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INFLATION THEORY AND ANTI-INFLATION POLICY

Between Aug. 28–Sept. 3. 1975 the International Economic Association organized a conference in Saltsjöbaden under the title "Inflation theory and anti-inflation policy". Selected studies, submitted to the conference, were published also in Hungarian edited by Béla Csikós-Nagy. The editor also wrote an introductory study to the Hungarian edition. This is now published in English.

The word "inflation" comes from the English expression "inflated". It was used for the first time in the civil war between North and South of the United States. It was to mark the state when coined (metallic) money had an agio over uncovered paper-money and, parallel with it, prices were rising, though to different degrees, but generally [1]. That is, the expression "inflation" began to be used in the phase of development of monetary economy when paper money gained ground beside metal currency. Therefore, the first analysis of inflation was directed at the special process of *"doubling"* prices.

This remark about the development of the concept of inflation is not intended to be an introduction to the history of theory. Only those elements of the history of theory will be used that may provide useful information for a better understanding of the inflationary phenomena of our age. From this viewpoint it seems sufficient to centre our attention on the turning points connected with the changes *in the concept of inflation.* On these grounds three main theoretical directions may be distinguished. According to them inflation is either

– abundance of money or
– excess demand or
– rising price level.

The order of sequence is also a chronological one. Identification of inflation with abundance of money had been the prevailing standpoint up to the 1890s, and its identification with excess demand prevailed up to the 1950s. In the last decades, however, the view has been spreading in which the sign of equality is put between inflation and rising price level. *Thus, the concept has broken away from the original word.*

Association with the *concept of value* presents itself spontaneously. Value as the amount of labour expended on producing commodities has become the starting-point for understanding the price phenomenon. If one denies the hypothesis of the labour theory of value, as is done by the marginal utility school and, in general, by the recent non-Marxist price theories, *Cassel* is right in suggesting that the word "value" should be eliminated from the terminology of economics, and only the exchange relations should be studied. [2] In the same way, why should we need the concept of inflation if we identify with a rising price level? The expression may not have been born at all, if we had interpreted the concept according to the now prevailing view.

The *value concept was incorporated into the body of economic knowledge by the English classical school, and the concept of inflation by the quantity theory of money.* The connexion between value and inflation is created by the value of money, i. e. its possible deterioration. Turning over the pages of old textbooks one finds shades of difference – sometimes even important ones – in the interpretation of inflation. We are mentioning it only for illustration's sake that Liefmann considered inflation as the effect of multiplying money on prices [3], while Cassel considered it to be oversaturation [4] of the market with paper money. The former one indicates a state, the latter a process. There was agrement, however, in that inflation as well as deflation amount to an upsetting of the general equilibrium (abundance and scarcity of money resp.) brought about as a rule, by economic (monetary) policy.

With the value of money interpreted as price level, inflationary monetary policy is an instrument to raise the price level, and deflationary policy is one to lower it. Both directions of the changes in price level start in such a case from the *side of money.* But the price level may change also under the effect of factors that appear on the side of commodities. What is more, if we look at changes in prices placed within the framework of general equilibrium, price tendencies and changes in price proportions can be interpreted only as changes in value relations. This accounts for the fact that old economic textbooks separated the comprehensive analysis of prices from the analysis of inflation and deflation; the latter was considered as a special manifestation of changes in prices induced by monetary regulation.

Interpretation of inflation as *excess demand* is a new explanation for a rising price level determined from the side of money. This change was brought about by *Wicksell* [5]. It was upon this basis that *Novozhilov* formulated his theory of repressed inflation. [6] According to the quantity theory of money, if the quantity of money grows – under orherwise unchanged conditions – the price level will be rising as a consequence. Wicksell deduced the price effect starting from the side of money not directly from the change in the quantity of money, but from relations between demand and supply. The difference is important. An increase in the quantity of money is economically justifiable, if it is in proportion with the expansion of the economy; if the ratio of money savings is growing, or, in general, the velocity of money circulation slows down. In the final analysis, the inflationary effect on the price level exerted from the side of money can be based only on the fact that more goods are demanded and more services required than the supply determined at the given price level.

For Wicksell – thinking in terms of the free market model – it seemed only natural that excess demand should lead to rising prices. Novozhilov again had in mind the situation prevailing in the Soviet Union in the period of transition from War Communism (barter economy) to the New Economic Policy (commodity economy). In the period of transition a policy of low prices was pursued. These were prices adjusted to the level of wages paid for producing the goods; they did not – or hardly – realize any social net income. The makers of price policy were guided by the intention to open the market wide for workers earning low wages. On analyzing the situation, Novozhilov found that the policy of low prices functioned similarly to inflation, with the difference that rising prices were replaced by a growing shortage of goods. He called the emerging situation credit inflation.

In analyzing the controlled economy during World War II the Western dispute recalled the dispute in the Soviet Union in the 1920s. The difference is in terminology: shortage of goods was replaced by inflationary gap, [7, 8] and credit inflation by repressed inflation [9].

