Monetarism's Muddles

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The whiplash of United States inflation, the stern Federal Reserve policies, and the dizzy interest rate plateaus, must inexorably revise the preponderant German monetarist convictions. Financial market interactions have stripped away the veneer that Bonn could adopt an independent policy to serve national needs. Rocketing United States interest rates have been a magnet to siphon funds from Germany, compelling skyward patterns of interest rates either in conscious defense or mechanical interlock. The fiction of separate monetary initiatives has been exposed; the Bundesbank has been demoted in this episode to the status of a perplexed follower rather than a bold intrepid leader, retaining only a straw vestige of national assertion in succumbing to a damaging inflationary drop in the exchange rate. External winds have thus exploded the glowing monetarist vision of a free domestic monetary hand.

This is the urgent message carried by the 1981 thunderclaps. The tale was never amply foretold by monetarists who blithely assumed that each country could set, and hit, its own precise money supply target. Financial flows today are so massive and electronically instantaneous, that interest rate disruptions in one center transmit immediate shocks in other countries. Granted a fairly equal political climate, the country at the top of the interest rate heap will drag others up to near its own perch and, with the Federal Reserve recently at the top of its game, it has come to rule the roost. The impact on Germany has thus been high interest rates, slow growth, and nagging inflation in some unhappy mimicry of the United States stagflation fiasco.

Germany partly escaped the devastating United States inflation havoc of the 1970s, with the comparative score about 140 to 70 percent. Policies fostered by bitter past inflation memories encouraged a huge inflow of funds to lift the dollar DM rate by about 80 percent. Laudable productivity advances, a restrained wage stance by the trade unions, and an available pool of "gastarbeiters," facilitated the superior price per-

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formance. Ebb and flow in "gastarbeiters" cushioned the unemployment ticks exhibited in the United States. Too, interest rate phenomena and inflationary expectations for the United States, created a Bundesbank illusion that it was largely the undisputed master in its own house, directing its own destiny. Suddenly, for diverse and some opposite reasons its sway has become diluted and an unadulterated monetarist stance will be evermore suspect as an operational guide.

The doctrinal loss need not be mourned for errors penetrated its foundations and permeated its superstructure. Last rites in economics, however, are always premature for tenacious partisans live on, unwilling to concede blunder; yet the rigid influences will decay under an appropriately revised perspective. Fatal to domineering monetarism nonetheless has been its confident affirmation of the co-existence of select and isolated islands of monetary power despite the obvious international transmission belt that invokes stark parallels, differing only here and there in details, with either the *Bretton Woods* scheme or vintage old gold standard.[1] For Germany the implications are profound for a future concatenation of events can flare up in many ways from a variety of quarters. Germany's superior price performance can even be impaired, with modest previous lurches being transformed to sizeable lunges unless the facets of interdependence are assigned greater credence than under the dominant monetarist theology of neglect and exchange rate abandonment.

I. Aspects of Macroeconomic Policy

The broad directions of macroeconomic (including monetary) policy are few: (1) the price level, and thus inflation; (2) optimal output and the associated employment, including for Germany the "gastarbeiter" brigade, and (3) identified with (2) are interest rate patterns; and not least (4) international ramifications including the DM foreign exchange value, import-export magnitudes, and the capital flows generated by interest rates abroad, which result from a complex of judgments in the world economy on expected inflation and interest rates in the respective centers.

[1] See *Sidney Weintraub* (of the University of Texas, not to be confused with this author), "Flexible Exchange Rates: Old Vinegar In New Wine," Journal of Post Keynesian Economics (Summer 1981).

Nonetheless, the key to success on (2-3-4) and the whole interdependent chain, sits firmly in the pocket of (1): curb inflation and economic troubles can be averted and victories sighted. Failure on the inflation front opens the door to wider chaos and a domino reaction. Inflation is thus the overriding issue and generally correctly perceived as such in Germany, as inculcated by history. English world economists, in contrast, are more apt to misorder their priorities in favor of jobs, output, or energy self-sufficiency. Stop inflation and the grand prizes in the economic domain are open. Acquiesce in inflation and formidable or even insurmountable barriers obstruct every turn.

II. Money and Monetarism

Money has been in the forefront of economic conjecture since early times despite some evangelical fervor of monetarists for about two decades to pretend they invented the medium and discovered its study. Particularly spurious was the early allegation that *Keynes* had neglected its vital essence despite a lifetime of devotion to the subject, and the legacy of the IMF and the World Bank.[2] The testy monetarist assault was capsuled in the enticing slogan that "Money Matters", as if anyone steeped in economic affairs ever doubted it. To be sure, many of the self-styled Keynesians — surely not *Keynes* — had underplayed the ramifications of money and, to this extent, the monetarists restored a more reasonable balance. Too, to their credit their overstatement provoked academic economists to devote more attention to serious practical issues and shed the trend to arcane immersion in empty and pretty techniques replete with obfuscatory mathematical symbolism.

Granted the significance of money, monetarists can be faulted for their perception of how "money matters." It is in their policy prescriptions that we best can catch the spirit of monetarism; they generally avow that monetary policy can stand alone in achieving economic stabilization. Largely they deride fiscal policy and raise hackles at the mere murmur of Incomes Policy.

[2] See my essay on "Keynes and the Monetarists," in Keynes, Keynesians, and Monetarists (University of Pennsylvania Press, 1978). *Paul Davidson* has pointed out that in practically all his major writings the word 'money' appears in *Keyne*'s titles. See *Davidson*, Money in the Real World (Macmillan, 2nd edition 1978).

1. Monetarist Wings

Two wings of monetarism can be identified: (1) foremost is the dominant religion espoused by the indomitable Professor *Milton Friedman* that the sole prerequisite is a steady and undeviating growth of the money supply per annum. Central banks are marked for extinction, to be supplanted by a statistical clerk (of the utmost integrity, to be sure) delegated to execute the "3 Percent Rule."[3] Sometimes this is presented as if 'steadiness' was the unique criterion but surely nobody has intimated that a 1,000 percent (or more) daily emission of money would suffice. Thus it is really a two-part rule, steadiness at 2, 3, or 4 percent: for convenience we use hereafter the middle range figure. (2) the breakaway fringe, hardly less adamant about monetary policy as the chief tenet for economic salvation, led by Professors *Karl Brunner* and *Allan Meltzer*, but who are willing to countenance some cyclical oscillations from the rigid Rule. *David Laidler*, for example, most recently announced some defection in declaring "that the case for governing monetary policy by rules [rather than judgment or discretion] is impossible to sustain."[4] The latter article goes far toward abandonment of the ideological ferocity with which monetarism was tendered, though receptivity toward other policy instruments is still markedly hostile even though the rug is pulled out from steadfast monetarist stands; the acknowledgement of monetarist conceptual lapses evades a concession of analytical or policy defeat.

2. The Monetarist Indictment

In indicting monetarism as a more chaotic, incomplete, muddled, and less articulate doctrinal array than its public hyperbole has conveyed, the following bill of particulars will be entered: (1) the bewildering vagueness of the money concept to which the Rule is to be applied;

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[3] See, e.g. *Milton Friedman*, "The Role of Monetary Policy," American Economic Review (March 1968), p. 16. A longer discussion appears in *Martin Bronfenbrenner*, "Monetary Rules: A New Look," Journal of Law and Economics (October 1965).

[4] *David Laidler*, "Monetarism: An Interpretation and An Assessment," Economic Journal (March 1981), p. 25. Cf. the admirable article by James Tobin, "The Monetarist Counter-Revolution Today — An Appraisal," Ibid. Also the shorter comments by *R. C. O. Matthews*, *J. E. Meade*, and *Tobin*, in the same issue. In the same critical context, see (Lord) *Nicholas Kaldor* and *James Trevithick*, "A Keynesian Perspective on Money," Lloyds Bank Review (January 1981).

