ΟΙΚΟΝΟΜΙΚΑΙ ΚΟΙΝΩΝΙΚΑΙ ΤΕΧΝΙΚΑΙ
ΣΠΟΥΔΑΙ
ΤΡΙΜΗΝΙΑΙΑ ΕΠΙΣΤΗΜΟΝΙΚΗ ΕΠΙΘΕΩΡΗΣΙΣ
ΕΚΔΟΣΙΣ ΤΗΣ ΕΝ ΠΕΙΡΑΙΕΙ ΑΝΩΤΑΤΗΣ ΒΙΟΜΗΧΑΝΙΚΗΣ ΣΧΟΛΗΣ

ΟΙΚΟΝΟΜΙΚΟΝ ΕΤΟΣ 1975	ΑΠΡΙΛΙΟΣ - ΙΟΥΝΙΟΣ 1975	ΚΕ' ΤΟΜΟΣ	ΑΡΙΘΜ. ΤΕΥΧΟΥΣ 2

FULL EMPLOYMENT, PRICE STABILITY AND EXTERNAL EQUILIBRIUM

By Prof. DIMITRIUS J. DELIVANIS
University of Thessaloniki

The Piraeus Faculty of Industrial Studies has decided to publish a volume in honour of Professor Andreas Kyrkilitsis who has retired some years ago. I was asked to contribute which I do with great pleasure because I know and esteem Professor Andreas Kyrkilitsis for at least 40 years. He has been the first economist to work for the Bank of Greece and has been for a long number of years the head of the economic research division of our central bank. Under this capacity Professor Andreas Kyrkilitsis considered as his duty to support any decision of the central bank's presidents even if they were wrong. This led more than once to discussions between us without of course affecting our reciprocal friendship and esteem. I believe that the subject to be treated in my contribution to the volume in honor of Professor Andreas Kyrkilitsis is one on which the undersigned has not always been in agreement with his colleague and friend Andreas Kyrkilitsis without certainly meaning that he has been or is right. Audiatur et altera pars.

Economic theory is usually accused that it does not grasp sufficiently reality. This accusation is frequently right but in one case economic theory may be found wrong by accepting or at least not overthrowing a slogan found in many speeches and statements of statesmen, journalists and even central bankers. This concerns the possibility of securing simultaneously, provided the appropriate measures are carried out, full employment, price stability and external equilibrium. It has to be mentioned in this connection that in the fourties many economists were afraid that after completing reconstruction the world economy would face unemployment and depression. It is well-known that this belief was shared also by Soviet economists who had advised in this connection their own government that then its troops would be able to overrun easily Central and Western Europe.

Unemployment and depression did not occur thanks to the continuous efforts of strengthening economic growth and development and to the economic repercussions of both the cold war and of various local hot wars which did not disappear since the official end of world war II on August 15, 1945. Whilst full employment existed then and the governments concerned were simply eager to preserve it neither prices were stable nor the external equilibrium of a great number of countries was secured. It follows that in the programs of the various governments concerned the continuation of full employment and the realisation of both price stability and external equilibrium were linked together. The creation of the rather mysterious term «magic triangle» persuaded many people that its realization is possible provided the appropriate policy is applied. In accepting this possibility those concerned did not consider that whilst in theory full employment does not exclude the stability of the various price indexes which constitute averages of price rises and of price falls in reality this is possible only if the workers and employees limit their claims for higher wages to the level permitted by their productivity's increase; as experience teaches this is not frequent. On the other hand the external equilibrium of an economy is secured when full employment prevails only if this happens also in the countries with which intercourse is substantial or if the full employment country is receiving capital flows from abroad, or is protected by exchange control, quotas and high custom duties. In that latter case the flows of commodities, services and incomes are reduced and we may speak only of an external equilibrium secured through govermental measures and not through the market.

This introduction shows that in reality the goverment concerned cannot really secure at the same time full employment, price stability and external equilibrium except if certain conditions are fullfilled and are kept on for a rather long time. It will be necessary to examine if perhaps the countries applying the principles of planned economy are more successful in securing simultaneously full employment, price stability and external equilibrium.

Part I will deal with the possibilities of credit, monetary and foreign trade policy to secure either full employment or price stability or external equilibrium.

Part II will deal with the possibilities to achieve simultaneously two of three aims.

Part III will deal with the possibilities to achieve simultaneously all three.