Manifestations of repressed inflation are concealed price increases, forced purchases, and forced saving. These phenomena are found even today in socialist economies, in consequence of excess demand being institutionally incorporated into the economy of most socialist societies. Economists of socialist countries regularly indicate the presence of inflationary pressure, although they generally avoid the word "inflation". In case the state controls prices, it may be assumed that it observes factors affecting value relations, that is, this control follows – at least in its tendency – the change in prices determined from the side of commodities. In this case, however, inflationary pressure can be determined only from the side of money. In other words: repressed inflation fits into the framework of the excess demand theory. If there is excess demand, it is exactly as a function of free price movement or official price control that a distinction can be made between open and repressed inflation.

A rising price level has become permanent in market economies after World War II. Permanent excess demand has also played a role in it. Under such circumstances a separate analysis of the commodity side and of the money side i. e. such approach to the problem as is capable of drawing the line between inflationary price movements and price movements determined by changes in production and consumption relations has, of course, become more difficult. It seemed easier also from the point of view of econometric model construction if inflation was simply identified with a rising price level. This is what *J. M. Clark* did when he examined the development of prices and wages on commission of the American Banker Association [10]. As a result of the activity of Clark and others the view has become general that

– slow, accelerated and galopping inflation should be distinguished, depending on the yearly rate of the rise in price level

– as a function of causes behind the rising price level cost-push inflation and demand-pull inflation should be distinguished from each other.

It follows from the nature of things when price movements are fitted into the framework of inflation theory, that cost aspect need also to be drawn into the sphere of examination. This expansion is held important by Western economists mainly in regard of wages and import prices. The concept of "structural inflation" was born, which explains the changes in relative prices and the increasing costs of individual products and, in particular of services, as a function of proportional wage development and differentiated productivity growth.

Phillips published a study in 1958 in wich he considered his three hypotheses in relation to Great Britain as statistically proven:

1. There is a non-linear relationship between the rate of unemployment and the change in the wage level. Wages increase faster in the case of full employment, when demand for labour is considerable, than is the decrease of wages in case of a high degree of unemployment.

2. The extent of changes in wages depends on the changes in demand for labour. The workers' position in validating their demand for higher wages is better if demand for labour is on the increase (or unemployment decreases).

3. The cost of living affects wages only if consumer prices increase considerably. If the cost of living increases by a few per cents only the rise in the consumer price level neutralizes only the difference between the improving rate of productivity and the rate of wage increase. If, however, the cost of living rises considerably, the price–wage spiral will start functioning. [11]

Today's theories of inflation are based on the Phillips curves or their further developed versions.

Price movements determined from the commodity side

Some consider it only a matter of convention what economic content is attributed to various concepts, such as e. g. inflation. According to their opinion, the problem of inflation may be analyzed in the framework of various investigation systems; the important thing is only to reveal the causes of the rising price level, and to find instruments for overcoming inflation, having in mind also economic efficiency. In fact, however, concepts, classifications, etc. determine thinking. Correct concepts and correct classifications help to get to know the real world. And this is important, since scientific research concerned with inflation is to serve economic policy. It is with this in mind that we have to answer the question whether the modern concept of inflation is a further development of the old one, or its deformation; whether the shift from price analysis on the *commodity and money side* to the analysis of *demand and cost inflation* might be considered a forward step.

Let us start *from the price relations of a given date,* at which we assume that there is no excess demand and prices are controlled by the market, so that they function as equilibrium prices. Looking at them from the supply side, these prices deviate from the socially measured value. This is necessarily so, because

– the market price can maintain the equilibrium between demand and supply only in its movement around input;

– the various kinds of products are in a substitution relationship with each other. Their relative prices are influenced by the consumer through a comparison of use values.

That is why, beside other things, the theory of value can be interpreted only together with the rent theory;

– it is one of the characteristics of the production process that several products may be obtained parallelly. Products are classified accordingly into primary products, secondary products and waste; and primary products obtained simultaneously are called twin products. In such manufacturing processes the inputs by products cannot be determined at all in many cases, and relative prices only as a function of substitution relationships.

Looking at it from the *demand* side the assumption seems sufficient that we may reckon with consumer sovereignty, and the supply structure will be adequately adjusted to the demand structure.

Now the question is what price movements are brought about in the short run, in the long run, and secularly by the changes taking place in production and consumption relations (on the commodity side). We continue to assume general equilibrium, that is one in which a change in the quantity of money and/or on the velocity of money circulation (the money side) does not induce price movements.

In the short run, such price movements are obviously characteristic as are natural concomitants of the equilibrium function of price in a smoothly developing economy. Price analyses of such type are concerned with changes connected partly with the seasonal movement of prices and partly with their movements around value. These short-term price movements do not lead, as a rule, to changes in the price level (and thus in the value of money). Let us add immediately: some representatives of the quantity theory of money examined the price movements determined by changes in production and consumption relations only in the short run, and this is how they came to the conclusion that, *looking at it from the commodity side, only a change in price proportions can take place.* Accordingly, if there is a change in price level, it can be traced back only to causes on the money side. [12, 13, 14]

Representatives of the quantity theory of money are inclined to underestimate the autonomous laws of real processes taking place in the economy, and to interpret, as far as possible, every important change of state as a reflexion of monetary processes. Thereby, however, they almost supplied the grounds for the change in the theory of inflation, according to which inflation is interpreted no more as inflation of the currency, but as a rise in the price level. And this happened in spite of the considerable amount of knowledge which had accumulated when the quantity theory of money was still flourishing in respect of the long-range price trends asserting themselves as a result of changes in production and consumption relations.