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(2) the shallowness in the monetarist dismissal of the erratic fluctuations of money velocity; (3) the looseness of the identifiable lag between money maneuveurs and the corrective stabilization response of the economy; (4) the lack of a monetarist *general* theory of the relation between money and prices; (5) a peculiar opaqueness in not discerning the connection between money incomes and the demand for money, with especial reference to the wage bill; (6) the monetarist espousal of the Phillips curve hoax in a contingent sadistic acquiescence to indirect monetary overkill afflicting jobs and production, and (7) the monetarist dereliction in neglecting to alert the various national money authorities of the vulnerability of their exchange rates in the sensitive international network under the pursuit of the simple-minded Rule. Today the Federal Reserve exerts much of its will on other centers; in the future similar mischief may by perpetrated from other quarters. Lastly for our purposes (8) in seeking to stabilize the real output and price sector of the economy, practical monetarism procures its questionable relief by upsetting and destabilizing the financial sector, setting in motion a costly seesaw that rarely achieves a steady balanced norm.

This is a strong brief, condemnatory of monetarism. If sustained, it suggests the need for new policies involving new ideas in order to thwart inflation and to avert the stagflation rot of associated unemployment, stupendous output losses, and rocketing interest rate phenomena in money markets gone berserk in recording 'usury made legal.' The squalid economic sequel is the baneful price that western economies are paying for their sometimes explicit and more often implicit addiction to monetarist nostrums.

Money maneuvers have a major part to play in economic stabilization policies. But the manner in which they can contribute to more robust economic performance has not been discerned by the monetarists.

III. Monetarism's Egregious Half-Truth

Monetary policy has been beguiled by the fractured truth that inflation results from "too much money chasing too few goods." This has been the archaic superficial 'axiom' behind which central bankers have taken refuge to escape fresh thinking. Its content suffused monetarism, with Professor *Friedman* being its modern prophet. The non-verity reverts at least as far back as *Jean Bodin* in 1576, and it was conveyed with more acuity by *David Hume* in 1752, usually travelling under the name of the "Quantity Theory of Money" (QTM). While it has been dressed up to look new, incisive, and profound, the original conditions that once gave it credence no longer prevail.[5]

How easy economic policy would be if only it were true! The central bank would only have to wave its restraining wand and the long inflation nightmare would be over. The Federal Reserve is nearly 68 years old. The Bank of England awaits its 300th anniversary. Apparently, to believe the monetarits, they are too dumb — as are the Bundesbank officials — to grasp the "intricate" monetarist secret to the riddles of the economic universe, as revealed through the monetarists, which enjoins the central bank to grab tight hold on the money supply to end our sea of economic troubles. Implicitly, monetarism alleges that inflation bears the label "Made At the Central Bank." It fancies that a single person, or a handful of persons throughout the world, have concocted our price trials and have obstructed the elimination of our ordeal.

The monetarist assessment must rank near the top in the annals of myths, superstitions, and theology pontificating as economic analysis. The sophomoric notion has been the soporific that has overwhelmed the professional fraternity for years, and one to which central bankers have assented in exaggerating their own powers. They have acted on the elemental foolishness of the proposition, and when their flailing thrusts have fallen way short of aborting inflation they have scraped in consoling themselves with the monetarist rationalization that they missed out in the hunt for the elusive operating formula. In recent years they have even bowed to the monetarists' theological injunction to ignore interest rates, or even foreign exchange rates, and to act by a hypnotic focus on mythical monetary "aggregates."

If not for the trauma inflicted on our economies we could be bemused by the solemn shallowness of this pseudo-intellectual 'deep-think.' Despite the high-brow mathematical symbols and the scholastic econometrics frequently deployed to throw dust and jargon to bewitch those unwary of the esoteric exercises, the only options open to central banks, after all the mysticism is removed, remain: (1) to increase, (2) to decrease, or (3) to keep constant, the annual flow of money supplies.

There is no mystery about these alternatives, and the central bank should not often have to await the latest technical article before deli-

[5] See my Capitalism's Inflation and Unemployment Crisis: Beyond Monetarism and Keynesianism (Addison-Wesley, 1978), especially pp. 82 - 83.

berating its money supply strategy, despite the dither injected by the monetarists over such elementary notions which have been elevated to a complexity akin to nuclear physics or genetic research. Central bankers, to our sorrow, have taken fright at the superficial banalities even though the monetarist 'discoveries' are about as original as sea travel.

IV. The Bewildering Array of Monies

Monetarists stress a lock on money supplies as the method to stabilize the economy. What then is "money?" Here then are the initial perplexities.

In a fully monetized economy money would appear as shovelled out from one side of every exchange, and thus would enter in more transactions than any other item, in fact money would be part of all exchanges. On this conception we would have no difficulty in identifying the money in our respective economies, recognizing it as the coin, currency, and checks that are used daily, despite the lingering remnants of barter transactions. Befuddling to this humdrum tabulation of the money aggregate is the fact that in each country there are a variety of savings accounts, say, that can be quickly converted into cash to be used for payment. Government obligations can also be liquidated, along with shares of stock, holdings of foreign exchange, etc.

Under the zeal for numerical magnitudes we have thus been bombarded with different aggregates, each containing a more inclusive assortment of liquid assets, such as M-1, M-2, M-3, . . . M-n, in bewildering profusion, with each higher numbered "money" containing the previous categories with some new additions. Thus the M-1 would contain coins, currency, and checking accounts, a next higher M would add in savings accounts, etc. until Treasury bills or other highly negotiable instruments also find their moneyness sanctified in the numbers. Presumably a M-∞ might contain all saleable assets, including existing tombstones! The numbering spiel can, under Socratic logic, ultimately prove that "money" is something in the eye of the beholder as an economic version of beauty.

Monetarists uniformly view this slippery statistical array with the utmost solemnity, issuing warnings to the central bank to control *the* money supply. Yet if the central bank tried to undertake the mission with the exactitude demanded by some monetarist fanatics it would have to extend its policing arm to near and far monetary substitutes, and end up monitoring all wealth capable of conversion into cash or its equivalent.

Under the aegis of monetarist doctrine engrossed in the proliferation of *M*-concepts, central banks have tended to calculate more and more of the aggregates to provide busy work for its staff. With each invention of new money substitutes, as Eurodollars or Certificates of Deposit, as in the United States as a rational response to interest rate phenomena or as a tax shelter, there is a new *M*-trail to follow as a canine sniffs a scent. Each new series is presented as if it were exact, down to two decimal places, until new (and always incomplete) data compel a revision. It is on such imprecise and flexible information masquerading as hard facts that precise and inflexible policy recommendations are made.

Outside the solemn hocus pocus magic show the central bank can only exercise direct, but porous and never watertight, control over *M*-1, the coin, currency, and checking account category. It then becomes a bystander in watching its maneuvers marginally, or may be significantly, aborted by spillovers in or out of the amorphous *M*-1 sieve from neighboring *M*-constituents. The central bank is placed in the position of a swift master chasing a fleet dog of matching stamina able to shift direction at will. It can reach out often to grab the dog which always is adept at eluding it. The central bank may get very close on occasion only to be frustrated when it smells success.

After the early flirtation with the *M*-1 concept in the United States, monetarists have tended to opt for an *M*-3 concept which includes savings banks deposits although this opens up avenues or magnitudes only tenuously related to the Federal Reserve operating instruments. Copious studies abound to demonstrate the better correlation of this 'money' magnitude with national income. So the central bank is commanded to seize on the money magnitude which, based not on the statistics of tomorrow but on yesteryears data, allows the highest past correlation. The central bank is to be made a slave chained to the correlation which monetarist's, in fractious conclave, approve.

Monetarist puffery blows on a grand scale. Money exerts when it as money serves. The central bank can exert a powerful lever affecting the payments flow. But it cannot control it, except within sometimes wide bounds. It can be ordered to fly to the moon but it will not get there without a spaceship. The point becomes even more decisive as we turn now to the velocity concept.

V. Velocity in the Old Quantity Theory (OQTM) and the Monetarism

Manifestly, the relative importance of the *M*'s can change over time, otherwise the monetarists' statistical fussing and mesmeric chart-reading would vanish. Evidence on the changes is implicit in the facts on money velocity which also suggest that the exclusive preoccupation with money aggregates is a most suspect pastime.

