the principle had been established had pushed for a higher participation. Perhaps because he has on the first occasion asked for as much as he did, the public will be more ready to grasp what the establishment of the principle would mean.

The recognition of the right of the worker of a firm, *qua* worker, to participate in a share of the profits, irrespective of any contribution he has made to its capital, establishes him as a part owner of this firm. In this

[2] See the Statement by Theodore O. Yntema, Vice-President-Finance, Ford Motor Company, before the Subcommittee on Anti-trust and Monopoly of the Committee on the Judiciary, United States Senate, Washington D.C., February 4–5, 1958.

sense the demand is, of course, purely socialistic and, what is more, not based on any socialist theory of the more sophisticated and rational kind, but on the crudest type of socialism, commonly known as syndicalism. It is the form in which socialist demands usually first appear but which, because of their absurd consequences, have been abandoned by all of the theorists of socialism. It is at least possible to put up a rational argument in favour of nationalizing all industrial capital (though I believe it can be demonstrated—and is confirmed by all experience—that the consequences of such a policy would be disastrous). But it is not even possible to construct a rational argument in support of the contention that the workers employed at any one time in a firm or industry should collectively own the equipment of that industry. Any attempt to think through the consequences of such an arrangement soon shows that it is utterly incompatible with any rational use of the resources of society, and would soon lead to complete disorganization of the economic system. The final outcome would, no doubt, merely be that some new closed group of established workers would entrench themselves as the new proprietors and endeavour to get out of the seized property as much for their benefit as they could. The expropriation of one group of capitalists would have been achieved, but only to give some other group an equally exclusive (and probably equally temporary) right to the particular assets.

This is not the proper place to demonstrate the unworkability of a syndicalist system, nor should it be necessary once more to attempt to do so. What needs to be brought out is that the fulfilment of Mr. Reuther's demand would be a step towards syndicalism and that, once the first step was taken, it is difficult to see how further demands in the same direction could be resisted. If the U.A.W. have now the power to appropriate part of the capital of some of the biggest enterprises in the country, there is no reason why the same power should not next time be used to appropriate more and in the end all of it, and why the same should not happen in other industries. Nothing, indeed, brings home more vividly the dangers of the situation we have allowed to grow up over the last twenty-five years than the fact that it is necessary to examine such demands seriously and to explain at length why they must on no account be accepted if we are to preserve the fundamental character of our economy. I hope it is owing to the fact that most people believe that these demands will not be pressed seriously and that, at least this time, they have been put forward as a bargaining manœuvre, that they have not caused more concern. But I fear that it may be more owing to the fact that the public have not yet realized that much more is at stake than the prosperity of three big

corporations. What will be tested when these demands are seriously put forward is the crucial issue of how far the organized groups of industrial workers are to be allowed to use the coercive power they have acquired to force on the rest of this country a change in the basic institutions on which our social and economic system rests. This is no longer a situation where we can afford the detached view which assumes that in a conflict of interests there is always something to be said for both sides and a compromise to be desired. It is a situation in which even the fear of the grave consequences which at this juncture a prolonged labour dispute and perhaps a long stoppage of production might have must not be allowed to influence our position. It is, it seems to me, a moment at which all who desire the preservation of the market system based on free enterprise must unambiguously desire and support an outright rejection of these demands without flinching at the short-run consequences this may produce.

Many people probably still feel that the great automobile manufacturers are able to take care of themselves and that we need not concern ourselves about their problems. This is scarcely any longer true. The fact is that we have permitted a situation to develop in which the unions have grown so powerful, and at the same time the employers have been deprived of any effective defence, that there must be grave doubt about the outcome if Mr. Reuther, according to his favourite practice, singles out one of the Big Three for attack. We have reached a point when the question of how we can still enable one such corporation effectively to resist demands which, if satisfied, would place us straight on the road to syndicalism must be a major public concern. Mr. Reuther may, indeed, be in a position to bring most severe pressure, not only on that corporation but on the public at large, because it may depend on him whether the present decline is turned into a major depression. It should be clearly recognized that the responsibility is entirely his and that no threat will frighten the public into a compromise which in the long run could be even more fatal. It seems to me that in this situation the economist must not shirk this duty of speaking plainly. This is not a pleasant task for one who as a scientist must aim at being impartial and whose inclination is either not to take sides in a particular dispute of interests or, if he has to, to favour the side on which are the relatively poorer. I have to admit that I have my doubts whether the predominant concern of so many economists with what they regard as justice in the particular case rather than with the consequences of a measure for the structure of society in general has on the whole been beneficial. But I am quite sure that the present issue has nothing at all to do with questions of justice between the particular parties involved but raises a question of principle which should be decided in the light of the consequences which its general adoption would have for our society. If this means that the economist, whose chief duty it is to think through and explain the long-run consequences, has to take what may be the unpopular side, particularly the side which is likely to be unpopular among the general class of intellectuals to which he belongs, I feel it becomes even more his duty to do so unreservedly and unequivocally. Perhaps I may conclude with the words of one of the wisest and most detached of economists, which have been quoted before at the head of a well-known essay called 'Reflections on Syndicalism' and which is now proving to have been dreadfully prophetic. The passage by Alfred Marshall which Henry Simons quoted at the head of that essay runs as follows: 'Students of social science must fear popular approval; evil is with them when all men speak well of them. If there is any set of opinions by the advocacy of which a newspaper can increase its sales, the student, who wishes to leave the world in general and his country in particular better than it would be if he had not been born, is bound to dwell on the limitations and defects and errors, if any, in that set of opinions: and never to advocate unconditionally even in an *ad hoc* discussion. It is almost impossible for a student to be a true patriot and to have the reputation of being one in his own time.'[3] It is probably equally impossible in our time for a student to be a true friend of labour and to have the reputation of being one.