The scientific examination of *long-range price trends* is based upon the laws of returns characteristic of production factors. It was the diminishing returns of land, and the increasing returns of capital that gave grounds for such opinion that the trend of prices is rising with regard to agricultural products (minerals) and falling as regards industrial products [15]. Thus, in the long run the commodity side induces also a change in the price level (in the value of money). In the interpretation of the laws of returns this must clearly come to expression – in an advanced period of industrialization – in a declining price level (in the increasing value of money). From this viewpoint not only a rising price level, but even an unchanged one would indicate the presence of inflation. If, namely, as a consequence of changes in production and consumption relations, the price level must fall, but this does not happen, then it is on the money side that causes must be assumed which shift price movements out of their natural trend.

We have come to a point at which a question constantly discussed in socialist countries comes to the centre of attention. *Marx* analyzed thoroughly the long-term price trends of the last century in the free-market capitalist system and formulated the thesis of the *diminishing tendency of value*. Since price is the money form of value, many think it natural if the socialist state asserts this tendency through planned pricing. That is why a rising price level is qualified *a priori* as bad, and a falling price tendency as good. It has been found in practice, however, that those socialist countries which consider precisely this as the most important requirement to be raised against price policy, can at most set the objective of a full or relative stability of the consumer price level, but even that only by increasingly resorting to budgetary price subsidies.

Socialist countries *raise the state purchase price level of agricultural products* from time to time. Beside improving the self-financing capacity of agriculture they do this mainly in order to bring about and maintain income parity between workers and peasants.

In Western Europe this had been achieved at an earlier date. Historically the gap between agricultural and industrial prices was created in Europe by the low world market price of agricultural goods. With such price relations it would have been impossible to ensure the continuity of agricultural production in Europe.

The industrial price level was raised from time to time in most European socialist countries, as a consequence not only of rising wages but also of changes in socio-economic conditions. The creation of facilities for research and development, the acceleration of technical progress and environmental protection increased costs. In certain productive branches low-cost technologies had to be discarded; the workers were no longer willing to undertake the type of labour they represented. This led to wage rises, in the first stage, and to inevitable changes in technology in the second. The urgent need of the masses for commodities and services can sometimes be met only with higher-cost technologies than those previously employed.

The socialist countries do not regard a rise in the price level as representing inflation. The elimination or narrowing of the gap between agricultural and industrial prices has relaxed increasingly acute social tensions and has contributed in no small measure to enhancing general social stability and to equilibrium. If there is a sufficient volume of commodities to satisfy the increasing purchasing power of the peasantry, why should that be described as an inflation? If it were, any changes which increase social stability by maintaining economic equilibrium should be regarded as upsetting economic stability. Similarly, if a rise in industrial production costs due to acceleration of the rates of technological development, of environmental protection and of increasingly demanding social requirements and other similar factors were to be described as inflation, this would imply an identification of economic stability with the preservation of historically evolved conditions of production. In this case only such changes in conditions might be considered compatible with economic stability as would decrease specific input and absolutely none that would increase it.

In describing the mechanism of the capitalistic mode of production in the last century, Marx analyzed thoroughly the factors appearing on the product side which are carriers of changes in value (in price). He examined such free-market economy, in which only such organizational measures are taken, such technologies and modernization processes are introduced as a result of which the change in the organic composition of capital (increase in the share of constant capital) simultaneously leads to a reduction of the input per unit of product, that is, of the value of the commodity. In the free-market capitalist system of the last century this was almost forced by the keen competition, and made possible by the oligocentrally organized world economy, the industrial reserve-army and, consequently, by the weak position of the working class.

Nor can it be left out of consideration, *that Marx explained the tendency of decreasing value and price in the framework of a critical analysis of capitalism.* If the capitalist could reduce value of the product by technological development, he was forced by competition to express this in a reduced price. At the same time, the tendency of decreasing price was closely related to the reduction of wages. In this model the product price follows the decreasing tendency of product value, while wages follow the decreasing tendency of the value of labour power with unchanged working hours, and maybe with an increased intensity of work.

In this model, the value of labour power and thus wages diminish through the reduction of the price level as a function of the living costs.

All this may be enough to make it clear that in analyzing price movements determined from the product side we cannot rest content with taking into account the long-term changes in production and consumption relations. Attention must be extended also to *secular changes.* Therefore, our task would be to compare the general political, social and economic relations of the 19th century with those of the 20th and to examine, whether new conditions have come about for value and price movements in this century. Scientific research still owes us such an analysis. In this study we cannot do it. We can but suggest what fundamental and thorough changes have been (and are still) taking place.

– The world economy is not oligocentrally but polycentrally organized.

– National economies develop under relations of conflict and fight between the different socio-economic systems.

In the accelerated technological development competition renders the time factor more determinant than profitability.