1. Velocity as an Absolute and Relative Magnitude

Even more than over its vagueness on 'money,' it will be over its mythical suppositions about the velocity of money that monetarism will be knocked off its moon. In the OQTM and its most rigid formulations it was surmised that the velocity of money (V) was constant, year to year. Thus $V(t) = V(t\text{-}1) = V(t\text{-}2)$, etc. The annual rate of change was nil, or $(\Delta V/V) = 0$.

More moderate *QT* exponents were always uneasy with the mechanical version, quizzing the 'constant' V as downgrading changes in mass psychology or spending behavior. Still, if the strict *QT* proponents could show that any velocity flux was trivial they had only to bend their policy advice. Big swings in velocity would negate their unqualified maxims.

Professor *Friedman* leaped into the breach in another way by pronouncing that the percentage changes in velocity per annum tended to be quite stable, stipulating that for the United States that the ratio $[(\Delta V/V)/(\Delta M/M)] = 0.8$.[6] Each 1 percent lift in the money supply carried nearly a 1 percent advance in velocity.

On the presumption of a 'constant' rate of change in velocity, central bankers could easily factor in the impact of money supply changes equally as well as if $\Delta V = 0$. This was the supreme monetarist econometric tenet, or feat, or sleight of hand, to buttress the argument that stabilization miracles would ensue from solely central bank money control. The stable velocity ratio is the simple and single pillar supporting the Rule of the strict conformist sect.

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[6] *Milton Friedman,* The Optimum Quantity of Money and Other Essays (Aldine Publishing Co., 1969), p. 227.

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2. *Recent Evidence*

Recent experience has undermined the touching faith; the belief has come apart at the seams. Professor *Almarin Phillips*, for example, remarks that "the velocity of money has risen dramatically," with the income velocity of money gushing from 3.0 in 1955 to nearly 7 in the last quarter of 1980.[7] The turnover rate of bank deposits in major New York City banks zoomed from about 50 times to 800 over the same dates. *Phillips* illustrates by declaring that an average balance of $ 100,000 could establish a series of payments of $ 5 million in 1955 and $ 80 million in 1980!

This is hardly a reassuring corroboration of stable velocity or a constant rate of change in the velocity rate, or even an intimation of a constant *M*-? magnitude, monetarist claims to the contrary notwithstanding. The monetarist empirical error is not difficult to spot for their earlier dazzling statistical calculations were extracted from the American economy which had long reported interest rates in the 3 or 4 to 7 and 8 percent range, for short and long term borrowing. The findings were spuriously transposed to portray behavior in the modern economy recording 14 to 20 percent interest rate phenomena. Individuals and firms willing to hold large inactive balances at the interest rates down toward the lower end of the spectrum were driven to seek out profitable lending outlets for their idle funds once interest rates crossed the threshold to the historic high interest rate environment. Economies in cash holdings, by ferreting out new available money market instruments, replaced the languid attitude toward idle funds.

The spending or payments flow consists not only of the money total, however defined, but on its velocity. The central bank is shorn of its control over the outlay magnitude whenever money velocity is erratic or unpredictable. The true art of central banking consists of making judicious projections of fluctuations in velocity in executing its money supply maneuvers. Recent take-offs in velocity must deal a near-mortal blow to the recipe for merely a steady annual increase in the money aggregate as the be-all and end-all of monetary policy. The attitude must be slated for quiet burial because of the velocity accordion playing out its fast tunes. More deftness at the central bank will be imperative in defiance of the Rule.

[7] *Almarin Phillips*, "Paradigms Lost: Money, Interest Rates, and the Velocity of Money," University of Pennsylvania (mimeo May 1981).

VI. Looseness on Lags

On the time span before monetary policy wrings its miracles the monetarists have tested credulity and patience in their wavering, and their retreat from the dogmatic certitude in espousing their dubious doctrines. Nobody expects the central bank motions to have an instant durable heavy impact on prices, or jobs and production, though there can be, through psychology, quick repercussions on interest and foreign exchange rates through eager speculative presences guided by hopes and fears. Of course, if the *Friedman* wing of monetarism had its way in fidelity to the Rule the reactions to monetary policy would be negated under the inviolate money increases. The economy could fall into the grip of a money panic, with liquidity demands abounding, and the monetary authority would merely watch the writhing, tantamount to a doctor watching stoically a patient enduring a deadly coronary attack which he could allay by oxygen and known approved medication.

Early writings of monetarists briskly affirmed that a revised monetary policy would take hold rather quickly, turning the economy about in 3 months or so. After disappointment in the early days of the lamentable *Nixon* administration, beginning in 1969, they counselled patience, extending the corrective phase to 6 months, thence to about 18 months, and upped further to about 3 years. As the American inflation proved stubborn and grew worse the monetarist subterfuge rallied around the vapidity that "the lags are longer than expected." Recently, the Monthly Review of the Federal Reserve Bank of St. Louis (October 1980), which is a house organ which hallucinates monetarist scenarios, observed that whereas "research conducted at this Bank" formerly showed "that a change in the growth rate of money is fully reflected in the inflation rate in about five years," based on the 1955 - 1971 data, for the 1970 - 1979 period the data show a "shortening ... to 12 quarters," or 3 years (pp. 3, 6).[8]

Consider the implications of this "research," divorced apparently from any reflection on the deteriorating United States events. It professes that we will have to wait 3 years for positive benefits. Implicitly it assumes that in the intervening period there will be no critical developments or no new events to invite a modification of the therapy. The physician is to adhere to the regimen regardless of the state of

[8] *Keith M. Carlson*, "The Lag From Money to Prices," Monthly Review, Federal Reserve Bank of St. Louis.

health of the patient, or the appearance of new ailments. Presumably there would not be even a need to monitor the patient's health. It is so reminiscent of the story that *Keynes* invoked long ago, in commenting on the business cycle, of castor oil being prescribed for the patient showing symptoms of constipation at just about the time diarrhea was setting in, calling for bismuth![9]

On lags it is clear that theology and ideological conviction have overtaken fresh diagnosis, an open mind, and even small confessions of mistakes and misjudgment. After 3 and then 5 years of the same rotten medicine the monetarists will persist in asking for more time, extending exactly the same therapy out to all eternity. This is too exacting a test of our credulity and endurance.

Ironically, it is commonplace to ridicule military leaders for being 'brass heads,' for holding on to their pet battle theories regardless of the situation. Rarely, however, will a general proceed without a contingency plan to invoke either for retreat or to meet unexpected challenges from the enemy. Monetarists, alas, have none but a fervent order to adhere to the undeviating program for all eternity, regardless of the economic outcome. They are ideologically convinced that it will succeed-ultimately. Bang your head into a brick wall of deep thickness; they assure us that the wall, not our heads, will crack.

In neglecting to give us a reasonable time frame under which they expect their policies to be effective, and in failing to sketch out a contingency plan, the monetarists have displayed an awesome degree of irreponsibility. There is nothing rational or 'scientific' about a diagnosis which proceeds bullheadedly without ever bothering to check empirically the state of the economy.

VII. The Elusive Real Sector Stability and Actual Financial Market Instability

Few aspects of monetarism, and its sway permeating central bank thinking has been as damaging to the market system as its complacency while decapitating bond values and disorienting the financial network generally. The depth of the hardships are too dimly apprehended, concealed often behind a facade and overlooked by virtue of the surprising

[9] *J. M. Keynes,* Treatise On Money (Harcourt Brace, 1930), Vol. II, pp. 223 - 234.

resilience of financial capitalism. Since 1968 the New York Stock Exchange has shown its oscillating gyrations while tracing a flat trend in the face of higher earnings; the stock market has been effectively dormant in underwriting new equity issues. The brokerage business has contracted through mergers and the entry of firms into diversionary sidelines, holding onto their brokerage places for ultimate revival. A generation of analysts has been brought up in the belief that the stock market never rises, but goes up and down, testing 1,000 in the Dow Jones average before plummeting away. Insurance companies have been driven to the subterfuge of valuing their bond holdings at maturity nominal values rather than market prices to escape the onus of reporting balance sheet insolvency. Professional people who went into government bonds, presumed to be 'perfectly safe,' have seen market values erode by over 30 percent. Savings and loan associations, organized and confined to mortgage lending for the new housing market, are in a precarious shape, with more bankruptcies and many tottering on the verge, as depositors withdraw funds or fail to make new deposits as they seek out the more lucrative interest rates offered by the newly created money market funds: savings and loan banks thus find themselves in the abnormal position of having to pay out high short term interest rates, to survive, while receiving inadequate long term yields from their investments. The interest rate pattern has just gone topsy-turvy during the last decade of 'fighting inflation' through money maneuvers at the Federal Reserve. Financial instability has been its chief undisputed achievement, along with the havoc in new housing and the attendant unemployment, and chronic slow growth or recession.