I. (a) Credit policy, monetary policy and foreign trade policy when combined in the appropriate way and when not neutralised by other governmental measures may secure full employment provided a) the tendency to hoard does not increase, b) the propensity to consume and to invest, both in the private and the public sectors, does not diminish, c) the deficit of the balance of payments is not increasing. As a matter of fact full employment presupposes that the appropriate purchasing power is placed at the disposal of the economy and is not hoarded nor used for imports from abroad neither for the payment of debts there except of course if also exports abroad and capital inflows from there rise. The efficacity of the policy of full employment through the appropriate credit, monetary and foreign trade measures may of course be neutralised by hoarding due to the unwillingness of those having substantial balances to use same. This is the case when depression is expected or when the businessmen concerned consider that their possibilities are ample enough to cope with any demand. Full employment may further be prevented by the lack of the appropriate raw materials, fuels, means of transportation, foreign balances and whenever foreign trade is important by unrealistic monetary parities affecting unfavourably exports, both visible and invisible whilst encouraging imports both visible and invisible from abroad. The impossibility to secure full employment in the interwar period has proved without doubt that even the best conceived credit, monetary and foreign trade policy is not enough to secure full employment. This negative experience connected with deflation and with pessimistic forecasts of investors explains the importance attributed all over the world to the securing and upholding of full employment. The fear it will vanish explains why many steps which were not justified were decided particularly in the western countries.

(b) The experience of the interwar period with the single exception of 1919-20 was that it was not possible with supply exceeding demand to prevent prices from falling. This explains why to begin with price stability in peace leading in the downwards phase of the cycle to price fall was considered to be quite normal. Despite the end of world war II in August 1945 whilst local wars and the cold war connected with rearmement and inventory building up continued inflation did not stop and so price stability was of course not reached. The hectic price rises caused by the Korean war showed developments in the opposite direction and led to the belief that price rises are unavoidable except if blocked provisionally by governmental decrees or decisions. There is no doubt that price stability is impossible when all governments indulge in inflation, when central banks extend credit not only to the public but also to the private sector of the economy, when wages and salaries move continuously upwards independently of the productivity's evolution, when taxes, freights and insurance premiums are continuously rising and when monetary devaluations are frequent.

Gradually all those concerned came to the conclusion that under the conditions prevailing after 1945 price stability cannot be reached. As a matter of fact the deflation needed for this purpose cannot be enforced without leading to unemployment which all countries want to avoid. Despite this conclusion the achievment of price stability continued to be included in the programs of the governments all over the world whilst as a rule they did not take those steps which were most needed for this purpose. It has to be stressed that price stability would lead eventually to unemployment at least up to a certain degree and so had to be avoided. It may be concluded that price stability cannot be reached when inflation continues, when incomes increase more than output and when workers and employees are able to impose continuous incrases of their rewards. Of course the deflationary credit policy, the freeing of imports from abroad and even more the increase of the foreign exchange value of the local currency may reduce the upwards tendency of prices but deflation will lead to unemployment or at least reduce employment whilst monetary appreciation is feasible only when the current balance of payments does not show substantial deficits, when the foreign balances and the gold stock of the central bank are substantial and when a great setback of exports with its unfavourable repercussions on the conditions of the economy concerned is not to be expected.

(c) As a rule external equilibrium cannot be secured nor preserved with inflation except if similar conditions prevail abroad and at least in those countries with which intercourse is substantial. This explains why external equilibrium can be reached with smaller difficulties since inflation has become a world wide phenomenon of course not of the same intensity all over the world. Despite these inflationary conditions external equilibrium constituted a more serious problem in the first decade after world war II than later. The expansion of international capital flows, the reestablishment in many countries of external and even in some cases of full convertibility and the substantial expansion of production all over the world contributed to this favourable development. The contribution of credit policy and of monetary policy except through devaluation has been minor because the avoidance of unemployment was always given priority in relation to external equilibrium and other aims of economic and monetary policy. However, in certain cases the recourse to deflation cannot be avoided when the external equilibrium cannot be preserved otherwise, I mean by the reduction of the central bank's foreign balances, by the contraction of loans abroad or by capital inflow, when all efforts to fight the consequences and not the causes have not proved satisfactory and when the normal operation of the economy cannot be secured. Of course before having recourse to deflation foreign trade policy's measures and even devaluation are given preference.

Conclusion

It may be concluded that credit, monetary and foreign trade policy cannot secure full employment if the propensity to invest and to consume is curtailed whilst their success with price stability and external equilibrium presupposes stingent deflation which cannot be enforced in our days when stagnation of the economy and unemployment are considered to be worse than inflation except if they have to last for a very short time.

II. In view of the inability of the appropriate credit, monetary and foreign trade policies to secure price stability and external equilibrium whilst they may contribute to full employment it seems most unprobable that they will be able to secure each of them combined with full employment even if the conditions analysed in Part I (a) are realised.