– Because of increasing scarcity of non-renewable resources, or which are renewable only to a limited extent, the kind of rationality is undergoing a transformation which enables the minimization of input while wasting resources.

– Politics puts the price category at the service of equalization; it wishes to achieve in this way an international redistribution of national incomes in favour of developing countries.

– The relationship between society and economy is changing in a manner, which reduces social mobility.

– Demand for full employment and equity is growing stronger.

– Social expectations (towards labour safety, environmental protection, improvement of working conditions, etc.) raise demands on technology in a changed manner.

The opinion seems justified according to which the tendency of value (price) cannot be determined on the basis of criteria characteristic of the last century. What is more, the hypothesis also seems justified that *the commodity side determines a rising tendency of the value (price) level.* Insofar as the price level is rising, exactly because of changing production and consumption relations, why should it be considered inflation? This is without justification, just as it is to qualify the falling tendency of prices in the last century a deflationary process. After all, the general process of socio-economic development cannot be formulated as a system in which inflation and deflation are alternating.

There are, of course, we must repeat, people who consider this merely a question of convention. It is even more characteristic that certain expressions spread in the wake of a scientific fashion, giving thus the semblance of modernity. Let us remark against the prevailing tendency, that the substitution of an inflation-deflation analysis for a comprehensive analysis of price movements is a *retrograde* step.

Price stability

Up to the world economic crises of the 1920s and 1930s neoclassic schools presented the capitalist market economy as a harmonic system in which capital goods always find investment possibility providing for enough profit, so that development takes place with a satisfactory rate of employment [16]. The regularly recurring crisis was interpreted as a natural phenomenon and held for compatible with the equilibrium [17]. Crisis – it was said – was objectively necessary: it was so to say *the natural price of economic development,* since in the general course of development the economy needs periodical self-clearing.

The traditional theory of crisis was no longer tenable after the Great Depression between the two World Wars. With this also the scientific opinion failed which judged any state intervention into the economy harmful from the outset. Revision of the traditional economics was carried out by *Keynes* forty years ago [18]. The objective necessity of *an anti-cyclical economic policy* found general approval. Its justification is recognized today even by those who otherwise do not deem the presence of the state desirable in the economy. At the same time, the neo-classic school hold the state's function acceptable for the solution of a single task only, which is to guarantee, by controlling the quantity of money in circulation, an economic development free from crisis [19]. According to their opinion the government (the central bank) does not solve even this task well. That is how the old dispute about crisis has transformed into a dispute about inflation. The same economic reasoning which four decades ago qualified the crisis as the *natural price* of economic development, now qualifies inflation as the same for an economic growth free from crisis. Inflation is inevitably present – says *Röpke* – if full employment and economic growth have priority over equilibrium [20].

Facts are stubborn things. They constantly remind us of deviations between reality and what we would like things to be. Inflation is disturbed equilibrium which first arbitrarily redistributes incomes and then breaks up the economy. Such a state can be, of course, maintained transitorily, but the situation must be overcome sooner or later either by currency reform or stabilization measures independent of the former. Political economy – studied as a scientific discipline applied either to the socialist or the capitalist society – cannot be based on a hypothesis of socio-economic disequilibrium and, particularly, it cannot be built upon a theoretical system of inflation carrying elements of irrationality. If we denied the efficiency of a stabilization policy, science would offer mankind only the following alternatives: *either recurrent crisis and unemployment with stability, or regular economic growth and full employment with inflation.* This is, indeed, the theory of *permanent* inflation. Yet science cannot represent economic development as an ever renewing process of irregularities. In economic life irregularities may appear and may be present from time to time. Scientific examination has to be extended so as to cover them. *The initial hypothesis cannot be, however, anything but stability.*

Policy is obliged sooner or later to solve the problem of inflation. Yet it is not indifferent whether this is done with the support of the schools prevailing in economics, or by denying them. Economics has to mediate the information that can enable us to develop the economy by observing rationality. Stability in regard of prices may be formulated as *price stability*. Economic stability itself is, as a matter of course, a wider concept. Economic policy may set various aims in order to eliminate or at least ease the widely different kinds of unevenness e. g. in economic growth. But we shall now centre our attention on questions of price stability.

Interpretations not only of inflation but also of price stability are different. Those who qualify a rising price level as inflation put a sign of equality between price stability and unchanged price level. What is more, those who view price movements in the real income-determining role of prices, may interpret even the changes in relative prices with an unchanged price level as a destabilising factor. This is because, as a consequence of changes in relative prices, money incomes of different sizes are transformed into real incomes in changed proportions. This is a consequence of the income-redistribution effect of changes in relative prices i. e. of the fact that there is considerable difference between the consumption pattern of families with low, medium, or high income, or of those with no children, with one child or more children, etc. Therefore, in the interpretation of price stability one might reach the standpoint of freezing the prices. Otherwise, let us remark: whoever objects to the price having a role in the income distribution process should object also to a reduction of the price level concomitant with changes in relative prices.

Namely, if the additional financial funds available for the consumers raise the standard of living through price reduction, additional purchasing power is brought about in a differentiated manner depending on the consumption patterns.