The feedback from financial to real markets has real and lingering echoes, whether in deterring investment in plant and equipment and thereby arresting productivity gains or, by the near mortal strike at savings and loan banks in tempering home financing for a long time to come. All this ensues because every time the economy exhibits buoyancy the central bank "fears inflation," often with and occasionally without basis in fact, and engages in its self-proclaimed valiant stance, even boasting of its heroics of future conquests in overlooking its past defeats expressed in its simultaneous lugubrious recital of the latest price statistics. The end result on the economy is predictable as the central bank galvanizes the only instruments available to it, namely, monetary policy which chops off jobs and production to throw the economy into either recession or to hold it to slow growth. Meanwhile, as the worst peacetime (or war aftermath) record of the last decade reveals, our economies suffer the worst of inflation and abysmal stagflation disasters in this century, or of modern industrial experience: the price level just wends its uninterrupted skyward course. Despite its pieties tendered with due gravity the price record, which is the central bank monthly report card on its performance attests to monetary, and monetarist, ineptitude in stopping inflation.

Although the transmission mechanism tracking the monetary blunderbuss is undoubtedly different in Germany, the general set of relations will resemble the United States experience.[10] Monetary tactics can be likened to a children's see-saw. Whenever the economy is floating up and enjoying the exhilaration, the central bank jumps up at the other end to repress the elevation by tightening money and thereby clipping and destabilizing the financial sector. The clout on jobs and production in the real sector, especially the housing and construction industries, is certain. The inflation arrest is dubious, for reasons we detail.

VIII. Basic Monetarist Formulas

We consider now the basic monetarist price level formulas for contrast with the alternative foundations. The analysis will stay only with essentials, bypassing the many lesser subtleties.[11]

1. The Old QTM

The QMT, in its various guises in this century, descended from the Equation of Exchange (EOE) staked out by *Irving Fisher*. Thus:

[10] For an account of the financial sector instability, see *Ervin Miller*, "The Pains of Monetary Restraint," Lloyds Bank Review (July 1973).

Professor *Hyman Minsky* has been particulary articulated in pronouncing the fragility of the financial markets and the prospect of spillovers to the real sector to undermine the economy in a repeat of the Great Depression. Among his numerous writings, see *John Maynard Keynes* (Columbia University Press, 1975), "An 'Economics of Keynes' Perspective on Money" in Modern Economic Thought (University of Pennsylvania Press, 1978), *S. Weintraub*, editor, and "Money, Financial Markets, and the Coherence of a Market Economy," Journal of Post Keynesian Economics (Fall 1980).

[11] For amplification of this analysis, see my Capitalism's Inflation and Unemployment Crisis: Beyond Monetarism and Keynesianism (Addison-Wesley, 1978), especially Chapter 3. Also, Keynes, Keynesians, and Monetarists, passim.

(1a) **EOE:** $MV = PQ$, where M = money supplies, V = money velocity, P = price level, Q = real output or domestic GNP

Obviously this is a truism that asserts that sales receipts from output must equal money outlays on that output. Pure QTM'ers would disregard any flex in V or Q and vow a direct chain between M and P, with M being the causal variable. More moderate expositors allow for V and Q variations. Still, major stress on M for control over P discloses a QTM disposition.

In percentage terms (neglecting [$\Delta M \Delta V$ and $\Delta P \Delta Q$]), from (1a):

(1b) $(\Delta M/M) + (\Delta V/V) = (\Delta P/P) + (\Delta Q/Q)$ or $m(\Delta M/M) = (\Delta P/P) + (\Delta Q/Q)$

Austere QTM disciples view $\Delta V = 0 = \Delta Q$, and $m = 1$, so that these terms vanish. Strident monetarists, under Friedman's estimates, see (for the United States), $(\Delta V/V) = 0.8$ and $m = 1.8$, or nearly 2 for simplicity. Interpreting $m = 2$ signifies that a 1 percent increase in money leads to a 2 percent gain split in some way between the P's and Q's.

Earlier remarks were highly skeptical about m-constancy. Monetary policy, when m is variable, must rest on surmises of future m (or $\Delta V/V$) and not on ΔM variations alone. The payments flow or expenditure stream is an amalgam of MV, as much contingent on V swings as on M emissions by the central bank. Oscillations in V are not under the central bank thumb. Judgment on waves in m are critical in making decisions on ΔM emissions. Perplexity is compounded, however, in forecasting m-values in an era of peak interest rates and the concomitant concoction of money substitutes.

2. *The "New" Quantity Theory*

With much fanfare Professor *Friedman* promulgated the "new" QTM as:

(2) $MV = Y$ or $m(\Delta M/M) = (\Delta Y/Y)$, where Y = national income

Clearly, this connects money supplies and money income and it is more tautological and less informative than the EOE. In a bizarre chapter in economics, after opting for (2) for nearly 15 years, and plunging in heated debates over inflation, *Friedman* finally discovered that his version of monetarism lacked a price level anchor! The theoretical foundation inherent in (2), so far as the price level was concerned, was suspended in thin air. Hence there has been a reversion to (1). We shall note a worse muddle shortly. As doctrinaire ideologists monetarists never are deterred by their mistakes, however egregious.

The "new" QTM hardly deserves notice in the inflation context beyond evidencing frequent monetarist confusion. One point is worth extracting, however, inasmuch as monetarists allege causation from left to right, with more money provoking price lifts. The money volley is presumed to ricochet and strike prices, automatically.

Ordinarily, however, purchases are made, prices agreed upon, deliveries executed, and then, thereafter, payments for the transactions are consummated. In any temporal ordering of the sequence it is buy now and pay later. Factually, the monetarists see the chain backwards. Money flows, from a realistic perception, would usually follow price ascents, rather than the other way. Individuals and firms acquire goods on temporary open credit and then make payment, generally out of income, or sales proceeds, or by sale of other assets, or credit cards, or other modes of financing. Unravelling typical market sequences would generate deeper skepticism of the monetarist thesis. For brevity we forego this exploration at this time.

IX. The Wage Cost Markup Theory

Many Post Keynesian critics of monetarism have organized their attack on monetarism around an alternative formula to catch the price level dynamics, namely, the Wage Cost Markup (WCM) equation. Thus:

(3a) WCM: $P = kw/A$, where w = average money wage (and salary)
A = average product of labor
k = average markup of prices over unit labor costs ($= w/A$), or the reciprocal of the wage share

As the WCM is less familiar than the EOE, an illustration ought to help. If the average wage (and salary) $w = 25{,}000$ DM, and the average productivity of labor is equal to 2,500 units, whether tons of steel, bushels of grain, tins of canned goods (or the like) then unit labor costs are (25,000 DM/2,500) or 10 DM. If business markups average out to 2, then the average price or price level will be 20 DM. If the average wage level zooms up to 50,000 DM, with A and k unchanged, the price level will double. Considering the restrained fluctuations in k and A a rocketing price level will reflect mainly the orbiting in w.

In percentage terms applicable over time, it follows:

$$(\Delta P/P) = (\Delta k/k) + (\Delta w/w) - (\Delta A/A) \tag{3b}$$

In the United States the k-term is remarkably constant, perhaps the most nearly stable ratio in all of economics.[12] If so, or if its fluctuations are small, then we can disregard it and equation (3b) simplifies to:

$$(\Delta P/P) \sim (\Delta w/w) - (\Delta A/A) \tag{3c}$$

Confronting (3c), price level perturbations or upheavals come from a tug-of-war conflict between the average pace of pay gains and the customary improvements in labor productivity.

