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The typical inflation--of the kind that has occurred from time to time--has been characterized as being generated by excess aggregate demand. On the other hand, it has been argued that the most recent inflation occurred at a time when no such excess demand existed, and that this inflation was generated by the action of sellers - it has been labeled a cost-push inflation. In many ways, this distinction between buyers' and sellers' inflations may be considered to be a false distinction. However, I wish in this statement, which is in part an extension of the statement I have filed with the Committee, to examine one possible mechanism by which such cost-push inflation can be generated.

Inasmuch as this is a new type of inflation, it may be useful to identify what is new about the post war economy so that it will work in a different manner than it did in earlier times. For the problem of cost-push inflation, I think we can identify four major ways in which this economy differs. Two of the ways are subjective, dealing with the attitudes and beliefs of the various decision makers, and two are objective, dealing with the institutions and usage of the economy.

The subjective new attributes are:

1. The expectation that full employment can and will be maintained.

2. The expectation that economic growth, accompanied by improvement in the standards of life, will take place.

As a corollary to the above, there is the expectation that financial
stability will be maintained, i.e. that no financial crisis of the sort that took place from 1929 to 1933 will ever occur again. Hence, in the present, world decisions are made in a framework that is basically optimistic.

The objective institutional changes that are relevant are:

1. The increased significance of Trade Unions.
2. The greater sophistication of firms that operate in the non-competitive sectors of the economy.

In addition, an objective institutional change is the construction in times of general prosperity of price maintaining techniques adopted to combat a deep depression.

How do these new factors tend to generate inflation in the absence of current excess demand? First of all, the objective institutional changes make the possibility of a cut in sellers inflation greater.

If a seller is confronted by an infinitely elastic demand curve, of the kind that characterizes a competitive market, then he must take price as given. If a seller is confronted by a negatively sloped demand curve, of the kind that characterizes markets where deviations from competition exist, then it is technically possible for the seller to raise price, allowing the quantity he sells to decline. A negatively sloped demand curve confronting a seller is a necessary condition for a price to be initiated by a seller.

However, there is no reason to assume that once a seller adjusts his price to his negatively sloped demand curve, any further rise in prices will take place due to the sellers initiative. However, in a world where deviations from competition exist many prices are set intermittently and once set will not
be changed for some time. The optimistic expectation that growth will occur means that prices are set assuming that demand curves will shift to the right. Hence, the decline in sales that will result from a rise in prices, given the negatively sloped demand curve, will be soon offset by the rise in demand due to the growth of the economy. However, if the rise in demand does not come quickly, employment will fall but it is expected that if a significant amount of unemployment occurs, appropriate monetary and fiscal action will be taken. And it is expected that this action will be successful and it will shift demand curves upward.

Whether appropriate action is taken by the authorities or whether the workings of the economy is due to required changes, if an inflation initiated by sellers is not to result in rising unemployment then the increase in prices must be ratified by an increase in aggregate demand.

Before going on to policy recommendations, I would like to point out that in my statement I examine new what I call the cohesiveness of wages operates to spread price and cut increases that start in one set of sectors so that they become quite general. This cohesiveness of wages depends upon the absence of large scale unemployment.

What is the relevance of the above argument to the determination of appropriate public policy? To the extent that inflationary movements of prices are initiated by sellers exploiting negatively sloped demand curves, appropriate policy should be directed toward changing the nature of the demand curves that confront sellers rather than to constraining aggregate demand. For if aggregate demand is not allowed to rise to ratify the initiating upward movement of prices, unemployment and a decline in aggregate output occurs.
The optimistic expectations of price setters and portfolio owners are necessary for inflation to take place in the absence of current excess aggregate demand. These optimistic expectations can be removed by demonstrating to all concerned that they are false. This can be done by generating large-scale unemployment and by making sure that the economy enjoys another period of stagnation such as took place in the 1930's. No one, I hope, seriously suggests that this be done. But this would be the result of trying to prevent such sellers' inflations by constraining aggregate demand. If sellers are allowed to exploit their noncompetitive position, then to avoid punishing us all by forcing mass unemployment and stagnation on us all, the rise in prices that takes place must be ratified by a rise in demand.

Monetary, fiscal policy by constraining demand can make sure that large-scale unemployment and a period of economic stagnation result from inflationary pressures by sellers, and hence are not appropriate.

This does not mean that there are no weapons that can be used against these inflations. It does mean that the weapons have to be designed to attack the cause of the inflation, which is the existence of noncompetitive markets. I shall sketch a number of policy measures that can be undertaken to combat cost-push inflations.

I do not offer the following set of policies as a panacea that will cure our economic problems for all times and for all circumstances. I do believe that if some such program is adopted in the present circumstances, the possibility of inflation taking place in the absence of excess demand will be decreased, and if anything the program would operate to increase output and the prospects for vigorous growth.
First, I would make more concrete the employment goal of the economy. I suggest that 3 per cent of the labor force should be designated as the maximum tolerated unemployment rate. Congress should declare that any excess of unemployment over this rate shall be taken to mean that there is a deficiency of demand and monetary and fiscal measures are to be vigorously used to increase demand. Should the excess supply of labor be due to pockets of unemployment arising from structural change, the appropriate demand increasing measures would be described to eliminating these pockets. With this assurance of an overall availability of jobs, Congress should also state that it will not guarantee nor will it protect the existence of any particular job.

Once this assurance of a sufficient number of jobs is given, Congress should repeal all legislation which insulates domestic producers from competition, thereby making the demand curve confronting sellers of transportable commodities more nearly like the demand curves confronting sellers in purely competitive markets. This means that all farm legislation, all tariffs and quotas, and laws permitting so-called fair trade agreements should be eliminated and the legislation determining the behavior of the regulated industries should be rewritten to foster, rather than to stifle competition.

The freeing of markets would make it impossible for sellers to raise the price of transportable commodities above world market price. In addition to transportable commodities, there are nontransportable commodities and services. If these markets are noncompetitive, then prices and incomes earned in these sectors can rise. However, if this occurs, and with constrained prices and wages in the sectors producing nontransportable
goods, the differential in incomes that can be earned in the two sectors will increase. This will tend to induce entry into the sectors that produce nontransportable outputs. The Congress should make all constraints that tend to prevent entry into professions, trades or businesses illegal. Trade unions and professional associations, while permitted to set standards for their members, should be prevented from blocking the entry of new firms and new practitioners into their trades and professions.