Maybe the question should not be put in the form, what is price stability, but rather: *what are the limits to price movements set by economic stability?* Only such interpretation of economic stability seems reasonable which does not put obstacles in the way of the development of the production forces, and is not in conflict with the political, social, and economic conditions that are determinant for economic growth. Consequently, price movements accompanying changes in production and consumption relations should be recognized as justified. The price of a product may rise or fall in comparison with that of other products, either because relative input or because relative demand grows or decreases. These changes must be expressed in price movements, unless the phenomenon is only transitory. In the latter case it is exactly price stability that may render it desirable that the government should take temporary counterbalancing (financial) measures. Therefore, price movements induced from the commodity side are justifiable, since they reflect only the objective changes because of which relative shortages of some products necessarily grow or decrease. Society must not neglect them.

Thus, in first approximation stability may be formulated as a demand on financial policy: surplus money starting excess demand should not be issued, and growth based on equilibrium should be guaranteed. Yet two qualifications should be added right now:

– Scientific examination cannot leave out of consideration the economic relations in which excess demand appears. Steps may be taken against monetary policy giving rise to excess demand, but it must be taken into account as a possible alternative.

– From the consumer's point of view it is indifferent, whether in the process of his money income transforming into real income the loss caused by a price rise is interpreted as being compatible with price stability, or as an inflationary process. Nor can politics qualify the price movements in this manner. As a consequence, from the viewpoint of wage and income relations every kind of price movement is reduced to a common denominator.

It was *Lerner* who first put forward the theory that rendered the assumption feasible according to which a *price rise without inflation was possible.*

According to Lerner we can imagine a state of affairs in which there is a continuous increase in demand in relation to supply, and a continuous rise in prices; a process which is generally foreseen. We can then have rising prices without any of the evils that we dislike in inflation. Inflation is dangerous not because of the price rise but because of the lack of foresight, and because thus its offsetting is missing. In the case of a foreseen price rise there is no excess demand. People know they will spend more money in the future, but they also will have to pay higher prices. The expected demand can be equal to the expected supply [20].

Anti-inflationary policy of socialist countries

Socialist economy is characterised by *stability of consumer prices*. Socialist countries consider consumer price stability an important element of social stability. It is rather a difference in judgement that some countries interpret stability as consumer price level maintenance (Soviet Union); other countries regard a slow price rise taking place through fashion articles and industrial products embodying new technologies compatible with stability (Czechoslovakia); and others again which, keeping in view relative price stability, lay a greater stress on the function of equilibrium prices (Hungary).

The socialist countries endeavour to follow the *Lerner formula*. The rise in the price level, under central control, takes place in harmony with the trend of relative incomes, in the form of *planned pricing*. The price and incomes policy is institutionally integrated into the central control of the economy. A restrictive foreign exchange policy makes it even possible to arrange a relationship between the world market price (the C. M. E. A. contractual price) and the domestic price in a centrally organized system. Yugoslavia is an exception from this rule, partly because it is the market price which best suits the system of workers' self-management and partly because the dinar is a convertible currency. As a consequence, the effect of inflation on the world market upon the Yugoslav economy assumes the same form as in most market economies.

The criteria of planned pricing are different in the cases of agricultural procurement, of industrial production and of consumer goods. They vary also from country to country since there are differences in economic mechanisms, and thus also in the role of price to be played in the planned process of development. In all socialist countries, however, the criteria of price regulation are the same. All socialist countries try to proceed with full regard for the principle of *complexity*. When agricultural procurement prices or industrial producer prices are changed, they always consider the effect such changes are likely to have on the productive branches concerned. In some cases price changes must not be permitted to effect the viability of the productive branch in question; in others, price changes may be aimed at providing new conditions for enterprise decisions. It is always in terms of such considerations that decisions regarding prices are linked up with changes in the monetary regulators, such as taxes, subsidies, credit terms, and the like.

If one does not regard price movements within the control of planned pricing and offset by measures of incomes policy as inflation, then inflatory manifestations comprise

(1) any rise in the price level not planned and therefore not covered by incomes policy;

(2) any disguised price rise;

(3) any forced purchase; and

(4) any forced saving.

The possibility of an *unplanned rise in the price level* is a consequence of the mixed price mechanism. Even in those socialist countries in which prices are fixed in the widest sense, this is enforced in detail only for those products and for those services which are sold in socialist (state and cooperative) retail trade. It goes without saying that there are controlled prices (for public services, for example) outside this sphere; but there is also a free market on which small producers sell their goods (for instance the Kolkhoz market in the Soviet Union). Furthermore, some socialist countries (Poland, Czechoslovakia, Hungary), permit the pricing of certain non-staple commodities and services manufactured by state enterprises and/or cooperatives, to be subject to determination by the enterprise concerned. If, under this system, there is a rise in the price level and the consumer price plan fails to take it into consideration, which implies that it is not offset in incomes, then the price rise must be regarded as a form of inflation.