1. Price Level Regardless of Money Sleight of Hand

Most noteworthy is that all of the equations (3) reveal that the price level and inflation emanate entirely divorced from the machinations of the central bank and money supplies. Unless the money maneuvers operate in some way to staunch the eruption in money wages and salaries they will lack any impact on the price level. Implicit, too, is the proposition that unless we are able to establish some reasonable alignment of money wages and average productivity we cannot stem the price level march.

There is no warrant, however, for concluding that monetary policy is impotent or without incident. Money impacts jobs and production, directly. Indirectly, by creating unemployment and slow growth or recession, the central bank can therefore retard the surge in money wages by the sadistic unemployment roundabout. According to (3) it can thereafter affect the price level.

The dismaying fact is that we have no direct means in our stabilization arsenal for gearing movements in w and A. Yet the alignment is indispensable if we are ever to succeed in stopping inflation from running riot without paying the awesome price in lost output and wasteful unemployment. Western economies have been going on in some madness, assaulting the laws of arithmetic revealed in equations (3), granting wage hikes of 10 or 15, or 25 percent in the United States and the United Kingdom, and then expressing consternation at

[12] See my Capitalism's Crisis, pp. 46 - 48.

equivalent outbreaks in the price level under minuscule productivity creeps. Germany, not least because of the pool of "gastarbeiters," and a more rational labor movement, has been spared the worst of the inflation extravagances.

2. *Everyone a Billionaire?*

If incomes can go up without ushering in the inflation plight then we can all be billionaires, this afternoon. Why not? Raise everyone's pay a billion times and let the central bank stop inflation, as it *pretends* it can under monetarist urging. This is the absurd logic which underlays their untenable sophistries.

Once we concede that there is an optimal or proper pace of income advances we shall be on the path to stopping inflation. Monetarism cannot accomplish miracles against inflation in the face of unruly pay escalation. England, the United States, Canada, other countries including Germany, and surely Israel, testify to this, as a certitude. Monetarism has simply lost sight of income realities.

X. Monetary Policy in a Continuing Economy

From the above formulas it follows:

$$Y = MV = PQ = kwN, \text{ where } N = \text{employment} \tag{4a}$$

This merely repeats that money incomes (Y) equal money outlays (MV) equals the value of output (PQ) equals k times the wage bill (wN). It is from $PQ = kwN$ that the WCM is deduced, for $A = Q/N$. Equation (4a) also enables us to isolate the following vital relations:

$$MV = kwN \tag{4b}$$

$$m(\Delta M/M) = (\Delta k/k) + (\Delta w/w) + (\Delta N/N) \sim (\Delta w/w) + (\Delta N/N) \tag{4c}$$

Equations (4b-c) are the vital ones in a *continuing* economy rushing out into time for (4c) discloses that if money wages are boosted inordinately, and the money supply slacks in pace, then employment (N) must falter: central bank dalliance after a big money wage eruption will undermine jobs and through $Q = Q(N)$, output will recede. To illustrate, if $m = 2$ and the money wage climbs by 10 percent, unless the money supply is augmented by 5 percent then jobs will be washed away.

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Equation (4c) is basic in the continuing economy of reproduction, where goods are produced today or this week, consumed, and reproduced, as the bread, milk, newspapers, shoes, fruits, etc. Unless money supplies are ample to sustain the higher wage bill emanating from the bargaining process then jobs, and output, will wither away as the production accordion contracts to the slower financing music.

It is in myopia of equation (4c) that the monetarists commit their most grievous blunder. They innocently pretend, as in equation (1), that Q is a fixed mass of goods, already at hand and effectively invariable for all time. Changes in the money supply thus descend upon the goods volume, like a guillotine, and yield the price level charge.

Unfortunately for the monetarist conception, ours is a production-flow economy where labor inputs are continuously hired to underwrite production flows. In the reproduction image, discerned by *Marx* and the classical economists, outputs are the consequence of labor inputs, and moneys and the banking system exist to facilitate the labor input process, and on a size to carry the immanent wage bill. When pay scales mount, moneys must follow suit or jobs and production will be in jeopardy. Unit labor costs (w/A) decide the price level, with provisos for k under monopoly or competitive markets. Moneys, however, are removed from the direct price level scene but come on cue for jobs and production.

To shift the imagery, the monetarists' QTM vision conjectures the economy to be a huge farm where outputs are produced "naturally" with hardly any decisions on labor hire. Subject only to stochastic and negligible vagaries in the weather, the Q-magnitude is rather flat from year to year. Money descends from outer space, as in the helicopter illustration of *Milton Friedman* or in the anecdotal magic of *David Hume* where Englishmen awake to find £ 5 notes stuffed in their pockets overnight. In either case, more money hits the unchanging volume of goods and the price level bounds up. While Q-constancy and M-increases from outer space may have been true in *Hume's* time of an agricultural economy, where money was augmented by ships laden with gold and silver returning from other shores, the vision is indecently mistaken as a model of the modern economy where money wages advance strongly, and discontinuously, and where central banks proliferate, and production is subject to technological advance. Quantity theories may have fitted the bygone era. They are a vast irrelevance for the modern scene.

XI. Consumer Price Levels and the Open Economy

Attention has so far been riveted on the general price level of all output, and in a closed economy. A valuable short digression can deflect the focus to the consumer price level and the open economy, requiring only modest adaptations in the point of view.

1. The Consumer Price Level

For the consumer price level, writing C = consumer expenditures, we can write:[13]

(5a) $C = P_c Q_c = awN$, where the subscripts denote the *C-sector*.

Also, a = some multiple of the wage bill

(5b) $P_c = a(w/A_c)(N/N_c)$

Equation (5b) is intriguing for it divulges that, starting wholly from demand considerations, unit labor costs still occupy center stage for prices in the C-sector. Relative sector size, conveyed in the labor hire ratio (N/N_c), also enters. Likewise, α which in the United States in recent years has been about 1.04. Palpably the average money wage is capable of performing stronger leaps than the combined other terms whose movements are bounded while for w the sky is the only limit.

2. The Open Economy

For an open economy such as Germany the wage-productivity nexus as the price level generator must be modified only in details, in encumbering the WCM with terms to reflect the external world forces. Thus:[14]

(6) $P_{d+f} = k(w/nA)\,(Qd/Q_{d+f})$, where d = domestic and f = foreign or imported. Effectively, in (6), the price level is written to include domestically produced and imported wares inasmuch as foreign content enters into the price of every pound of coffee, or cigarettes, or suit of clothes, or automobile, etc. The term n = the domestic value content of each item of final output, with $n = 0.9$ in the United States so that 90 cents of every $ 1 of items sold consists of domestic inputs, and ranging

[13] On the significance of a, see my "Generalizing Kalecki and Simplifying Macroeconomics," Journal of Post Keynesian Economics (Spring 1979).

[14] For a fuller exposition, see my Capitalism's Crisis, Chapter 3, and the elaboration in my "Price Level In The Open Economy," Kyklos (1977).

from 0.8 to 0.85 in Germany where roughly 80 to 85 pfennigs of each 1 DM of sales contains domestic inputs.

The Q-terms denote the relative physical volume of domestic to domestic and foreign content. Examining the equation the n- term will tend to cancel all or much of the Q-ratio. If these terms move within a small range, as they often do, the "imported inflation" charge could be completely laid to rest.

Thus any dramatic price level explosion must originate in the domestic economy. World price phenomena usually inject mainly a pin-prick complication in Germany where, other things unchanged, a 100 percent eruption in import prices might lift the home price level by roughly 15 percent. Blaming import prices for inflation is disclosed as either journalistic hysteria, political apologetics, or public confusion in seeking and accepting scapecoats. The German price level is not made abroad or in outer space; instead it bears the label of being "made at home." When prices abroad are behaving well the domestic money wage and salary vigilance can be somewhat relaxed. Under global inflation a country must take a tougher stance to nip inflation. All major countries, and surely the United States and Germany, can fashion their own P-destinies, admitting only some price wriggles.

