

INTERIM REPORT OF THE STUDY GROUP  
ON THE  
"Problems of Inflation"

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Study Group on the "Problems of Inflation"

Interim Report of the Study Group  
presented to the Commission

PREFACE

1. This Report has been prepared by a group of independent experts set up by the Commission and chaired by Mr. R. MALDAGUE, Commissaire au Plan in Belgium (a list of the Group's members can be found on the next page).
2. The sole objective of the Interim Report is to highlight the major aspects of a structural approach to inflation. These aspects, which cover social, political and economic dimensions of the problem, are complex and not readily understood. The Final Report, which is to be presented to the Commission at the end of the year, will present both the analysis and proposed remedies in greater detail.
3. It is important to stress that the economic, social and political structures of the Member States differ appreciably. The analysis of inflation and the proposed recommendations must not therefore be applied uniformly to all Member States.
4. The Report is concerned mainly with the internal problems of inflation. A number of external aspects have already been dealt with in the report drawn up by the Study Group on Economic and Monetary Union by 1980, which also contained practical proposals for action in these fields.
5. The document was forwarded to the Commission on

II

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### III

#### CONTENTS

	<u>Page</u>
<u>INTRODUCTION</u>	1
<u>Part One : The causes of inflation</u>	5
A. <u>New Economic Structures</u>	5
I. The rise of meso-economic power	5
II. New inflexibility in the price mechanism	7
a) The price-making power of leading firms	7
b) The relationship between productivity, returns and prices in different sectors	8
c) Rigidity in the distributive trades	9
III. New dimensions to capital and labour markets	10
a) The labour market	10
b) The capital market	13
B. <u>New Social Factors</u>	16
I. Inflationary consumption : a new model	16
II. The failure to meet "qualitative" demands	16
III. Structural change in national production and incomes	17
IV. The growth of internal liquidity	20
C. <u>Decentralization and weakness in political decision-making</u>	21
I. Social strain and social tension	21
II. Compartmentalization of decision-making	22
a) The tendency towards decentralization	22
b) The tendency towards corporatism	22
III. The weakness of political decision-making	23

## IV

<u>Part Two : Recommendations</u>	26
A. <u>The clearer definition of economic strategy</u>	27
B. <u>Control of economic power and competition</u>	29
C. <u>The conception and construction of a new growth model</u>	30
I. Increased admission of qualitative factors	31
II. Progressive redistribution of the national product	31
III. Employment policy	34
IV. Regional policy	36
V. Strategy for change	36
D. <u>A new framework for negotiation and decision-making</u>	37
I. Social accounting and social analysis	37
II. New terms of reference and choice of priorities	39
III. Public opinion and public debate	40
<u>CONCLUSIONS</u>	42

## INTRODUCTION

1. Inflation has become a problem of dramatic proportions.

At the national level, it encourages economic speculation, provides some people with unjustified profits, and results in a generally unjust allocation of income, especially when the direct and indirect income of certain social groups (in particular, the non-active sections of the population) are not adjusted in line with increases in the cost of living.

Inflation constantly distorts the assessment of economic performance and frustrates rational calculation in both the public and private sectors. Inflation thus contributes to a less rational distribution of the factors of production.

Savings are moved out of long-term investment into forms of 'hedging' against inflation (precious metals, land, etc.) or are kept in liquid form, simply not reinvested.

As a result of the lack of monetary discipline and negative interest rates, inflation alters the terms of lending and the criteria for choosing investments, thereby wasting resources or reducing growth potential and creating higher structural unemployment.

Further, the implementation of anti-inflationary measures which concentrate unduly on single aspects of the problem has given rise to substantial distortions which have often meant that public authorities have to sacrifice plans for structural reform and public services.

The overall effect of inflation is to jeopardize progress towards a more egalitarian society; to aggravate social tensions and intensify the corporatist reactions of those wanting to safeguard acquired privileges; it thus erodes democracy.

At the European level, the differences between rates of inflation and the specifically national character of anti-inflationary measures place the European Economic Community in considerable danger of disintegration, a risk accentuated by the present conditions of international competition and by the 'beggar-my-neighbour' policies of a number of member countries,

which prompt others to give priority to their bilateral relations with the United States. Such developments make a Community response to inflation even more unlikely.

2. The dramatic increase in the pace of inflation over the last eight years was probably due to an unfortunate combination of circumstances: namely, a particularly sharp economic upturn in all industrialized countries, accompanied by rapid cost-push and demand-pull inflation; an explosion in raw material prices due partly to overheating and ancillary factors such as the use of oil as a political weapon; an acute phase in the upheavals besetting the international monetary system.

However, this is only part of the story. These accelerating factors - both cyclical and accidental - occurred against a background of structural inflation rooted in profound economic, social and political changes which have occurred in the last twenty years.

3. These changes will be analysed in greater detail in the first part of the report dealing with the causes of inflation. However, it is important first to consider the extent of these changes.

Forty years ago, Lord Keynes formulated the main elements of a new economic theory based on the principle that, if public authorities intervened to regulate private and public demand, the price mechanism and competition would ensure a supply of goods and services at full employment without inflation.

Since then, there has been a considerable change in the general economic framework. The widespread use of demand management, full employment and welfare state policies has considerably altered the pattern of supply, competition and foreign trade as well as the composition of both public and private spending.

In the meantime, our economies have been subject to the rapid growth and increasing influence of very powerful large firms that will be referred to below as the "meso-economic" sector", a phenomenon between microeconomics and



macroeconomics. This sector does not respond to overall demand management by the public authorities in the same way as an economy based on small firms. The structure of competition itself has been transformed and operates under new 'rules of the game'.

The combination of stagnant investment, rising unemployment and persistent inflation since the late 1960s indicates that the regulation of overall demand alone as advocated by Keynes is no longer in keeping with meso-economics.

To cope with these new factors, the Keynesian approach needs a new and different complement.

In all, several hypotheses on which European integration was based have been profoundly modified.

It will be remembered, moreover, that the report of the Spaak Committee (1956), which preceded the Treaty of Rome, stressed that considerable imbalances and inequalities could result from the liberalization of foreign trade, capital and labour, a warning that was reiterated ten years later in the Community's first Medium-Term Economic Policy Programme.

Although the Community has now implemented the main points of its trade liberalization programme and its programme for the free movement of workers, the progress envisaged and achieved in the structural areas of sectoral, regional and social policy have by no means come up to expectations.

4. Structural inflation - a problem which gives cause for much concern - cannot, therefore, be isolated from its economic, social and political context. For instance, a number of measures that brought very positive social benefits, such as those for ensuring better job protection, for providing assistance to farmers and for narrowing income disparities, have played their part in fuelling inflationary pressures, for want of a coherent general framework of policies for balanced growth.

5. There are two main ways in which governments could master inflation :

- either accept recession and depression resulting from over-reliance

- on traditional instruments of economic policy, i.e. "stop-go" measures;
- or undertake a programme of more fundamental reforms and measures designed to achieve a more balanced economic, social and political structure.

In order to halt inflation, "stop-go" measures would have to be applied more frequently and on an increasingly wider scale, with intolerable human and economic cost less and less acceptable and causing a greater waste of resources. If full employment, a better distribution of resources and the profits for investment cannot be safeguarded, measures which simply restrict demand will increasingly clash with social expectations of improving the quality of life, extending public services; combating inequality, promoting individual liberties, achieving a higher degree of participation and social integration, etc.

