The Irrelevance of Aggregative Policies against Inflation under Conditions of Resource Misallocation

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The paper deals with the inadequacy of disinflation policy by aggregate restraint and gives some guidelines for a better arbitrage between short- and long-term requirements.

1. The Issue

There has been increasing awareness of the allocative nature of the post-1974 economic crisis. Resource allocation was all but optimal in the early seventies, as was evidenced by growing worldwide inflation, profitability losses, overindebtedness of all sectors, the overflowing of the international monetary system, or by all kinds of social discontent towards the costs of economic growth. The blowing-up of the international price structure and of industrial cost structures, because of wide exchange rate adjustments and the oil-price increase, disrupted the world economy as a system.

The policy issue was however proposed in terms of symptoms rather than causes. It was unemployment on the one hand, and a set of monetary and financial disequilibria on the other hand: inflation, private, public and external deficits, and exchange rate instability. The political debate, which economists were not able to inform adequately at the time, focused on the dilemma between stimulation and stabilization. And it was discussed, then designed, along the usual aggregate and short-term lines.

In a short-term perspective, the two targets were conflictual indeed. Financial stabilization called for curbs in wages and in public expenditures. Stimulation would have implied sustaining wages and public expenditures. Only in a long-term, allocative perspective could the trade off be overwon. Such long-term concerns would have been the most relevant, indeed, but we were not intellectually prepared to design them, and short-term concerns looked urgent.

In the keynesian tradition, I shall consider as of long-term relevance, all that is related with the production or allocation of resources, and as