XII. The Ultimate Monetarist Muddle

Previous passages developed the necessary theoretical base to substantiate our ultimate denunciation that, at bottom, the monetarist perceptions of inflation are mythical for they dissolve into technical indeterminateness. That is, the presumed explanations are defective in that they lack a theory of movements in the price level in any significant time dimension. This is the analytical 'black hole' in monetarism despite the aggressive and assertive statement of position to pretend that the monetary origins of inflation are axiomatic and above challenge or reproach.[15]

We live in an economy moving out in time. It is not given to us to start the world anew so that the best we can do is to induce changes in the evolutionary economic processes in motion in the system about us. On this premise, to deal with the effect of changes in the pace of money augmentation we again invoke equation (1b).

[15] Cf. my Capitalism's Crisis, Chapter 4.

(1b) $$m(\Delta M/M) = (\Delta P/P) + (\Delta Q/Q)$$

Suppose $m = 2$, and about 'constant' as *Friedman* avers. Suppose the central bank also follows his injunction to increase the money supply by 3 percent, in fealty to his Rule. By arithmetical necessity then, the terms on the right must increase by 6 percent.

1. Monetarist Frustration

The nub of monetarist frustration lies in the fact that on their conceptions they are unable to fathom, in conditions of a growing labor force, the presence of abundant unemployment, and circumstances of advancing productivity — all of which are the realistic cases — whether the 6 percent swing in MV will carry with it a $(\Delta P/P)$ jump of 12 percent and a $(\Delta Q/Q)$ output decline of 6 percent, or vice versa, or any combination of variations totalling 6 percent. Their prevision is simply blank on how the money supply emission will be split between supporting production or underwriting inflation. On the most elemental and supreme question monetarism is exposed as pleading ignorance! For the central bank it makes all the difference in the world whether its deliberations lubricate a salubrious production and job outcome or wreak price havoc.

The WCM theory can unravel *Friedman's* baffling puzzle which has confounded monetarist thinking and which is of such immense practical importance.[16] Recall, too, that monetarism's stipulation of m-'constancy' has already been denied. On the vital money life signs on which central bankers beg illumination monetarism thus comes up empty and barren, with their doctrines generating mainly furious intellectual heat rather than a glowing sure light. Their policy advice has to be taken with a barrel of salt rather than the proverbial dosage.

2. The WCM Analysis of the Price-Production Split

In their candid moments, reserved for occasional confessionals in professional journals, monetarists have conceded that their theory is indeterminate, *vide* sterile. Yet the enormity of their muddle has

[16] On several occasions *Friedman* has admitted that "the general subject of the division of changes in money income between prices and quantities badly needs investigation." See his "A Theoretical Framework for Monetary Analysis," Journal of Political Economy (March-April 1970), pp. 222 - 223, 234.

hardly penetrated official circles, or filtered down to journalists, or percolated through public opinion which monetarists have captivated to an inordinate and undeserved degree. The lag in comprehension is distressing in obstructing the development of a rational economic policy.

The WCM theory solves the *Friedman* puzzle which has defied the monetarist probe, and does so with passing ease. The WCM argument maintains that money supplies have literally nothing to do with the price level so that $(\Delta P/P)$ is untouched, and at some remove from the central bank's flailing gestures. Money, to be sure, packs a potent wallop but with the determinants of P wrapped in kw/A, then the money clout is reserved for jobs and production. This proposition is central to WCM theory. Monetary swipes hit at real phenomena, at jobs and production and not at prices, contrary to the monetarist thesis which, in unbridled assertions, ignore the baffling "puzzle."

On this foundation monetary policy can be described as restrained, neutral, or relaxed and stimulating depending on whether:

$$m\,(\Delta\, M/M) \gtreqless (\Delta\, P/P) \tag{7}$$

3. *The Monetarist Dubious Rule*

The monetarist frustrating nervousness in confronting equation (1b) also throws into disrepute their espousal of their steadfast money supply rule for economic stabilization. For example, if annual money supply increments are reined, say to 2 percent, and if $m = 2$, the monetarists presume (from their chart-reading astrology) that $(\Delta Q/Q)$ "normally" sprouts ahead by 4 percent. Thus the 2 percent money augmentation, they think, will barely tolerate the production creep and it will foreclose any spillover to generate inflation.

Herein the monetarist position displays two theological tenets to test the analytical faith: (1) the factual non-axiom of $m = 2$, and (2) that the price level is decided by money emissions, rather than the money wage and productivity nexus.

On m 'constancy,' with the creation of money substitutes the jury verdict is in, having dismissed the monetarists' claim. On (2) it is inherently vacuous to allege that unions, or wage earners generally, will behave in proper conformity. If money wages mount, say, by 10 percent while the central bank adheres to the 2 percent rule then stagflation will be our lot, with prices jumping by 8 percent and production falling by 4 percent (*if* $m = 2$ and $A = 2$, with k constant).

Essentially this has been the sordid tale of the 1970s in heeding the monetarist prescription (imprecisely and with deviations, to be sure). On the other hand, if we did have a feasible mechanism to guarantee that the (w/A) ratio would hold steady, so that $(\Delta P/P)$ would be practically frozen near zero to impart a flat price trend, then the central bank might readily be able to subscribe to the monetarist dictum, with occasional aberrations depending on liquidity considerations.

Monetarists have thus omitted the cardinal first step in promulgating their message proclaiming the monetary Rule, namely, a call for the alignment of money wage (and salaries) on average to productivity gains. Without the money income gearing the implementation of their Rule is a recipe for self-inflicted wounds and imbibing the bitter stagflation brew. Money wage discipline is the inescapable imperative for freeing the economy from the inflation fever.

Monetarists are guilty of myopia in a self-inflicted blindness in refusing even to entertain any serious discussion of wage policy, or Incomes Policy generally.

4. The P-Q Matrix of Economic Possibilities

The possible combination of P and Q outcome are far more numerous and complex than monetarist superficialities have pretended. In contrast to the monetarist stumbling over the indeterminate puzzle the WCM theory can expose the inherent causes of the 9 alternative concatenations of P and Q relations disclosed in Table 1.[17]

Thus with the P-movement grounded in unit labor costs (w/A) it follows that (if m behaves) the central bank can exert either benign or baneful impacts on production. According to the table the row we land in depends on the (w/A) performance: ideally we would like to be situated in the middle row. The column we enter is amenable to central bank policy. Monetary authorities thus carry the awesome responsibility of influencing output. But they misconceive their mission, short of full employment circumstances, in thinking that they can subjugate the price level; they have failed abysmally in this objective — and inevitably according to WCM reasoning.

[17] Cf. my Capitalism's Crisis, p. 76.

Table 1

The ΔP and ΔQ Macroeconomic Matrix

$$(\Delta Q/Q) = m\,(\Delta M/M) - (\Delta P/P)$$

$$(\Delta P/P) = (\Delta k/k) + (\Delta w/w) - (\Delta A/A)$$

$\Delta Q/Q \rightarrow$ $\Delta P/Q$ $\downarrow$	+	0	−
+	Growthflation	Stagflation	Slumpflation
0	Growth at Constant Prices	Stationary State	Recession
−	Deflationary Growth	Stationary State Deflation	Depression

According to the table there are 9 possible P and Q combinations. While we would like to be in row 2 column 1, and stay there, too often in recent years our fate has been row, squirming uneasily between column 1 and 2 under slow or nil growth, and in column 3 under recession with inflation — the slumpflation category. In the 1930s Great Depression row 3 and column 3 registered our sorry state. For those who quiz the likelihood of row 3 column 1, the sequence was not uncommon in the last quarter of the 19th century in the United States development wave marked by large immigration.

If we included jobs or unemployment in our Table 1 matrix, we would discern 27 possible outcomes! The proliferation of cases would try our ingenuity in assigning names to describe them. The lesser exercise of Table 1 demonstrates that the usual characterization of growth or recession is incomplete. Textbook focus on the trade cycle, growth theory, or recessions, analyzed in terms of constant prices, ordinarily isolates row 2 and thereby loses contact with the actual economy.