The public will not tolerate these contradictions for long. Therefore, unless far-reaching reforms are undertaken, there is a great danger that authoritarian methods - open or concealed - may gradually obtain a hold on our democratic societies.

PART ONE : THE CAUSES OF INFLATION

6. The present wave of inflation and the economic upheavals that accompany it (in particular, the problems of unemployment and growth) can no longer be explained solely by one specific factor, whether the disorder within the international monetary system, the rise in raw material prices or wage claims.

The current inflation and the accompanying difficulties are no longer a passing phase in a traditional economic cycle but reflect more deeply-rooted changes in economic and social structure. Consequently, the Group's report deals mainly with the structural causes of inflation. It is important and urgent for politicians to grasp these structural causes since, if no action is taken to remedy them, there seems little likelihood of restoring and maintaining the growth, employment and price trends we had grown used to over the previous two decades.

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A. NEW ECONOMIC STRUCTURES

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I. THE RISE OF MESO-ECONOMIC POWER

7. Macro-economic demand management policies assume that competition determines price formation at the micro-economic level. In other words, it assumes a price-flexible supply and demand in response to monetary and fiscal policies. This fails to take into account the emergence of a new "meso-economic" sector between the macro-economic level of public policy and the micro-economic level of small and medium-sized undertakings. (Greek: mesos - intermediate).

The term "meso-economic" refers to the increase and growth of monopolistic, multinational companies, whose behaviour is totally different from that of small-scale national firms in the micro-economic competitive model.

The structure of competition itself has thus been transformed. What has emerged is a new dualism between large and small firms (meso-economic and micro-economic undertakings).

The following figures illustrate the size of the meso-economic sector :

- in the United Kingdom, less than 1% of firms account for 50% of the country's output and foreign trade. 100 firms control half of industrial output, with 75 firms accounting for half of direct exports and 31 firms for 40% of direct exports.
- in France, the top four firms in each of the following industries accounted for over half the total sales in 1969: metal-working (82%), extraction and processing of various metals (80%), steel (77%), aircraft construction (65%), production of non-ferrous metals (60%), oils and fats (54%), rubber and asbestos (52%).
- in Germany, about 2,5% of industrial firms accounted for more than half of total sales in 1968.

There is every indication that meso-economic firms are continually increasing their share of the market despite the policies attempted at national and Community levels to promote competitive structures.

The same is true of exports in the 'meso-economic' sector. A considerable proportion of their export transactions is composed simply of products traded between multinational subsidiaries of the same meso-economic firms. This growing "internalization" of foreign trade has, furthermore, helped to undermine the effectiveness of "externalized" exchange rate changes.

The growth of this powerful new meso-economic sector is not a conspiracy against the public interest; it is the natural outcome of economies of scale and the need for specialization.

## II. NEW INFLEXIBILITY IN THE PRICE MECHANISM

### a) The price-making power of leading firms

8. The inflationary power to raise prices is in part a direct result of the rise of meso-economic power: there is a significant correlation between the size of a firm and its ability to set its prices at a relatively high level, thereby earning super-normal profits.

In the meso-economic sector, the consumer sovereignty has been replaced by a producer sovereignty, who can "impose" prices. Large firms generally set their prices in relation to the costs and prices of smaller marginal firms. This provides a kind of price umbrella for those small firms which large firms, or public authorities, want to keep in business. This policy enables competing firms of very different sizes to remain on the market and offers the more viable firms super-normal profits which, in turn, makes possible their further expansion and unequal strength.

This price umbrella technique is also used in trade between subsidiaries of multinational companies in different countries, i.e. using the transfer pricing technique. These companies can thus promote inflation by raising the prices of imports from their foreign subsidiaries virtually with impunity.

The price umbrella practice is substantially the perverse result of competition policies which encourage price increases instead of curbing them. Large firms set their prices at a level which permits a number of competing firms to remain on the market (an objective of competition policy).

This practice is inflationary in that :

- it makes for a constant upward alignment of prices;
- it slows down the process of modernizing equipment and thus narrows the scope for subsequent price cuts.

This does not mean that competition no longer exists. In fact, meso-economic firms both continue to compete for a larger share of national or world markets, and at the same time enter into various types of agreement designed to limit other effects of competition and strengthen their own position of firms. In short, large firms are motivated in different and more complex ways than conventional economic theories suggest: they aim as much to expand their activities and supplies and markets, as to raise the profitability of their operations; the ultimate aim, in terms of power, is survival and relative autonomy.

b) The relationship between productivity, returns and prices in different sectors

9. Industrial growth has been rapid but unequal both between sectors and regions.

Productivity, therefore, varies considerably between sectors and between regions.

The fact that increases in productivity differ from sector to sector is not in itself inflationary, provided that the most productive sectors pass on to their customers a considerable share of their gains in the form of lower prices.

However, the sectors in which productivity gains are the most rapid rarely reduce their prices: for the reasons given at (a), high-productivity sectors, which are often dominated by a few leading firms, can conduct virtually independent pricing policies regardless of their productivity. As a result, profits and wages in these sectors will rise sharply. Given the general tendency to pay equal wages for the same type of work, higher wages quickly spread to all the other sectors of the economy.

Sectors in which productivity increases at a relatively slow rate raise their prices even more sharply in order to be able to pay the higher wage rates and ensure their survival.

Thus the return to factors of production in the different sectors of the economy has climbed rapidly.

In brief, the greater the productivity differences, the greater the increase they now can entail in the general level of prices.

c) Rigidity in the distributive trade

10. The structure of profit margins in the distributive trades is generally such that measures taken to hold back prices, particularly in industry, often do not work through to consumer prices.

There are a number of reasons for this :

- the traditional and outdated structures of part of the distributive trades;
- the gradual replacement of price competition by a form of competition which tends, on the contrary, to raise costs and prices and involves in particular :
  - artificial differences in products, markets, prices and related services;
  - massive, insistent and emotional advertising;
  - prestige goods and items "for show";
- the "middle class" policy pursued by many governments;
- the low price elasticity of demand on many markets (inadequate market transparency, lack of time available to consumers, particularly as a result of the increase in the number of women who go out to work);
- growing consumer expectations regarding choice of varieties available, presentation of products, product specialization, etc. Also, more generally, in the consumer society a tendency for prices to be related to the satisfaction expected from the purchase or possession of an object, or from the use of a service - social prestige, attempts to imitate or to be different from others, the more widespread importance of fashion ...;
- consumer protection requirements.

The size of the distributive trade's profit margins in terms of consumer prices can be illustrated by the following statistic: the gross trading surplus of

the distributive trades alone is equivalent to about half (1) of the gross trading surplus of industry as a whole. In a number of countries, the distributive trades' surplus is even larger than that of industry (2).

Apart from the factors mentioned above, the main reason for this is that traders often calculate their selling prices by adding a fixed percentage to their cost prices. Wherever demand is relatively inelastic, this is tantamount to indexing profits to cost prices. This triggers primarily an upward pressure on prices. A downward movement in producer or import prices is rarely passed on to the consumer.

