COMMENT: WAGE INCREASES AND INFLATION.

Recent public statements regarding wage increases illustrate once again the widespread acceptance that wage increases must result in further inflation. The implication is that this link is the result of the workings of "economic laws" of some sort. However, anyone who has made an attempt to understand the nature and causes of inflation in recent decades, must dismiss such firm assertions and suspect the motives of those making them.

The possible interactions between various forces giving rise to inflation at any one time are so numerous as to rule out simplified statements regarding the course that events will take. The role of wage increases in the inflationery process might be better understood if we spell out some of the major forces at work in such a process. The point being made is that simple statements obscure more than they explain and are therefore dangerously misleading.

An increase in wages will lead to an increase in money income, a large proportion of which will be spent on goods and services (exactly how large a proportion depends on the income level of the recipients). Such increased incomes and the resultant expenditure will be infationery if the increased demand is not matched by increased supply of the goods and services. From the point of view of the economy as a whole, the ability to expand supply depends on the extent to which all productive capacity is utilised. There is the possibility of various "bottlenecks" that prevent full utilisation of all factors at the same time. eg. skilled labour, steel or imported goods. The exact nature and extent of such "bottle - necks" at any one time would always require further investigation.

There is a sense, therefore, in which it can be contended that wage increases should only accompany productivity increases in order to prevent inflation. This is essentially a macro issue, however, applying to the whole economy. The relationship between productivity and wages at firm or industry level is far more complicated. Furthermore, one cannot proceed far referring only to the aggregate supply and demand position in the economy. The inflationery impact that wage increses might have depends on supply conditions in the various sectors producing the goods and services which are in increased demand. Where expenditure takes place depends on the group that receives the increases. It should be borne in mind that it is absolute increases in expenditure that are important. That black government employees get larger percentage increases than whites has a significance which we shall return to below. But from the point of view of any inflationery impact, it is the larger absolute amounts that whites will receive that is more significant.

It is apparent, therefore, that a number of important factors have to be taken into account. Any inflationery impact of wage increases would depend on who is getting them, how large they were, where they would generate expenditure and on the supply conditions in the sectors producing the goods and services demanded. This complexity raises further considerations. The expenditure patterns and supply conditions are empirical matters and the available information on which to base predictions is not entirely adequate. Furthermore, a great deal depends on the responses of individuals, businesses and institutions to the forces at work, and such responses can never be mapped out in advance with any great accuracy.

In fact the overall institutional structure of the whole socio-economic system is intimately linked to both the causes and the effects of inflation. In any economy there is competition on the part of various groups for the goods and services and productive resources produced, this being more particularly so in inflationery situations. It might not be too simplistic to see it as a process of who wins and loses, and how they do it.

The ability to purchase goods in this competitive environment depends on income. Inflation with rising prices means that the real value of income will decline unless money income rises at the same or a faster rate than prices.

The major groups of spenders in the economy are government, investors and consumers. Within this last group, another important distinction must be made between black and white consumers. For our purposes here, it is not so much the race that is important but rather that it gives rise to differing institutional environments. To make the point let us simplify and accept that government income is from tax revenue, and the money printing press (deficit financing), investor income from profits and consumers from wages.

There is a strong circular causality that has to be broken into. If one group tries to spend more, without output expanding, then prices will rise for all groups. Each other group would now try and defend itself against this process by making sure that their money income would rise to counteract the effect of rising prices.

Government is in the best position to do this since its income level is essentially a policy matter depending on the extent of deficit. Business will try and maintain profits by passing on cost increases and there is an incentive to keep wages (as part of costs) growing at a slower rate than prices. The income of consumers depends on their bargaining position as workers which is why it is important to distinguish between white and black.

This simplified outline suggests some very important consequences. Clearly, inflation will have a different impact on the four groups depending on the concurrent changes in their money income (that is, what happens to real income). In fact, differentials in the rates of change of these magnitudes experienced by the groups, is tantamount to a redistribution of income. If one group's real income falls whilst another's is maintained, then the former's position relative to the latter's has deteriorated, since it now has lesser access to the goods, services and productive resources produced.

It is apparent, therefore, that the link between wage increases and inflation is complicated for two main reasons. Firstly, wage increases need not automatically lead to further inflation since this would depend on a number of other factors. Furthermore, inflation is the product of both demand and supply factors, so that a corrective policy cannot ignore the supply side. Secondly, we see that more fundamental factors regarding income distribution would appear to be intimately linked to inflation. That wage increases lead to price increases is best seen as part of the proces outlined above regarding the potential redistributive effects of inflation. So wage increases become another factor in a circularly causal set of events. Where to ascribe blame is now far more complex, although to pin it on wages may be convenient for some.