A disguised price rise represents a rise in the price level that is not measured by price statistics. This may happen even when the price is most scrupulously calculated. Price statistics constructed in the traditional form are neutral or indifferent to changes in quality and to changes in assortment. The price level may rise even without the price of a single product changing, partly by putting commodities of an inferior quality on the market, partly by withdrawing certain types of goods from the market and replacing then by new types only slightly different, but sold at disproportionately higher prices. It is mostly the manufacturing and the commercial enterprises themselves that are in a position to check whether both the prices and the quality comply to official regulations. If, however, there is excess demand, this supervisory function becomes much less effective.

Forced purchase is a situation in which consumer preference is restricted. The consumer is unable to find the assortment of goods on the market which he wants. Naturally, no country can rely for her supply on factors of production she does not possess. Nor can a country resort to international division of labour to improve her supply beyond the point where she is capable of keeping her international balance of payments in equilibrium. Forced purchase is a situation which indicates a *deterioration in commodity supply*, caused by an imbalance and by inflationary pressure.

Furthermore, with the growth of productive forces, and with a rising living standard as its result, the pattern of consumption changes and the supply structure has to follow in its track. Demand for more expensive types of goods causes a rise in the average prices of various commodity groups affected. But such a rise in average prices must not be considered as an indicator of forced purchases. In the case of excess demand, on the other hand, as part of a general rise of average prices, the quality factor contributes to the elements of inflationary pressure.

Forced savings indicate that there is a shortage within a field of non-substitutable products combined with definite demand. The consumer is reluctant to spend money reserved for certain definite goods on any commodity available on the market and prefers to save his income in the hope that the desired goods will be available later.

In the case of excess demand inflationary pressure asserts itself naturally *not only in the sphere of consumer articles, but also in that of means of production.* This is not changed at all by the opinion that when means of production are managed centrally, they are not commodities, and the money available for the purchase of means of production only replaces direct allocation.*

It is impossible to distribute all the means of production centrally. Furthermore, in a system of central quotas the specifications and technical parameters of every product cannot be described in the same detail as they appear in the form of commodities in relations between enterprises. Accordingly, control by plan directives has to assume that the most essential criteria of the means of production, including their use value, will be enforced in the enterprises' contractual relations. This in itself gives opportunity for manifestations of an inflationary pressure.

In the field of the means of production the opportunities for disguised price rises, induced by excess demand, are still more favourable, because the authorities can regulate the price of components, subunits, special-purpose machines, all of them produced with widely varying technical parameters only indirectly and by normative prescriptions. In the field of the means of production the inflationary pressure appears also in various new forms, of which the excessive stocks of unfinished products, disturbances in the organization of production and investment, delays in the completion of new projects, etc. are typical examples.

Excess demand causes difficulties also in the *management of labour.* Excess demand in the consumer market, in itself, has an adverse effect on labour discipline, preventing as it does the workers from freely using their wages. Excess demand for means of production creates bottlenecks in plants; imbalances within enterprises prevent the most rational use of the available manpower; the result is underemployment within the factory, in varying degrees.

In socialist countries *inflationary pressure is not only felt but also regularly analyzed* during the preparation of the yearly plans. Planning, of whatever type, begins with a critical analysis of the actual economic situation, with summing up the experience accumulated in the course of a continuous observation of trade in the means of production as well as in consumer goods. The information used for operative market supervision includes the utilization of capacities, the state of order books, reports on delays in deliveries, changes in stocks, and so on. This means that the targets for economic growth which planning attempts to fix for the medium or the long range on the basis of the system of economic balances is preceded by an analysis of the past real processes. It is this analysis which must provide an answer to the question whether economic growth can go on under conditions of equilibrium or under conditions of disequilibrium with the abolition, mitigation, continuance, or even enhancement of the inflationary pressure.

*Such views have been recently expressed in the Soviet Union by V. *Kulikov* and N. *Shekhet.* For the whole problem see [22].

Anti-inflationary policy of capitalist countries

In the case of a monetary policy maintaining excess demand an effective stabilization policy may be only one in which, in addition to the instruments of monetary and budget policy, also those of price- and incomes policy and those of production and distribution policy are used. This implies, however, that the government does not restrict its activity to the elimination of serious troubles encountered in the economy, but that it fully takes control of the economy. It remains, of course, an open question, what changes there are with a capitalistic mode of production for an efficient state control of the economy. Scientific discussions are today carried on more about the question, whether the government can go beyond the limits set by market-conformity.

The adoption of a price and incomes policy raises a more serious dilemma than that of an *anti-cyclical economic policy*. When the armoury of instruments of anti-cyclical policy are developed the reconciliation of market mechanism with state intervention is based on the principle of *market-conformity*. This policy, therefore, has not changed the fact that the market-clearing function of the price was asserted as an effect of demand- and supply factors, though in the new situation the market is rather only a technical framework for process control, in which the state financial policy is determinant.

As opposed to this, with the adoption of a *price and incomes policy* capitalist production cannot be organized any more in a way conforming to the market, since direct regulators are institutionally incorporated into the market mechanism. This restriction has been for long applied by capitalist countries in agriculture. But economics – in which agriculture used to be one of the most important fields of examination – has grown into a discipline centred on consumption and industry for several decades. Price and incomes policy is in conflict with the traditional theses of economics thus interpreted, although the latter are intertwined with the ideology of the bourgeois democracy. This is the dilemma that accompanies the scientific examination of accelerated inflation and discussions of anti-inflationary policy in the capitalist world.