Moreover, the development of integrated retail outlets often has little beneficial effect on consumer prices. Although, at the outset, supermarkets and the like frequently apply a policy of low prices in order to attract customers and to drive small competing traders out of business, they then often raise their prices, thereby making considerable and unwarranted profits. In addition, their sales and promotional techniques often encourage over-consumption.

### III. NEW DIMENSIONS TO CAPITAL AND LABOUR MARKETS

#### a) The Labour Market

11. The Treaty of Rome provides for the free movement of workers within the Community. However, it has now been widely shown and recognized that imbalanced geographical migration is extremely costly in social and economic terms and thus fuels inflation.

12. Generally speaking, the factors making for an inflexible supply of manpower are not dealt with rationally. This is a matter of fundamental importance. It goes a long way to explaining shortcomings in public policies.

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(1) In 1970, the figure for Germany was 41%, for the Netherlands 51% and for the United Kingdom 58%.

(2) In Italy, the percentage 109%.



As not enough is known about mobility and the labour market, it is hazardous to offer a detailed diagnosis of labour inflexibility at this stage. Inflexibility is often the result of undeniable social progress which no one would think of reversing, e.g. laws and agreements on job security (length of notice of termination of employment, accident prevention, redundancy payments), improved benefits for the wholly unemployed, the creation of opportunities for promotion within firms, etc.

There also is increasing attention to demands that a certain level of employment be guaranteed in the less favoured regions of the Community when the major employer in a town or locality announces a cutback in production.

13. However, granted the social and economic aims of modern society, it would be mistaken to reject the aim of achieving improved allocation of manpower. In this respect, although the active employment policy pursued since the last war has produced very positive results, its limitations have, since 1965-68, become apparent to differing degrees in the countries concerned. Nowadays, the incentives to create jobs are often much less powerful than the pressures on companies to continue to provide a job.

14. One of the main sources of distortion to which attention must be drawn is the inability of certain groups to obtain worthwhile employment. This is the case of handicapped workers or foreign workers who have lost their previous jobs, but there is also an increasingly serious problem for the elderly, the ever-growing number of women seeking their first job or wishing to return to work after raising their children, and school-leavers with qualifications for which there is no great demand or with no real vocational qualifications. This has led to an increase in structural unemployment, even during phases of rapid growth.

Even when a large number of young people and women were registering with employment exchanges, firms were complaining of the shortage of skilled labour, which led to outbidding on the wages front between firms in need of such labour. The steps being taken to extend adult training schemes are not an adequate answer to such problems posed by shortage of skilled workers. This distortion is substantially due to the failure of employers to look ahead and to a lack of coordination between firms' requirements and training opportunities. There also is a deplorable tendency among employers to entice workers away from other firms, as a matter of short-term convenience rather than cooperate in organizing an accelerated programme to train new skilled workers.

Pending the results of a more thorough survey of labour mobility, it should be stressed how difficult it is for some employees to move to a new region: the arduous business of selling their home, which they often own, and of buying another in a new locality; the fact that such a move does not always fit in with the occupation of the spouse, who cannot always move as well; the loss of certain indirect wage or work advantages, although here collective agreements have resolved a number of difficulties; the inadequacy of the social infrastructure (schools, hospitals, transport facilities, etc.).

15. All things considered, employment policy has failed to create the conditions necessary for voluntary mobility that is satisfactory from both a social and an economic viewpoint. There are other causes such as the lack of a genuine market for part-time employment, which clearly would help adjust labour supply and demand in particular areas. There also is the fact that labour markets increasingly operate within the terms of reference of a number of large firms, which accordingly undermine the regulating function of the rest of the market.

16. This criticism in no way implies that an attempt should be made to reverse the gains already made by trades unions which are, in any case, irreversible. However, a comprehensive review of employment policies that also makes allowance for the limitations of medium-term and long-term forecasting in this field is called for. Although it is possible to detect

tendencies and to quantify them by reference to major occupational categories, it would be unwise, at present, to consider a too finely detailed classification. In societies in which producers, dealers and consumers enjoy freedom of action, they frequently take jobs or embark on careers to which their training is not tailored. Hence the need to review also the relationship between education and employment with a view to making it more realistic and flexible.

b) The Capital Market

17. The allocation of capital is also subject to considerable rigidities although financial capital is much more mobile than individuals.

18. Leading firms (meso-economic firms) - through price-making power - have more scope today for maintaining their profit margins and sales in periods of depressed activity (1); as a result, a key feature of the conventional price and profit mechanism is no longer functioning.

But, for the same reason, self-financing now is a regular feature of their capital-raising. Therefore, leading firms have relatively less recourse to the capital market. This is one of the causes of fluctuations in capital markets in recent years, but is a main cause of the declining role of stock markets.

19. Inflation is accentuating the tendency among firms to raise capital by issuing bonds rather than shares. This is an important aspect of the general trend away from share issues prompted, in particular, by the systematic extension of interest rate subsidies offered by central or local authorities and by the desire of firms to avoid control by institutional investors (banks, insurance companies, etc.) in countries where these have large shareholdings.

This increasing recourse to bonds for raising capital creates another inflationary factor, since it leads firms to maintain or even raise price levels in a recession in order to meet their fixed interest payments.

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(1) It will have to be seen whether this still holds in the event of the present crisis persisting or worsening.

This has transformed the price sequence of the conventional trade cycle. Previously, prices rose during the upswing of trade and fell in the recession. Nowadays, prices rise in both the upswing and the recession.

Moreover, this tendency can be aggravated by government stop-go policies. The more a government relies on a policy of restricting demand, the more firms tend to raise prices in order to compensate for the drop in turnover resulting from the fall in sales. Thus deflation can cause inflation.

20. In several countries, the powerful holding companies, over-concentrated in particular sectors, form monopolistic obstacles to competitive pricing.

21. The restricted spheres of financial capital, together with a tendency towards a regional concentration of investment, imposes social costs and so fuels inflation.

When taking investment decisions, firms are mainly concerned with good results for themselves. Capital, therefore, is invested in areas with the highest micro-economic productivity of capital and labour, regardless of the social costs of such concentration. Regional differences in micro-economic productivity and production capacity are thus accentuated, while differences in prices from region to region are tending to disappear (a phenomenon which is also becoming evident at international level).

These productivity differences, combined with the tendency for wages, and incomes in general, to level out between regions, produce a situation in which marginal regions are protected by the prices set by firms in more productive regions in a system that no longer reflects the lower real costs incurred in regions with higher micro-economic productivity. As a result, there is a spatial dimension between regions of the 'price umbrella' phenomenon described above in relation to meso-economic firms. (1)

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(1) See further, section A.II.

If social costs are not taken into account and no control exercised over the pattern of investment, this inflationary effect is to some extent offset by the migration of workers to regions with higher productivity levels. However, action taken to mitigate the social costs of emigration in turn may strengthen inflationary tendencies.

B. NEW SOCIAL FACTORS

I. INFLATIONARY CONSUMPTION : A NEW MODEL

22. Spurred on by advertising, consumption in our society tends towards a model which includes a large measure of frivolous, ostentatious or, at the very least, non-essential consumption. There are several factors behind this :

- anarchical advertising;
- artificial differentiation of markets, models, prices and related services (guarantee, after-sales service, etc.);
- unnecessary changing of models;
- production of over-sophisticated and expensive items in place of simple, more efficient and cheaper goods;
- insufficient consumer information (comparison of prices, technical characteristics and durability of products, etc.).