(a) Price stability cannot be secured at the same time with full employment because in that case all those employed claim continuously wage increases even if they are not justified by the evolution of productivity. As full employment prevails those claiming wage increases are not afraid to remain unemployed if their employer cannot afford to pay the wages they claim and feels obliged to stop business as they are certain to get another job. Of course it is taught in economic theory that his happens only with overemployment whilst in full employment both prices and rewards remain stable. It is welknown that the demarcation line between full employment and overemployment cannot be traded exactly and that independently of this in economic theory the expected stability of prices is the stability of average prices, as shown in index numbers and not of individual prices which cannot be kept stable except if the government is able to impose for a short time both price fixing and also the unabated continuation of production. As a matter of fact whenever the producers feel unable to ignore governmental orders they stop or at least reduce production or they deteriorate the quality of the goods they produce. The unfavourable repercussions of overemployment and even of full employment on price stability are strengthened by the claim of all those working to secure the rewards paid by the employees with the highest productivity and with the greatest profits. Experience shows that at least in the countries with market economy governmental measures can prevent these developments only for a short time.

It may be concluded that price stability and full employment cannot be secured at the same time in the market economy. Planned governmental interference may achieve this end only for a relatively short time provided the plan is satisfactory and is carried out in the appropriate way. I mean without leaks and without lags.

(b) Price stability and external equilibrium can be secured simultaneously only if price stability in the country concerned coincides with price stability abroad and if capital flows do not disturb the external equilibrium of the country concerned. As price stability cannot be enforced when demand exceeds supply except by the application of the appropriate rationing, by the prohibition of all developments leading to the institution of a black market, by deflationary policy whenever needed independently of unfavourable repercussions on the level of employment and by price fixing it cannot be expected to be attained as exposed in part I (b). It follows that external equilibrium provided it is not upset by capital flows can be secured only if by chance price developments but not price stability in the country concerned and in the countries with which intercourse is substantial are parallel and of the same intensity. Of course external equilibrium can also be secured by the diminution of the foreign balances of the central bank, by capital inflow from abroad both for investment and loans and eventually by an embargo on certain or on all payments abroad.

(c) Full employment and external equilibrium can be secured together only if full employment prevails also abroad at least in the countries with which entercourse is substantial. External equilibrium is not possible when full employment prevails only in the country concerned because it leads to increased incomes, to increased demand and to increased turnover. It has to be considered in this connection that external equilibrium may be secured by a diminution of the foreign balances of the country concerned or by the contraction of loans abroad or even by the inflow of foreign capital for investment. These steps can be carried out by the public sector and we may then speak of its achievement by the government's policy. The same happens if an embargo is imposed on certain or on all payments abroad.

Conclusion

Credit, monetary and foreign trade policy cannot secure together a) price stability and full employment, b) price stability and external equilibrium, c) full employment and external equilibrium. Of course external equilibrium may be secured together with price stability or with full employment when loans are contracted abroad, when capital flows in and when the foreign balances of the central bank are reduced.

III. As long as the appropriate combination of credit, monetary and foreign trade policy cannot secure simultaneously full employment and price stability, nor full employment and external equilibrium except by recourse to foreign loans, foreign investments and diminution of the foreign balances of the central bank, neither price stability and external equilibrium except by recourse to the developments mentioned just before it does not seem reasonable to expect the simultaneous achievement of full employment, price stability and external equilibrium even if in the latter case recourse to foreign loans, to foreign investments and to the foreign balances of the central bank is not ommitted. It has to be added that these developments cannot last indefinitely. As a matter of fact as long as the achievement of one of these aims is connected with so many difficulties and as long as it is even worse with the simultaneous achievement of two aims the difficulties are much greater with the three. Of course when speaking of full employment we may mean the reduction of unemployment to a very low level, when speaking of price stability we may mean fluctuations within certain margins and of external equilibrium with recourse to the steps mentioned before.

Conclusion

We have to conclude that when politicians, statesmen, journalists and central bankers speak of the simultaneous achievement of the three aims treated in this essay they simply mean efforts in this direction and not the expectation of their realisation 100% as the latter cannot be achieved without great difficulties even if pursued individually. This impossibility is confirmed even more in the planned economies where the support of the market forces is not needed. As a matter of fact there is no planned economy with price stability and without black market, with full employment except when achieved through the waste of labour force and through the expansion of military and paramilitary forces and with external equilibrium which in this case has never been achieved at least until now despite the limited satisfaction of the needs of the inhabitants, despite the lack of any consideration for the latter's preferences and despite the non application of the principle pacta sunt servanda.