Western economists' attention is centred first of all on what happens in the Anglo–Saxon world: in Great Britain, where the classical theory was born; and in the United States of America which is the leading power of the capitalist world. In these two countries the so-called *three-phase version of the anti-inflationary programme* was tried out. In the first short-term period prices and wages are frozen, in the second short-term phase selection principles are laid down for price and wage movements. In the third (and consolidated) period it is social responsibility that motivates the attitude towards stabilization. This programme, however, has failed to fulfil hopes attached to it.

If in monetary policy the main control principle is "stop and go", there is also a strong disposition to adopt in price and incomes policy a system of alternating freezing and release. But already the "stop and go" raises an increasingly difficult problem. This is because the market does not react any more with such obviousness and sensitivity on changing market conditions as is assumed by monetary policy. Also the social medium is in a process of transformation. Mobility is changing into immobility, flexibility into rigidity. And what is more: if enterprises may assume that the "stop" policy has to change into "go" policy at a certain point, decisions will not agree with the assumptions of monetary policy. Summing up: the social background behind the rules of the game of monetary policy is gradually dropping out.

What holds for monetary policy holds even more for price and incomes policy. Price is a delicate phenomenon. Enterprise behaviour becomes particularly irrational if in an inflationary process they may assume that price and incomes policy applies the alternating system of freezing and release. Even in a medium-developed and not too large national economy the number of commodities that have to be distinguished with regard to prices may amount to several millions. Owing to technical progress, changes in fashion, and other factors the exchange of products is extremely fast. Various kinds and assortments of products are in a substitution relationship with each other. Under such conditions price and incomes control *requires a high degree of organization and competence.* We must not forget that the ability of price control to function depends not only on whether anti-inflationary policy is successful, but also on whether it does not impair rational economy. The latter one is more determinant if the problem is interpreted not as a transitory price-stop measure, but as a state activity which is organically built into economic policy. It is not difficult to formulate the principles of selective price and incomes policy in legal terms. It is much more complicated to apply these principles in practice. The high degree of organisation and competence required there to is hardly to be expected from an institution established for a short transitory period.

Let us add that the problem which governments are faced with cannot be circumvented by appealing to social responsibility in the hope that the *self-discipline of market actors* will render anti-inflationary behaviour prevailing. It is found even in socialist countries that the enterprise can interpret the interest of society only on basis of the legal rules that set the limits to its freedom of decision. This is even more characteristic in a market economy. It is not possible to use the driving force of the free market, and simultaneously entertain the hope that the market behaviour of those participating will be governed not by market laws but by moral philosophy.

A number of arguments may be advanced againts stabilization policy. Nevertheless, no clear conclusion might be drawn without clarifying other possible alternatives. Such scientific analysis is rendered difficult by the fact that in market economies an increasing number of instruments are used in open and disguised forms which are not in conformity with the market. Thus, as a matter of fact, two questions ought to be answered: 1. Why have stabilization programmes not led to success so far? 2. What situation would develop, if economic policy really gave a free way to market forces?

Comparison of open and repressed inflation

Accelerated inflation in industrially advanced capitalist countries brought to the foreground the comparative study of open and repressed inflation. Economists of the Western world who take a stand for the free market consider, as a matter of course, open inflation as a better alternative that repressed inflation. This is supported also by the historical background of the theory of repressed inflation. The reason is that this theory was connected to the critical analysis of measures taken in the Soviet Union after the liquidation of war communism, and in the Western world it has existed from the very outset as a theory of restrictive war economy. This historical background of economic thought allows to draw erroneous conclusions in judging the inflationary pressure existing in a socialist economy.

The theory of repressed inflation based on a war situation was expounded most thoroughly by Bent *Hansen.* In such a situation the fixing of prices and wages is associated with an extensive *system of rationing and coupons.* Using two basic diagrams and models for perfect competition and for monopolies Hansen attempted to emphasize the significance of the inflationary gap caused by the administrative freezing of prices and wages. This may in part explain the fact that, when analyzing the inflationary pressure under socialism Western economists are prone to exaggerate its negative effect [23, 24, 25, 26]. According to them a socialist economy should be regarded as one in a state of *permanent mobilization;* that is, essentially an economy of the same type as a restrictive war economy. But a socialist economy cannot be described in this way.

Hansen's models had – even in regard of the new situation – certain weak points. *Hagger,* thinking of situations nearer to reality, considered the reexamination of the model important in case of a looser price control situation. He set out from the point that the aim of price and incomes policy is partly to freeze prices but partly to mitigate the inflationary pressure [27]. It was among others, *Polak* who outlined a price control model zo be used under conditions of war where the state strictly controls prices but not with a price freeze. He distinguished between autonomous price increased and official price adjustments. Prices are controlled in a manner regulated by the state with the aim of compensating to some extent the effect of previous price rises. [28] But all this will not alter the essence. These debates about price and wage control alternatives deal with the possible restricted war economy of a fundamentally market system.