Tied to this pattern of consumption, our society wants to consume too much too quickly. This generates heavy pressure for increases in direct and indirect income, while demand, oblivious to prices charged, expands too rapidly, spurred on by a supply of goods and services which are of increasingly questionable utility and novelty.

II. THE FAILURE TO MEET "QUALITATIVE" DEMANDS

23. Workers' demands today are increasingly concerned with the "quality of life and working conditions" : they centre on very concrete needs, some of which could be organized or provided publicly (housing, public transport, cultural and social services, etc.) and others privately (organization and content of work, desire to keep occupational expertise up to date, greater worker participation and increased industrial democracy). In general, these problems are poorly perceived both by the public authorities, and by employers.

Both prefer to try to solve disputes and ease tension through traditional negotiations on wages and working hours.

Such an approach fails to solve the problems involved, and at the same time boosts inflation in the following respects :

- increased wage costs are passed on by firms in the form of price increases;
- the unduly heavy pressure of consumption (resulting from the increase in direct or indirect incomes) limits the resources available for "social investments", which do not receive the necessary priority;
- production costs are aggravated by absenteeism, high staff turnover and poor quality work, all of which reflect wage earners' frustration with their working conditions.

### III. STRUCTURAL CHANGES IN NATIONAL PRODUCTION AND INCOMES

24. Public policy in this connection shows four main inflationary trends :

- an increase in subsidies to meso-economic firms (negative tax-push inflation);
- a growing share of tax transfers or social subsidy in the structure of household incomes;
- an increase in goods and services acquired with public subsidy (direct or indirect) in traditional private consumption;
- an increase in goods and services provided "free of charge" in enlarged private consumption (1).

The Group proposes to study in greater detail the links which might exist between these phenomena and inflation, bearing in mind the social and economic effectiveness of these subsidies. The Group has in mind in particular the importance of the subsidies paid to firms, which deserve a more detailed analysis.

25. However, certain conclusions are already emerging :

- a) Public transfers and in particular social security transfers are obviously an integral part of the policies aimed at achieving a fairer distribution of national wealth and income and attaining the fundamental objectives of improving social welfare and cohesion.

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(1) Traditional private consumption plus goods and services provided free of charge to households by the public authorities.

In most cases, direct income demands are formulated in such a way as to take account of the transfers which must be made to the State, but do not allow for cash payments or public services provided by the public authorities. A substantial inflationary pressure begins to weigh on costs, especially during wage negotiations. This is one of the conclusions to emerge from an OECD study of expenditure (1) : "... it seems clear that the rising tax burden stimulated income claims (...) and was thus one factor tending to keep up the household sector's share in 'primary' incomes. How far, on the other side, the rising volume of transfer payments (many of which go mainly to the aged, sick or unemployed) helped to mitigate claims for higher money incomes is an open question (...). These questions ... lie at the centre of the process by which resistance to attempts to shift the distribution of expenditure away from 'pure' private consumption (2) generates inflationary pressures ..."

Another potential source of inflation is that in collective wage bargaining the elements of direct and indirect wages are generally fixed without assessing the trend of overall wage costs. However, in most of the original EEC countries, indirect wages (3) have grown more rapidly (during the period 1966 to 1972) than direct wages (4) so that in 1972 they amounted to between 34% and 47% of wage costs.

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- (1) Expenditure Trends in OECD Countries, 1960-1980: OECD, July 1972
  - (2) 'Pure' private consumption is defined as follows by OECD : "consumption not paid for out of transfers received from the public sector in connection with social security and other welfare schemes" (ibid. p.11)
  - (3) Irregular premiums and bonuses, payment for days not worked, social security contributions, benefits in kind, other charges
  - (4) Direct wages and salaries, regular premiums and bonuses



b) Secondly, the Community countries do not yet have a breakdown showing to what extent national product is used for meeting the various needs of society (education, health, social security, research, law and order, housing, recreation, etc.) and to what extent the various sectors (public authorities, firms, households) contribute to meeting these needs. (1)

In the absence of such an overall survey, it is impossible to evaluate fully how growth contributes to meeting these needs. Endless political discussions take place without a sufficiently extensive and coherent statistical base. In such circumstances, it is very difficult for the public authorities to make rational choices and to formulate coherent policies.

c) While the public authorities can allocate part of new resources to new objectives, it is extremely difficult for them to cut back previous allocations. This results in a highly functional rigid structure of public expenditure.

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(1) The national accounts of the member countries which have adopted the new conventions of the European System of Integrated Economic Accounts (ESA) contain two distinct and uncoordinated functional classifications based on the United Nations' System of National Accounts (1970) :

- one showing general government expenditure (see Table 12 of the SOEC National Accounts Yearbook 1973) (breakdown to one digit of the United Nations classification);
- the other showing final consumption of households (see Table 7 of the SOEC National Accounts Yearbook 1973).

Apart from the national accounts, work on functional breakdowns has been carried out or is still going on in two other fields :

- social accounts: a functional breakdown of social security expenditure (cf. SOEC publications);
- public finance: a functional breakdown of public expenditure beyond the second digit of the United Nations classification (cf. OECD works).

In September 1973 OECD attempted, unsuccessfully, to establish a combined functional classification of public and private expenditure.

Thus, the utilization of the national product has not been sufficiently adapted to the changing needs of society. The inadequacies of social infrastructure in general and of public transport in particular are striking examples.

As has been seen, these inadequacies give rise to "qualitative" demands for which satisfaction is sought - with little success - in conventional wage concessions (direct and indirect) and which, in their turn, fuel inflation. These contradictions will become even more marked if, as everything would tend to suggest, growth over the coming years drops below the rate of the past decade.

- d) All in all, our present model of growth leads to a dilemma :
- having failed to make the necessary policy choices, the policy makers continue to increase taxes and equivalent charges in order to be able to step up transfers, subsidies, social welfare schemes, etc. This then creates tax-push inflation, the various aspects of which have been studied in depth by the OECD. Moreover, the level of taxation in several Member States is reaching the bounds of what will be tolerated;
  - if the option is made for a lower level of taxation, a choice also must be made between the following alternatives :
    - .. to slow down the development of public services, thereby increasing the sense of frustration in society in the short-term,
    - .. to finance it perversely (i.e. expenditure not covered by taxation),
    - .. to introduce or increase direct contributions to the cost of the services by those using them,
    - .. to stimulate savings so as to increase financing resources.

Several of these solutions will also certainly have an inflationary effect.

#### IV. THE GROWTH OF INTERNAL LIQUIDITY

26. The combination of internal inflationary causes and the unduly vigorous growth of international liquidity after 1969 forced monetary authorities to allow internal liquidity to expand rapidly. During the last twenty years liquidity has grown faster than real national product, even allowing for the increase in the number of persons engaged in economic activity and of the change in payment habits. But since 1970 the volume of liquidity

in the member countries has expanded at an extraordinary pace : between the end of 1970 and the end of 1974 the annual growth rates were between 9 and 29%. Such excessive growth reflects a permissive attitude which has considerable bearing on the pace of inflation.