5. *Qualifying Proviso*

Our analysis ordinarily premises some unemployment or some productivity advance so that $\Delta Q > 0$, meaning that output is capable of advancing. This is the usual state of affairs, especially in Germany with its access to "gastarbeiters." If the reasonably full employment stage is realized — and this should be our aim — then we are confined in or around column 2. Monetary policy must then be ordered merely to sustain the price advance if wage policy allows an inordinate creep. If wages are satisfactorily contained the price outbreak would signify a profit inflation, which would require other measures to check and repress it. Hyperinflation, however, can never develop if money incomes are not permitted to run riot. If, however, every time prices jump up, say by 10 percent or 100 percent, money wages are then let loose to escalate, then the hyperinflation spectacle is set in motion. Implicitly, in these remarks it is apparent that "indexing" is one sure road to hyperinflation, as Israel, Brazil, and Iceland are learning.

6. Non-Reproducible Goods and Speculative Markets

There is one avenue through which money supplies can have a more direct effect on prices outside the realm of reproducible goods. For example, borrowed bank monies do support speculation in commodity markets, foreign exchange markets, stock markets, and in real estate. Obviously, these are not markets of reproducibles and hence, inflationary expectations fed by credit may enter to influence the ephemeral outcome with only the most tenuous connection to unit labor costs.[18]

This can be acknowledged without impairing the main argument, namely, that our economy is mostly engaged in reproducibles which constitute the flow-processes tracked in our nationl income tabulations. Production flows are indispensable to our survival. And in this enduring economic sector of reproducibles, the alignment of money wage hikes to producitivity improvements is the paramount ingredient for inhibiting inflation and assuring a flat price course.

XIII. Nonfeasible Price and Wage Controls

How to bell the cat? How do we gear money wage advances to productivity gains? This is the telling question. Money wages and salaries comprise about 75 percent of the national income and they set the standard for about 5 to 10 percent more among small proprietors, farmers, professionals, self-employed, etc. Too, money wages not only constitute the lion's share of business costs but they comprise about

[18] I owe this proper amendment to conversations with Dr. *Bruno Foa*.

85 percent or so of consumer demand. So they cut both ways, lifting the price level by pulling and pushing on it as money wages chronically rise over and burst the productivity dike.

1. The Nonfeasibility of Price and Wage Controls

The short and hasty answer, for an alternative to spurious reliance on monetary maneuvers, is to invoke price and wage controls. Unfortunately they will not work for they are incompatible with the market system. They are costly to administer, they become politicized on insignificant small matters, they are bureaucratic and officious, they involve harassment and denunciation of simple transactions between consenting parties, they encourage illegal black markets, they require a legion of snooping enforcers, they are dilatory and mete out unequal justice; they clog the courts, and they provide a stage for expensive histrionics by lawyers. Too, if they enjoy success in the first flush of enthusiasm there will be clamor for their dismantlement sponsored by those harboring resentments, whether in fancied or real substantive grievances. Once the controls are dropped the basic disorders assert themselves in a fresh orgy of price blasts.

Price and wage controls had better remain interred as an unworkable tactic basically incompatible with the market economy. Some plan more in harmony with the system should be devised. Controls, at best, should be reserved as a stop-gap while we debate better strategems.

XIV. TIP: A Tax-Based Incomes Policy

The present author, in collaboration with Dr. *Henry Wallich* then a Yale Professor and now a Federal Reserve Governor, proposed TIP, an acronym for a tax-based incomes policy, as a method of consummating the (w/A) alignment.[19] Briefly, TIP is a plan to use the corporate income tax as a lever in order to have the largest business firms monitor the alignment of money incomes to economy-wide productivity trends. TIP would be confined to no more than 2,500 firms for, in the United States, 1,000 firms produce over 55 percent of business output and 2,500

[19] For the collaborated article on the *Wallich / Weintraub* proposal, see Keynes, Keynesians, and Monetarists, Essay 16. For further development, Capitalism's Crisis, Part 3. Further supplements and alternatives appear in my recent book on Our Stagflation Malaise (Quorum Books, 1981).

firms contribute upwards of 85 percent of the total. (For Germany a figure of about 1,000 firms might be appropriate.) Obligated for coverage, therefore, are firms that usually hire over 25,000 employees each.

Contemplated under TIP is a progressive corporate income tax on those firms which puncture a mandated average norm for year-to-year percentage pay increases. For example, if the average noninflationary pay hike was judged to be 3 percent, firms could allocate the figure as they saw fit among production line, clerical, supervisory, managerial, and executive personnel: only the average, and not any individual or group advance, need be constrained. Firms that surpassed the 3 percent average pay increase would be subject to an extra company income tax impost. With the prevailing U.S. corporate income tax rate at about 45 percent, the rate might be lifted in progressive steps for firms transgressing the pay norms.

Beyond the penalty tax there would be no fuss, no denunciation, no commotion nor official intervention such as under controls. Obviously, too, the corporate tax is an old and familiar market system institution; business firms have learned to live with higher and lower rates, always taking tax aspects into account before making their decisions.

1. Some TIP Implications

The object of TIP is *not* to collect taxes; in conception it resembles a posted speed limit in urban areas imposed to outlaw maniacal driving conduct. Insofar as some tax revenues would be amassed under TIP, the ordinary corporate income tax could be cut so that on balance the total company imposts would not be heavier. TIP could not then be assailed for eroding corporate venture capital; only the tax base for computing the company tax liability would be modified.

TIP would site the onus of collective bargaining at the correct pressure point, namely, as a dispute over relative pay scales. Production workers could eke out boosts in excess of the average provided that managers and executives got less; not everyone would have to move in lockstep with the average pay pace.

The principle of economy-wide productivity gains must dominate the pay norm. Otherwise a discriminatory pay range would evolve. For example, if in the airline industry productivity is spurting by 10 percent per annum, corresponding pay boosts would double the pay for the petrol attendant pumping gasoline into the aircraft in about 6 years and quadruple it in about a decade. The attendant's brother, doing the same chore at the local garage where productivity is stagnant, would take home constant pay for the same job over the same years. Arbitrariness would be rife. Furthermore, an industry by industry productivity norm would impede the functioning of the price system, and interfere with optimal resource allocaction, by bolstering costs and prices in sectors of advancing technology, and maintaining cost stability in non-progressive activities. Prices should fall in the former, and edge up in the latter, in an efficient pricing model. TIP would thus be conducive to the efficiency objective.

Supplementary features of TIP are bypassed at this time. Economically, the program should deter the wage-price spiral with minimal, practically nil, intervention in the market economy. In adopting TIP about 8 extra lines on the corporate income tax form would be entailed. For coverage of 1,000 firms about 5 extra auditors would be required in the tax bureau; if each examined 2 forms a day, looking at 8 lines in the morning and repeating the stint in the afternoon — not an arduous work day — one person could handle 500 in a 50 week year! Corporations would have all the information they require to complete the TIP computations in other sections of the tax form.

The TIP penalty aspect could accomplish the goal of pay restraint. If TIP failed to do its duty it could be dropped immediately for it does not pamper a huge bureaucracy devoted to its survival. Conversely, firms could violate the standard pay norm at their discretion, subject only to the extra penalty. TIP embeds this valuable safety valve, or escape clause, for those special cases where firms feel it incumbent to transgress the strict pay ceiling.

2. Collective Bargaining as an Obsolete Institution

Collective bargaining, practiced hodge-podge in separate industries, is basically obsolete. Steel unions, say, grab off a 10 percent increase and are jubilant. But then steel prices rise, affecting a variety of goods and part of the pay gain is eroded down the line. Likewise, managerial, executive, and clerical pay follows suit by 10 percent, dissipating any relative union pay gain, indeeed widening the absolute differentials.