The socialist countries control prices and wages in a fundamentally different situation. In all the European socialist countries the *consumption of the population takes place under free trade, without rationing.* As a general rule the only field outside the market is the distribution of flats. Rents in socialist countries are low and enable even people in the lower income brackets to live in comfortable flats. Low rents necessarily create excess demand which makes it necessary that new and empty flats shall be centrally allocated. But this does not necessarily mean an excess demand on the macroeconomic level. What is relevant is here rather that under socialist conditions, as they are interpreted in our time, housing is a transitional category between public consumption and individual consumption; it has a price but it is not the price that controls distribution.

Free trade establishes certain definite requirements to be met by price control. If the administratively guaranteed price level is divorced from the equilibrium level, it not only restricts the function of money, as a means of payment, but weakens the operation of planned pricing as a whole. In this connection it is worth-while to draw attention to what *Lerner* said in a note to his paper, when he used the term 'suppressed' inflation. Machlup reminded him that Röpke preferred the term 'repressed inflation' to 'suppressed inflation' because Röpke wanted to argue that prices could not be kept down for long [29].

From the point of view of the inflationary pressure under socialism the category of the *means of production* must be judged by different criteria. When, namely, the means of production are centrally distributed, so that the allocative function of price is replaced by a system of quotas, the incorrect assumption is that price need not play a compensatory role. Thus, in the sphere of the means of production the inflationary pressure may be considerably greater that in the field of consumption. It is perhaps precisely for this reason that *Kraus* stated that the price to be paid for abandoning central plan directives and for shifting to control through economic instruments must be the release of the inflationary spiral [30]. This hypothesis has not, however, been verified by the experience of the socialist countries.

Large-scale experiments are going on in some regions of the Soviet Union with the introduction of free trade in the means of production and in some other commodity groups. When choosing the regions and groups of products, the initial assumption was that demand at the given level shall not exceed the demand as limited previously by quotas. Experience has proved that with free trade demand even tends to diminish. This may be attributed to the fact that with free trade enterprises are disposed to keep their inventories at the justified level and to adapt their purchases to the production programme already specified. We may in this respect refer to the example of Hungary where the 1968 economic reform abolished the quota system for the means of production; allocation was kept only with the so-called shortage materials – and this did not release any inflationary spiral. An economic reform of this type, namely, does not merely activate the price function, but, as an organic element in the reform, at the same time the criteria for state planning are also revised.

Merely the freeing of price movements would not put an end to excess demand in socialist countries. The changing of a repressed into an open inflation would bring matters from bad to worse. It is not the prices that should be liberated: excess demand must be abolished. The presence of *inflationary pressure is not necessary in a socialist economy.* It can be abolished, or at least minimised if the state [1] determines the resources to be assigned from the national income to growth in harmony with the requirement for equilibrium, [2] creates more direct relations between producer and consumer, and finally, [3] ensures harmony between demand and supply with a flexible price mechanism.

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ТЕОРИЯ ИНФЛЯЦИИ И АНТИИНФЛЯЦИОННАЯ ПОЛИТИКА

Б. ЧИКОШ-НАДЬ

28 августа – 3 сентября 1975 года Международное экономическое общество провело в Сальтшёбаден конферефцию на тему „Теория инфляции и антиинфляционная политика". Избранные доклады конференции были опубликованы и на венгерском языке под редакцией автора статьи. Автор написал вступительную статью к венгерскому изданию, которая публикуется сейчас на английском языке.

В статье прежде всего анализируется понятие инфляции. Автор указывает на изменения этого понятия. На таком основании он подразделяет три основных теоретических на-

правления: инфляция – 1. обесценение денег, 2. чрезмерный спрос, 3. повышение уровня цен. Он отмечает, что отождествление инфляции с обесценением денег являлось господствующим взглядом до 90-х гг. прошлого столетия, а с чрезмерным спросом – до 50-х годов нашего столетия. В последние же годы все больше сторонников приобретает вгляд, который приравнивает инфляцию к повышению уровня цен.

Автор проводит параллель между изменениями, происшедшими в трактовке понятия инфляции, и изменениями по отношению к понятию стоимости. Понятие стоимости как трудовой стоимости было отправной точкой для понимания явлений экономики. Позднее буржуазные теории цен заменили объективную стоимость субъективной стоимостью. Это сделала теория предельной полезности. Однако уже тогда был прав Кассель, который предложил исключить выражение стоимость из экономического словаря и сосредоточить внимание науки только на изучении отношений обмена. Точно так же, для чего нужно понятие инфляции, подчеркивает автор, если его отождествляют с повышением уровня цен. Он указывает, что как со стороны денег, так и со стороны цены одинаково могут возникнуть факторы, под влиянием которых уровень цен понижается или повышается. Замена всестороннего анализа движения цен анализом инфляции – дефляции, по мнению автора, является шагом назад.

Далее статья рассматривает вопросы антиинфляционной политики социалистических стран, а также капиталистических стран. Он анализирует проявления сдерживаемой инфляции. Наконец, он дает сравнительный анализ открытой и сдерживаемой инфляции.