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## C. DECENTRALISATION AND WEAKNESS IN POLITICAL DECISION-MAKING

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### I. SOCIAL STRAINS AND SOCIAL TENSION

27. After the Second World War, growth was a prime objective of economic and social policy. It was unquestionably instrumental in restimulating employment and raising living standards. But it also promoted the internal strains in the economic and social systems of our countries. Since these strains were not eliminated immediately, they produced inflationary effects.

Inflation is therefore not only a source of increased distortions, but a sort of flight away from present realities. It masks certain structural problems and temporarily eases certain strains, but at the same time lays the foundation for even more serious tensions leading to social and political crisis.

28. Foremost amongst these problems and strains is the persistence of considerable inequalities of income and wealth :

- the differences between per capita income in the various regions of the Community have not appreciably narrowed;
- certain groups of workers have further consolidated their direct and indirect advantages, while others have seen their relative situation deteriorate (small and medium-scale farmers, small traders, certain categories of wage earners);
- economically unwarranted gains have become larger and more common (property speculation, earnings of certain professions, investment in hedges against inflation). Certain new forms of unjustified profits have developed (dividends received by the shareholders in large meso-economic firms who make little if any contribution to financing investments and who do not incur significant risk, save in periods of marked recession).

At the same time, conspicuous consumption has become increasingly common, thus highlighting these inequalities and reinforcing the general desire for parity.

## II. COMPARTMENTALIZATION OF DECISIONS

### a) Tendency towards decentralization

29. Even in countries with a strongly hierarchical trade union structure and a relatively high social consensus, there is a marked tendency to decentralize the decisions in which trade union organizations are involved. This tendency is reflected in the greater strength wielded by both management and unions in business, and in a greater awareness and often even greater willingness at grass roots level to take steps on matters which concern them directly.

Decentralization is not a bad thing in itself - quite the contrary - but its success depends on the ability to combine greater initiative at the base with a necessary minimum of coherence of action at the top. However, this is occurring less and less, in some countries in particular. Consequently, employer-employee relations become more and more uncertain, agreements and contracts are drained of their value, and the only possible solution to the problems of industrial bargaining is to be found increasingly in inflation.

### b) Tendency towards corporatism

30. Besides the individual trade unions, some countries have for a long time had organizations representing particular groups of the working population (farmers, small traders, craftsmen, civil servants, depending on the country). In recent years these groups have also adopted a new, much more aggressive attitude. In most countries, specific groups have recently set up their own representative organizations and are resolutely applying all the means of pressure at their disposal. This is a new and complex form of corporatism operating at all levels of society.

These two tendencies (decentralization and corporatism) have led to social groups competing more keenly between themselves. This competitiveness is becoming more and more specific and compartmentalized. This makes it virtually impossible to carry out the redistribution effort on a general basis. The danger of this corporatist tendency is all the more serious since it is not countervailed by the policy makers, who are the guardians of the general public interest, or by the trade union organizations, which are the guardians of working class unity of action.

In some countries, renewed awareness of the cultural and linguistic identity of regions is further strengthening the tendency to compartmentalize decisions.

### III. THE WEAKNESS OF POLITICAL DECISION-MAKING

31. Given these tendencies, political decision-making has never been so necessary. Nor has it ever been so lacking in force.

32. The fundamental principles underlying most of the political decision-making institutions and procedures were conceived many years ago in very different economic, social and political circumstances. In many cases these circumstances have altered profoundly. Institutions and procedures have not adapted to these changes.

33. Social and political objectives have become many and varied. Their relative importance varies considerably from country to country and from one interest group to the next. The hierarchy of objectives is vague and their inter-relationships not at all well understood.

Thus, many discussions on economic policy are still dominated by the explicit or implicit assumption that close relationships exist between several objectives, particularly between prices on the one hand, and unemployment and the balance of payments on the other. These relationships are in general much more flexible than is supposed. Where they exist and hamper the fight against inflation, they can often be loosened by a change in the behaviour of the main power groups in economic activity.

The relationship between prices and employment, which even in the past presented different characteristics in different countries, has changed appreciably in recent years; the increased rigidity of the labour force and the slower creation of new jobs have led to an increase in the "structural"

aspect of unemployment: in addition, fortuitous and structural factors have had an ever greater effect on price trends; even if the relationships between these phenomena have not yet been sufficiently analysed, it is obvious that the "cyclical" relationship between prices and unemployment has become looser and that in order to curb inflation, the public authorities must apply increasingly rigorous restrictive measures. Because of the ability of large firms to set their own prices, deflationary measures can actually reinforce inflation. This is the case where large firms raise their prices to offset an increase in taxes or a fall in demand. The resulting social costs are very high and entail increasing difficulties which may result in serious social crises.

The situation is different when it comes to the relationship between prices and the balance of payments. According to conventional theory, a balance of payments deficit should prompt governments to implement a restrictive monetary and fiscal policy (and vice versa). But when a currency is allowed to float without any State intervention, a balance of payments deficit normally no longer has the same restrictive effects on overall demand. Responsibility for managing the foreign exchange position passes from the central bank to firms. The system becomes increasingly unstable as it is taken out of the hands of the authorities. Consequently, the deflationary and reflationary relationships between prices and the balance of payments are undermined, thus encouraging inflation.

34. In many cases, the phenomena previously described have led to decentralization of public decision-making and a diversification of social structures. But this tendency towards more direct democracy has not been accompanied by adjustments of socio-political structures sufficient to offset the resulting power vacuum.

35. Consultation and negotiation procedures between interest groups in society are proliferating, overlapping and being drained of much of their value. In many cases, the very object of consultation has been defeated by the multi-  
plication of procedures.

36. In addition, several old-style rules and constraints have, in reality, disappeared : wage-productivity alignment, the balance of payments constraint on domestic expenditure, and other international monetary rules.

37. All these difficulties are further aggravated by the weakness of political decision-making. This is essentially due to :

- the narrow margin between the majority and the opposition, or the different currents of opinion within majority parties. These are factors which reduce the room for manoeuvre available to the parties in power; plus
- the fact that the public is able to express its views directly through other means than the political parties.

These factors largely explain the weakness of the political parties, the instability of governments and the difficulty governments have in taking major economic and social decisions. This is in addition to the divergent economic interests previously described which weigh more and more heavily on processes of political decision-making to the point of paralysing them.

These phenomena are the outward manifestations of a profound transformation in the way democracy works in our countries. Some of them are positive; but the institutions have not been adapted to the new realities, with the result that increasing difficulties are encountered in coordination and decision-making.

Under these conditions, inflation substitutes for the failure of other instruments to mediate and adapt claims to real and objective possibilities. This is despite the fact that the injustice and damage caused by inflation are universally recognised.

PART TWO : RECOMMENDATIONS

38. To sum up, inflation is inherent in :

- a new economy, the main features of which are the emergence of meso-economic power and the loss of flexibility. In some cases, this rigidity is a reflection of social progress which must not be jeopardized;
- a social impetus which, apart from its undeniable positive aspects, is reflected in an inflationary consumption, the failure to meet qualitative demands, plus changes in the allocation of national product and in the distribution of incomes;
- exacerbation of social strains, a tendency towards decentralization and corporatism, and weakness in political decision-making.

39. The effects of the deterioration in the international situation must not be underestimated. However, they were thoroughly analysed in the Marjolin report, to which cross reference can easily be made.