[3] Henry C. Simons, 'Some Reflections on Syndicalism', *Journal of Political Economy*, Vol. LII, No. 1 (March 1944), p. 1.

CHAPTER TWENTY-ONE

*Inflation Resulting from the Downward Inflexibility of Wages**

Contrary to what is widely believed, the crucial result of the 'Keynesian Revolution' is the general acceptance of a factual assumption and, what is more, of an assumption which becomes true as a result of its being generally accepted. The Keynesian theory, as it has developed during the last twenty years, has become a formal apparatus which may or may not be more convenient to deal with the facts than classical monetary theory; this is not our concern here. The decisive assumption on which Keynes' original argument rested and which has since ruled policy is that it is impossible ever to reduce the money wages of a substantial group of workers without causing extensive unemployment. The conclusion which Lord Keynes drew from this, and which the whole of his theoretical system was intended to justify, was that since money wages can in practice not be lowered, the adjustment necessary, whenever wages have become too high to allow 'full employment', must be effected by the devious process of reducing the value of money. A society which accepts this is bound for a continuous process of inflation.

This consequence is not at once apparent within the Keynesian system because Keynes and most of his followers are arguing in terms of a general wage level while the chief problem appears only if we think in terms of the relative wages of the different (sectional or regional) groups of workers. Relative wages of the different groups are bound to change substantially in the course of economic development. But if the money wage of no important group is to fall, the adjustment of the relative

* Reprinted from *Problems of United States Economic Development*, ed. by the Committee for Economic Development, New York, 1958, Vol. I, pp. 147–52.

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position must be brought about exclusively by raising all other money wages. The effect must be a continuous rise in the level of money wages greater than the rise of real wages, i.e., inflation. One need only consider the normal year-by-year dispersion of wage changes of the different groups in order to realize how important this factor must be.

The twelve years since the end of the war have in fact in the whole Western world been a period of more or less continuous inflation. It does not matter how far this was entirely the result of deliberate policy or the product of the exigencies of government finance. It certainly has been a very popular policy since it has been accompanied by great prosperity over a period of probably unprecedented length. The great problem is whether by the same means prosperity can be maintained indefinitely—or whether an attempt to do so is not bound sooner or later to produce other results which in the end must become unbearable.

The point which tends to be overlooked in current discussion is that inflation acts as a stimulus to business only in so far as it is unforeseen, or greater than expected. Rising prices by themselves, as has often been seen, are not necessarily a guarantee of prosperity. Prices must turn out to be higher than they were expected to be, in order to produce profits larger than normal. Once a further rise of prices is expected with certainty, competition for the factors of production will drive up costs in anticipation. If prices rise no more than expected there will be no extra profits, and if they rise less, the effect will be the same as if prices fell when they had been expected to be stable.

On the whole the post-war inflation has been unexpected or has lasted longer than expected. But the longer inflation lasts, the more it will be generally expected to continue; and the more people count on a continued rise of prices, the more must prices rise in order to secure adequate profits not only to those who would earn them without inflation but also to those who would not. Inflation greater than expected secures general prosperity only because those who without it would make no profit and be forced to turn to something else are enabled to continue with their present activities. A cumulative inflation at a progressive rate will probably secure prosperity for a fairly long time, but not inflation at a constant rate. We need hardly inquire why inflation at a progressive rate cannot be continued indefinitely: long before it becomes so fast as to make any reasonable calculation in the expanding currency impracticable and before it will be spontaneously replaced by some other medium of exchange, the inconvenience and injustice of the rapidly falling value of all fixed payments will produce irresistible demands for a halt—irresistible, at least, when people understand what is happening and

realize that a government can always stop inflation. (The hyper-inflations after the First World War were tolerated only because people were deluded into believing that the increase of the quantity of money was not a cause but a necessary consequence of the rise of prices.)