Thereafter as the same pay settlement spreads to other industries, not only are the relative positions frozen as before, but the money pay advance dissolves in the inflation smoke. The ongoing price flares goad central bank action to fight the inflation sequel by destroying jobs and production. Ultimately, the economy and the unemployed, as well as the pensioned, are victimized.

Germany has been somewhat better in avoiding the collective bargaining catastrophes by a greater sense of money wage discipline by more informal labor and management participation practices. But there is still more room for recognition that money incomes, and not money supplies, are the tinder of inflation fires. A TIP policy may impart new awareness as a persuasive agent not dependent on union or management personalities, either clashing or in happy mutual concordance.

XV. The International Culmination and Opportunity

In concluding we come full circle back to the international aspects of TIP or a feasible alternative Incomes Policy.

Under a successful (w/A) alignment through time, the central bank could be freed of its chronic fears of inflation; normal maximum demand for moneys would grow at a moderate pace because of the limited money wage strings in setting the wage bill: visions of indiscriminate money supply increases or the conjuring of hyperinflation would be an artificial scare. Meanwhile, the central bank, with the price level in hand, would be released to concentrate its activities on job, production, and exchange rate considerations.

With the stable price level fed by Incomes Policy, at bottom the mark would be a strong currency and a long-term magnet for capital inflows. From time to time, as interest rates in other centers escalated, the Bundesbank would have to weigh the alternatives of letting interest rates rise to match other centers, and the domestic economy suffer job and output losses, and imports be curtailed by the diminution in demand, or allow the foreign dollar value of the mark to fall to stem the DM to dollar exodus. Ordinarily we would expect a mixed or combined policy until the air was cleared. Not to be neglected, with the price level stabilized and with higher interest rates percolating through the domestic economy from, say, the Federal Reserve policy, a judicious application of fiscal policy either by way of tax cuts or expenditure increases could ameliorate the situation, with the foreign exchange value of the DM largely unaffected. Opportunities for rational conduct, to avert a recession disaster, would open up once the price level was removed as a restraint hampering central bank and fiscal policy initiatives.

In contrast, monetarism eschews adaptation to the situation confronting the authorities. Under an interest rate escalation it counsels the same policy as under an interest rate descent. When queried about capital outflows it prescribes the ingenuous medicine of stoicism, or doing nothing, however ill the patient and however much he writhes, and despite the availability of a cure. The monetarists recommend abandonment of the exchange rate, to let it float, even to descend precipitously to calamitous and inflationary regions. About unemployment, it counsels likewise a do-nothing attitude, regardless of the suffering and known restoratives. Myopically, it holds one end in sight, namely, to maintain the pace of money augmentation regardless of the economic shocks.

In its fascination with money aggregates monetarism has forgotten, or neglected, the purpose of money supplies, namely, to facilitate a stable price level, full employment, and interest rates and foreign exchange rates conducive to these ends. The supply of the money medium has, to monetarists become an end in itself, rather than conceived as a means of achieving the important objectives.

The confusion has become embedded in central bank policy, not entirely to be sure; the departures from strict monetarism have been our saving grace. But as the ideas have seized central bank psychology, all of the western economies have paid a severe price for the weird monetarist voodooism posing as verities to be violated at our peril. Indeed, it is because monetarism is partly honored in the breach that our economies have not been thrown into greater chaos. Time is overdue to cut loose from the monetarist shackles and to move out to Incomes Policy for price level stability, and thereupon to release monetary policy discretion, and the virtues of fiscal policy, to contribute to human economic benefit.

Monetarism has imprisoned us by preying on our fears. The facts are grim. The opportunities that await us can be grasped by acting on the WCM perception of the price level in the economy of producibles.

Zusammenfassung

Monetaristische Wirrnisse

Dieser Beitrag behandelt die monetaristische Theorie sowohl in ihren theoretischen wie auch in ihren angewandten Aspekten. Eingegangen wird dabei auf ihr nebelhaftes Konzept von der Geldmenge, ihre schwachen Behauptungen über die Umlaufgeschwindigkeit des Geldes, ihren falschen Zusammenhang zwischen Geld- und Preisniveau, ihre Vernachlässigung des Zusammenhangs zwischen Lohnerhöhungen und Preissteigerungen und ihre Torheit, wenn sie sich für strikte Geldmengenpolitik einsetzt und die Notwendigkeit einer diskretionären Notenbankpolitik verneint; und all dies in einer interdependenten Weltwirtschaft, in der die abenteuerliche Geld- und Zinspolitik eines so großen Landes wie das der USA sofort auf andere Wirtschaften wie die Bundesrepublik Deutschland, übertragen wird.

Westliche Volkswirtschaften leiden unter dem dreifachen Desaster: Preisexplosion, übermäßiger Arbeitslosigkeit und überhöhten Zinssätzen aufgrund der gegenwärtigen Geldpolitik. Stagflation und Slumpflation sind völlig neue und ungewöhnliche Erfahrungen, hervorgerufen durch den doktrinären Monetarismus, der die Implikationen der permanenten Einkommenseskalation ignoriert (in Deutschland allerdings wegen der Anwesenheit der Gastarbeiter und der kooperativen Einstellung der Gewerkschaften etwas besser bewältigt als anderswo). Aber bei diesen Zusammenhängen muß auch die Einkommenspolitik berücksichtigt werden, so daß die Notenbanken ihre ganze Energie und ihre beachtlichen geldpolitischen Instrumente auf das Produktionsniveau, die Zinssätze und die Wechselkurse konzentrieren können, ohne inflationäre Impulse befürchten zu müssen.

Summary

Monetarism's Muddles

This paper treats the theory of monetarism in both its theoretical and applied aspects, including its nebulous concept of *the* money stock, its uncorroborated assumptions of money velocity, its erroneous causal train of money and the price level, its neglect of the tic between pay hikes and the price march, and its follies in advocating rigid money supply policies, and denying the need for central bank monetary discretion, in an interdependent world economy where adventitious money and interest rate policies in one big country, such as the United States, are rather instantly transmitted to affect other economies, such as Germany.

Western economies have been reeling under the triple distaser of zooming prices, excessive unemployment, and extravagant interest rates by virtue of the monetarist policies of our times. Stagflation and slumpflation are literally new and strange experiences engendered by doctrinaire monetarism which has been impervious to the implications of the persistent pay escalation, managed a bit better in Germany than elsewhere because of the presence of

"gastarbeiters" and a more cooperative attitude of trade unions. But the relations will have to be formalized through Incomes Policies so that central banks can devote their full energies and formidable monetary instruments to cope with output levels, interest rates, and foreign exchange rates, without fear and trepidation of inflationary impulses.

Résumé

Chaos monétariste

Cette contribution traite de la théorie monétariste, tant sous son aspect théorique que dans ses applications. On examine à cette occasion sa conception vague de la masse monétaire, ses affirmations faibles sur la vitesse de circulation monétaire, sa fausse relation entre niveau monétaire et niveau des prix, sa négligence du rapport entre augmentation des salaires et augmentation des prix et son étroitesse d'esprit, lorsqu'elle se fait l'avocat d'une politique de la masse monétaire stricte et nie la nécessité d'une politique discrétionnaire de la banque centrale; et tout cela dans une économie mondiale interdépendante dans laquelle la politique monétaire et des taux d'intérêt insensée d'un pays aussi important que les Etats-Unis se répercute immédiatement sur d'autres économies comme la République Fédérale.

Les économies occidentales souffrent d'un triple désastre : explosion des prix, chômage excessif et taux d'intérêt excessifs basés sur la politique monétaire actuelle. La stagflation et la slumpflation constituent des expériences nouvelles et inhabituelles, engendrées par le monétarisme doctrinaire, qui ignore les implications de l'escalade permanente des revenus (toutefois un peu mieux maîtrisée en Allemagne qu'ailleurs vu la présence de travailleurs étrangers et la disposition à coopérer des syndicats). Mais dans ces relations il faut aussi tenir compte de la politique des revenus, de sorte que les banques centrales puissent concentrer toutes leurs énergies et leurs instruments considérables de politique monétaire sur le niveau de la production, les taux d'intérêt et les taux de change, sans avoir à craindre d'impulsions inflationnistes.