40. In these terms, inflation is not a passing or cyclical phenomenon, but a structural problem inherent in a far-reaching transformation of the market economy and society. These changes, some of which have in fact generated major social advances, particularly in more stable employment and social security, have not been accompanied by new up-to-date methods for managing the social side of the economy which, by introducing different means of controlling and distributing growth, might have largely eliminated the inflationary effects of these changes.

41. Effective action against structural inflation must, therefore, work towards two objectives :

- to ensure the functioning of a market economy, where possible, without jeopardizing the real social progress recorded since the war.



This calls for urgent action at national and Community level to deal with the behaviour of "mesoeconomic" firms in the formation of prices, in employment and in capital markets, where they now occupy a dominant position :

- to make this effort part of new economic and social planning
  - based on a coherent and democratic choice of priority social aims,
  - a permanent system of social concertation and negotiation,
  - operating at European, national and regional level,
  - and
  - selective in its objectives, means and implementation.

42. It would be foolhardy to try to put forward immediately any miracle solution to these problems, which are in fact medium and long-term problems. Nonetheless, the Group taking account of the deadlines to which it was subject, has tried in this interim report

- to identify the problems underlying inflation and
- to propose specific guidelines now for the solution of some of these problems.

43. The recommendations put forward in the following pages will have to be implemented at Community or national level, with varying degrees of intensity.

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A. THE CLEARER DEFINITION OF ECONOMIC STRATEGY

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44. If our society is to tackle inflation effectively over the long-term, it is essential to make and to adhere to a coherent strategy for society and the means of achieving it. This means major changes for our institutions.

The success of such an effort will depend essentially on the three main economic and social actors: government, the trade unions and the business organizations. It raises complex problems which the Group proposes to study in greater depth. However, several recommendations can already be made :

- to widen the scope of negotiations between those involved in economic life, both in terms of content and of those who participate in negotiations. With regard to the content, it is important to take into account not only the direct income of the parties involved (wages and profits), but also distribution (unearned income) indirect factors (taxation, transfers, community services) and qualitative factors (working hours and conditions, decision-sharing within the firm);
- to simplify the negotiation process and re-establish a genuine debate. In several member countries, the consultation and concertation procedures have in fact become over-complicated;
- to set up or improve a central body to discuss possible alternative economic policies, grouping together government representatives and professional and trade union representatives. It should be made obligatory at least to consult with this body, though the views expressed by its members on the main options of short- and medium-term economic policy need not be the same;
- to reinforce the primacy of political debate and strengthen political decision-making. This implies the strengthening of parliaments, which should be put in a position to make the main decisions concerning society;
- to help the representatives of the relevant social groups to implement choices once made. The bodies officially or unofficially responsible for preparing the technical ground for planning could make better use of their role and experiment with more effective forms of dialogue and negotiation.

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B. CONTROL OF ECONOMIC POWER AND COMPETITION

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45. The analysis has demonstrated the inflationary effects of the behaviour of large firms in the meso-economic sector.

The Group therefore proposes to look carefully at the strategy to be adopted in respect of these enterprises, the framework in which they must play the part required of them and ways and means of exercising more effective control over their decisions.

46. The extreme complexity of this task is illustrated by the obstacles which confront competition policies both in the EEC as a whole and in individual Member States.

The Group therefore intends to examine closely what measures should be taken in this field and how they should be adapted to the circumstances of each individual country.

These measures include:

- compulsory prior notification of price increases for certain key products;
- "authorized" rules and regular public adjustment of the fees of certain professions depending on the country concerned, especially those which maintain a monopoly position by fixing charges (lawyers, architects, doctors);
- more selective policies in agriculture, and in particular a better balance of price support and income support;
- tighter controls on corporate mergers, going as far as requiring large enterprises to seek prior authorization;
- time-limits on exclusive dealing contracts and concessions and a reduction in the period of patents and licences;
- removal of obstacles to the introduction of new production processes and methods of distribution;
- the development of agreements for both economic restructuring and social modernization on the lines of "planning agreements", "contratti di programmazione" and "contrats de modernisation et de restructuration", negotiated by the government, employers and trade unions.

- the introduction of a system for redistributing "excessive profits", either through taxation or by means for wage earners to take part in profit-sharing arrangements.

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C. THE CONCEPTION AND CONSTRUCTION OF A NEW GROWTH MODEL

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47. Fulfilment of such objectives will be subject to a number of fundamental constraints.

a) The choice between the various aims of our societies:

At present, governments and the main social pressure groups call at the same time for a continuing increase in material living standards, an improved quality of life, more social equality, more autonomy, and more public involvement, etc. Some of these objectives clearly must be given precedence over others.

b) Achievement of a new growth model will have to be a gradual process, since it will require far-reaching changes in the structure of production and employment. However, the pace of adjustment will probably be faster and more dramatic in the years ahead. This will increase social risks and disrupt accepted attitudes, especially as growth is likely to be slower in future. New machinery will have to be established to ensure that such changes can be made without jeopardizing the objective of full employment.

c) The new growth model cannot be developed in isolation from a new global economic and monetary order, the considerable uncertainties stemming from the need for a new international division of labour, from the struggles between countries over the distribution of wealth, etc.

These trends will raise awkward problems for economic management :  
reshaping the pattern of consumption, investment and competitive capacity, maintaining full employment (especially in countries with rapidly growing populations), etc.

The solution to these problems can only be found through better forecasting and effective planning.

## I. INCREASED ADMISSION OF QUALITATIVE FACTORS

48. In a new model for the development of society, greater attention must be paid to the qualitative factors which increasingly determine real welfare : increase in leisure time and leisure use, improvement of working conditions, protection of the environment, changes in the daily way of life (e.g. public transport versus private transport), etc.

It is therefore essential that :

- the desires and needs of citizens in this respect should be more fully understood. The information supplied by the market must therefore be supplemented and corrected by other means such as surveys and polls; development of social indicators, etc. (see below);
- an increasingly large proportion of national product should be used to meet these needs, reallocating resources and making choices as necessary.

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## II. PROGRESSIVE REDISTRIBUTION OF THE NATIONAL PRODUCT

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49. This new emphasis on qualitative factors will in the long run mean that there will have to be a gradual reallocation of national product. This in fact is in line with adjustments which anyway have been made necessary by recent events - the fundamental aim being to curb the increase in certain types of expenditure to free resources for other expenditure, to produce the exports required to offset the recent rise in the cost of some imports, and to provide aid to developing countries. These changes will call for a major reorganization of productive structure. They must be accompanied by action to align the structure of incomes with the new social pattern of production.

This policy cannot be set out in simple black and white terms. It will be examined more closely in the second phase of the Group's work. A number of recommendations can, however, be made now.

50. As regards private consumption, steps must be taken :

- to promote the production of goods of better quality and durability and fight against innovation for its own sake;
- to curb the overall increase in private consumption in the medium-term by action on several fronts including :
  - stimulation of personal saving and in particular medium-term saving,
  - review of certain forms of bank lending and consumer borrowing, including credit cards, etc.,
  - review of certain selling techniques, such as mail-order selling, tie-in sales, etc.,
  - reduction of superfluous advertising not only on a voluntary basis, but also through organizing corrective and comparative advertising, etc.,
  - curbing certain specific types of consumption (i.e. those which endanger health, and frivolous and/or meretricious articles),
  - no longer relying on tax measures alone to reduce consumption,
  - organizing consumers' rights (1) as defined at Community level and including :
    - protection of health and safety;
    - protection of economic interests;
    - advice, help and redress;
    - information and education;
    - consultation and representation.