We can therefore not expect inflation-born prosperity to last indefinitely. We are bound to reach a point at which the source of prosperity which inflation now constitutes will no longer be available. Nobody can predict when this point will be reached, but come it will. Few things should give us greater concern than the need to secure an arrangement of our productive resources which we can hope to maintain at a reasonable level of activity and employment when the stimulus of inflation ceases to operate.

Yet the longer we have relied on inflationary expansion to secure prosperity, the more difficult that task will be. We shall be faced not only with an accumulated backlog of delayed adjustments—all those businesses which have been kept above water only by continued inflation. Inflation also becomes the active cause of new 'misdirections' of production, i.e., it induces new activities which will continue to be profitable only so long as inflation lasts. Especially when the additional money first becomes available for investment activities, these will be increased to a volume which cannot be maintained once only current savings are available to feed them.

The conception that we can maintain prosperity by keeping final demand always increasing a jump ahead of costs must sooner or later prove an illusion, because costs are not an independent magnitude but are in the long run determined by the expectations of what final demand will be. And to secure 'full employment' even an excess of 'aggregate demand' over 'aggregate costs' may not lastingly be sufficient, since the volume of employment depends largely on the magnitude of investment and beyond a certain point an excessive final demand may act as a deterrent rather than as a stimulus to investment.

I fear that those who believe that we have solved the problem of permanent full employment are in for a serious disillusionment. This is not to say that we need have a major depression. A transition to more stable monetary conditions by gradually slowing down inflation is probably still possible. But it will hardly be possible without a significant decrease of employment of some duration. The difficulty is that in the present state of opinion any noticeable increase of unemployment will at once be met by renewed inflation. Such attempts to cure unemployment by further doses of inflation will probably be temporarily successful and may even succeed several times if the inflationary pressure is massive enough. But this will merely postpone the problem and in the meantime aggravate the inherent instability of the situation.

In a short paper on the twenty years' outlook there is no space to consider the serious but essentially short-term problem of how to get out of a particular inflationary spell without producing a major depression. The long-term problem is how we are to stop the long-term and periodically accelerated inflationary trend which will again and again raise that problem. The essential point is that it must be once more realized that the employment problem is a wage problem and that the Keynesian device of lowering real wages by reducing the value of money when wages have become too high for full employment will work only so long as the workers let themselves be deceived by it. It was an attempt to get round what is called the 'rigidity' of wages which could work for a time but which in the long run has only made this obstacle to a stable monetary system greater than it had been. What is needed is that the responsibility for a wage level which is compatible with a high and stable level of employment should again be squarely placed where it belongs: with the trade unions. The present division of responsibility where each union is concerned only with obtaining the maximum rate of money wages without regard to the effect on employment, and the monetary authorities are expected to supply whatever increases of money income are required to secure full employment at the resulting wage level, must lead to continuous and progressive inflation. We are discovering that by refusing to face the wage problem and temporarily evading the consequences by monetary deception, we have merely made the whole problem much more difficult. The long-run problem remains the restoration of a labour market which will produce wages which are compatible with stable money. This means that the full and exclusive responsibility of the monetary authorities for inflation must once more be recognized. Though it is true that, so long as it is regarded as their duty to supply enough money to secure full employment at any wage level, they have no choice and their role becomes a purely passive one, it is this very conception which is bound to produce continuous inflation. Stable monetary conditions require that the stream of money expenditure is the fixed datum to which prices and wages have to adapt themselves, and not the other way round.

Such a change of policy as would be required to prevent progressive inflation, and the instability and recurrent crises it is bound to produce, presupposes, however, a change in the still predominant state of opinion. Though a 7 per cent bank rate in the country where they originated and were most consistently practised proclaims loudly the

bankruptcy of Keynesian principles, there is yet little sign that they have lost their sway over the generation that grew up in their heyday. But quite apart from this intellectual power that they still exercise, they have contributed so much to strengthen the position of one of the politically most powerful elements in the country, that their abandonment is not likely to come without a severe political struggle. The desire to avoid this will probably again and again lead politicians to put off the necessity by resorting once more to the temporary way out which inflation offers as the path of least resistance. It will probably be only when the dangers of this path have become much more obvious than they are now that the fundamental underlying problem of union power will really be faced.