51. As regards public sector consumption (and social transfer payments), the necessary reforms must be carried out to make measures in the field of health, social security, education, etc. more socially effective.

52. As regards investments linked directly to production, the aims must be simultaneously to :

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(1) See Council Resolution of 14 April 1975 on a preliminary programme of the European Economic Community for a consumer protection and information policy (Official Journal of the European Communities, n° C 92, 25 April 1975).

- promote the investment required to carry out the structural adjustments made necessary by changes in relative prices, in particular in the field of energy and raw materials, the new international division of labour, etc.;
- promote a more stable pattern of economic growth. To this end, firms should be allowed to carry over some profits from one year to the next for the purpose of future investment, this amount being "frozen" by the government in exchange for tax exemption);
- use taxation and greater selectivity in the granting of credit, discourage the over-investment and innovation for its own sake associated with the practice of model differentiation and "planned obsolescence";
- create a Swedish-style investment fund into which companies would have to pay part of their profits, and from which the resources could be freed only after consulting or obtaining the agreement of the trades unions.

53. In the field of public-sector investment, given the emphasis being laid on qualitative factors, priority must continue to be given or be restored to social and human investment, despite the fact that such investment leads to greater operating expenditure than public investment in purely economic infrastructure. The realization and management of such investment therefore must be carefully monitored.

The key criterion must be the quality of the service rendered to the population and not simply the financial cost of the investment. Thus :

- prestige investment must be curbed;
- the investment and the operating expenditure required to put it to full use should be treated as one cost;
- orders for social infrastructure projects should be undertaken in the context of a planned re-structuring of resources;
- inter-related projects must be planned jointly, both to cut the cost of the investment and to enhance the service provided (e.g. coordinated policy for public transport, housing and town planning).

In order to ensure that public investment schemes (especially in recreation and the arts) provide an optimum return in the long run on the funds available, account must be taken when selecting and planning such schemes of the views of the public who are the potential users of this infrastructure.

Such steps must be taken to educate and inform the public if all sections of the population, and in particular the least well off, are to reap real benefit from new schemes to promote social and cultural infrastructure.

### III. EMPLOYMENT POLICY

54. A thorough examination must be made of the factors inhibiting the flexibility of manpower, bearing in mind that :

- some of these factors are rightly inherent in the welfare system which has been built up in recent years;
- the full employment objective will remain one of the fundamental priorities of all our societies but it will inevitably be more difficult to attain in view of the new growth model sought and the increased risks for employment stemming from the faster structural adjustment of directly productive sectors.

55. To deal with problems likely to arise in the future a direct policy will have to be introduced aimed essentially at ensuring mobility between occupations and between industries working on the following principle:

- Establish a coherent relationship between :
  - income from work proper,
  - income provided during periods of training and conversion,
  - unemployment benefits,with the aim of promoting, as part of an overall policy of full and better employment, work, adjustment efforts and thus voluntary mobility.
- Encourage employment agencies to give priority to those most in need (handicapped persons, immigrant workers, older workers, etc.) and to concern themselves less with those who can find jobs without their intervention.
- Influence the demand for labour from firms (not only on the supply) for instance by :



- requiring firms to employ a certain percentage of persons in special need,
  - reducing the gap between workers' aspirations and the content of the work offered; this would make it possible to reduce the frequent feeling of frustration and alienation, which results increasingly in efforts to find compensation in increased incomes or in various psychological reactions (feigned illness, absenteeism, etc.);
- Restore a more genuinely voluntary mobility :  
increase career flexibility (especially for manual workers), promotion opportunities, choice between continuing at work, or retraining and retirement;
  - Establish more flexible relationships between work and education, for instance by giving young people the opportunity to try out different jobs, thus enabling them later to make a sound choice of occupation (1);
  - Draw up forward studies, both overall and for individual enterprises, which are sufficiently detailed to prove really effective (breakdown by region, qualifications, sector, age, etc.).

56. In addition to these measures, which can be implemented from now, it is extremely important that a far-reaching study should be carried out at Community level into the phenomena connected with safeguarding employment and labour mobility, including : workers' expectations and desires; the reality and significance of difficulties encountered when workers are forced to change jobs by economic circumstances and management decisions, solutions offered by legislation or by collective agreements; agreements reached as the result of industrial disputes; analysis of the aspects of mobility between enterprises and institutions, between sectors of activity (with or without change in job qualifications), between regions, etc.

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(1) See Belgian draft law on the provision of adjustment training periods in enterprises.

#### IV. REGIONAL POLICY

57. The analysis has shown that regional differences contribute to inflation in various ways, particularly :

- through the strains created by the trend towards wage equality and the inadequacy of regional development policies : labour is forced to move to those regions where there are jobs, but not vice versa;
- since anti-inflation measures do not take account of regional differences, they hit the least developed regions hardest and become unacceptable politically.

58. Experience has shown that the scale and nature of regional aids available (subsidies and transfers) are insufficient to reduce persistent regional differences. Their impact on location is minimal, certainly in the case of large firms in the mesoeconomic sector which are best equipped in management terms to establish new industries in less developed regions. The budgetary cost of such ineffective intervention also adds to inflation inasmuch as the available funds are often wasted, for example, on the large firms which need the least assistance.

59. Although anxious to make better use of the various incentives and means of intervention available, particularly the various European funds (Social Fund, Regional Fund, etc...), the Group stresses that such measures can be fully effective only if they are part of a direct and selective planning of investment with specific quantitative objectives.

#### V. STRATEGY FOR CHANGE

60. The ideas outlined above may seem inappropriate in the present climate of recession. However, the preconditions for recovery should not be obscured by the immediate and damaging short-term features of the present crisis. It is for this reason that "reflationary policies" should break new ground and be based on a new approach to growth, new consumption patterns and new dimensions to social policy. Now is the time to prepare the way for a

future growth pattern that is more consistent and less anarchic, more balanced and less inflationary, especially granted the fact that the traditional remedies have proved so ineffective and so incapable of combating inflation.

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D. A NEW FRAMEWORK FOR NEGOTIATION AND DECISION-MAKING

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61. The present process of negotiating and decision-making in society is largely unsuitable as a framework for implementing the above recommendations.

What is needed is a new form of economic management. The Group intends to elaborate recommendations on such management in its final report, but some interim observations are made below.

I. SOCIAL ACCOUNTING AND SOCIAL ANALYSIS

62. A new approach to economic accounting will have to be established if there is to be a wider social bargaining in economic affairs, covering the qualitative features of a new growth model.

63. The scope of national accounts must be enlarged by new accounting dimensions including ancillary new social indicators

a) This enlargement should be three-dimensional : social, sectoral and regional. The aim should be to provide a more accurate picture of the pattern and objectives of development, particularly the choice of means and the monitoring of the results of the policy.

The various parties involved in negotiation - government, management and unions - should :

- be given every opportunity to obtain information about the methods and materials used,
- and
- help to determine priorities for enlarging the scope of national accounts and other statistics.

This enlargement of the scope of accounts should also make it easier to assess more accurately the contribution of the respective factor of production and of the share of each social group.

b) The disaggregated new accounts should cover the following :

- social consumption;
- a cross classification of production particularly of national product by function and economic category;
- incomes broken down by category, economic sector, socio-economic group and income bracket;
- regional accounts;
- accounts of real and financial assets;
- welfare indicators;
- the performance of large firms and multinational companies (the meso-economic dimension);
- time allocation;
- social investment.

c) The social indicators should be coordinated with and related to the existing conventional national accounts.

64. The new enlarged accounts should be made available as a term of reference in wage negotiations and union working and social conditions as well as national negotiation of economic policies.

For instance :

- in the context of annual budgets and medium-term programmes in order to assess performance against objectives : e.g. direct income (before and after taxation), social transfer payments, public and social infrastructure, increased leisure time, the reduction of inequalities, improvement in the quality of life and working conditions;
- in preparing the accounts of central government, local authorities and social security institutions in order to coordinate their activities and thus eliminate duplication, waste and the inappropriate allocation of resources in relation to the objectives pursued;
- in the various negotiations about social conditions including employer - trade union agreements.

## II. NEW TERMS OF REFERENCE AND CHOICE OF PRIORITIES

65. Not only should the scope of negotiations between government, management and unions be enlarged (by quantifying qualitative aspects as far as possible), but the main objectives and their inter-relationship should also be specified and integrated into "reference tables" to provide a coherent accounting framework.

66. These tables should take account of the following factors (to be specified in further detail later) :

- the inter-relation of productivity (production, capital employment), absolute and relative prices, returns to factors of production and unemployment;
- the inter-relation of the revenue and expenditure of public authorities (including local authorities and social security institutions, disposable incomes and the allocation of national product by function and sector;
- the inter-relation of the financial resources of the various sectors (variation in their commitments and claims), the monetary base and exchange rates.

Each table would imply a choice between several basic aspects, e.g. :

- present and future,
- status quo versus progress,
- production at home or abroad, etc...

The tables should also include :

- general norms or guidelines on :
  - utilization of national product by sector and region;
  - public revenue and expenditure;
  - the monetary base or money supply.
- Checks on whether real supply matches demand in money terms.

67. These tables could be used for forecasting future trends and preparing alternative strategies. They also could show clearly the consequences of attaching more weight to one specific objective and demonstrate how it can be attained. Once several alternatives had been prepared, the next

step could be the choice of a 'target', implementation of the table and, if necessary, its adaptation to take account of later changes.

### III. PUBLIC OPINION AND PUBLIC DEBATE

68. As the support of public opinion is essential for the success of the policies proposed in this report it is important that the public be informed regularly and objectively. This is difficult because of the natural inclination of the mass media for sensationalism and over-simplification, as well as the trend towards fragmented interest groups in politics and the diversity of parliaments (government parties and opposition).

In general terms the Group would stress the need for more information and better education on economic matters for broader sections of the population, including schools and for those taking major decisions affecting economic and social developments. The public should also be better informed about the work and decisions of parliaments.

More specific proposals could include :

- set up a "brains trust" to report each year on how it felt economic and social development corresponded in practice to the objectives which society had set itself;
- dispel secrecy as to incomes by publishing tax returns;
- transform indirect subsidies into selective direct subsidies, whose scale and extent should be published;
- impose stricter rules on advertising within the framework of work already in progress at Community level.

On this point the following steps should be taken :

- ban on emotive advertising and advertising of products harmful to health (e.g. cigarettes);
- make it compulsory for prices to be indicated in all advertisements;

- authorize comparative advertising and reverse the burden of proof;
- make it compulsory for advertisements and labels to indicate the probable life of durable goods.

## CONCLUSIONS

69. Inflation is not a passing phenomenon nor even is it essentially cyclical. It has been provoked over the last two years by the combined effects of fortuitous and cyclical factors, as well as mistakes in policy-making. Nevertheless, inflation is increasingly becoming a permanent and structural feature of our societies.

70. For these reasons traditional policies of restricting demand - i.e. deflation - which are unsuitable for combating structural inflation, have to be increasingly brutal to register any real effect. The experience of the United States and Germany is a clear demonstration of this. The long-term effect of these deflationary policies is also doubtful. It may well be possible to reduce the current pace of inflation in the short-term, at a very high cost to the economy (loss of production and loss of jobs). However, for the structural reasons examined above, the problems of inflation will recur once production and employment recover.

The medium-term forecasts of the Community and the Member States seldom predict inflation rates of less than 7 to 8% and it is to be feared that the next swing towards recovery will trigger off a new wave of inflation.

71. It is therefore essential to tackle the structural causes of inflation. The various causes, which have been analysed above, are based on two main phenomena :

- the search for a new social balance;
- new conditions for pricing and competition.

72. Profound social changes are taking place in all our countries. The demand for direct participation in the running of firms, in trade unions, local, regional and national government is becoming more and more widespread. This is a positive and necessary trend at a time when parliamentary democracy in several countries is in difficulties.



However, these changes make the choice of policy more complex and call for a far-reaching review of the methods of political administration and social negotiation.

Secondly, the growing awareness of inequalities coupled with trade union alertness has brought about major social advances in terms of stability of employment, guaranteed incomes, etc..... These legitimate reforms, some of which have still not gone far enough, may produce inflexibility - and hence a potential source of inflation - if they are not accompanied by a recasting of policies in the sectors concerned (an active policy on voluntary mobility and on employment, a policy on income distribution, etc.....).

Finally, people are increasingly demanding improvements in the quality of life and working conditions. If these demands are not correctly assessed, understood and satisfied, they will lead not only to increases in wages and incomes but ultimately to dissatisfaction and inflation.

While these various developments multiply and complicate the political decisions which must be taken, they also make the need for such decisions all the greater. To cope with them, flexible and selective planning procedures, properly integrated into the political decision-making process and based on simplified and revitalized machinery for cooperation and negotiation, will have to be established or reorganized. They must reflect the method most suited to the social and economic structure of the countries concerned.

73. The conditions of competition have also changed radically.

Many industries are controlled by a few meso-economic firms occupying "a dominant position" which enables them to set their prices at a level which will guarantee them maximum profit, while ensuring the survival of smaller, less profitable firms. The same firms often control the distribution of capital and labour between regions and maintain regional disparities.

If the rate of inflation is to be slowed down, these firms and their price-making procedures will have to be established within a coherent framework of medium- and long-term planning.

The State, which, to varying degrees according to industry and country, is an important producer and customer, has so far made little use of its power to make markets more flexible. Indeed, in many cases State action has reinforced the protection enjoyed by certain industries and regions and thus increased the inflationary effect.

The structure of certain sectors such as the distributive trades, the building industry and agriculture, together with public policy vis-à-vis these sectors, have a number of direct and indirect effects on inflation which the Group intends to study in more detail.

74. The Group also intends to take its analysis further and clarify its recommendations in the final report.

It is fully aware that the guidelines which it is proposing are difficult and demanding. They involve calling in question both the social and economic aspects of the conventional model of growth.

However, the choice is clear :

- either the Community and the Member States will have the necessary foresight and courage to square up to the task;
- or they will continue to apply traditional policies which must inevitably result in an increasing series of economic, social and ultimately political crises of an increasingly brutal and profound nature.