

REFERENCES

- DEL MONTE, C., 1973, "Un modello econometrico per l'economia italiana utilizzato a fini previsivi", *Rassegna Economica*, January-February.
- FRATIANNI, M., 1980, "Money, Prices and Wages in Italy", in this *Review*, December issue.
- MODIGLIANI, F. and TARANTELLI, E., 1972, "Curve di Phillips, sottosviluppo e disoccupazione strutturale", *Quaderni di ricerche*, no. 9, Rome, Luigi Einaudi Foundation.
- SPINELLI, F., 1980, "Wage Inflation in Italy: A Reappraisal", in this *Review*, December issue.
- SYLOS LABINI, P., 1974, *Trade Unions, Inflation and Productivity* (Lexington Books, Lexington). (The first chapter of this book largely reproduces the essay published in 1967 in this *Review*.)
- SYLOS LABINI, P., 1979, "Prices and Income Distribution in Manufacturing Industry", *Journal of Post-Keynesian Economics*, Autumn issue.

Sylos Labini on Spinelli and Fratianni on Inflation: A Reply

Given the nature of the critical comments raised by Professor Paolo Sylos Labini (PSL) to our studies — Fratianni (1980) and Spinelli (1980) — we thought that a joint reply would be more effective and economical than separate responses. We have selected four issues to emphasize how we differ from PSL in theoretical constructs, method and empiricism.

I. Wage Equations and History

For PSL the history of money wages cannot be explained by a single hypothesis. Different periods may require different models. In particular, during the period up to the first world war money wages depend simply on the rate of unemployment. For the 40 years from 1920 to 1960 the explanation of money wages requires a second variable, the rate of inflation. Finally, a third variable comes into play after 1960: trade union activity.

Consider the last of the three models. The majority of Italian economists have a strong philosophical commitment to non-competitive models. So does PSL. Yet, we are not told what is the underlying bargaining model where claims, offers, expected gains and losses interact. Theorizing union militancy

turns out for the most part to rationalize why a given variable, be it a string of dummy variables or strike activity, best approximates the phenomenon which is presumed to exist by virtue of the "obvious" observation that unions are powerful. Invariably, the measure in question, which does well with old data, reveals its deficiency when exposed to new data. The failure is blamed to the inadequacy of the proxy; the underlying "theory" is seldom questioned.

To exemplify, PSL states that "... in the wage equation a third variable [an explicit proxy for union militancy] is useful, though it must be clear that such a variable is not and cannot be significant every year: in the first world war a battle of Verdun was not fought every month or even every year." Furthermore, union militancy, according to PSL, shows up in other variables, in particular in the cost of living. If an event occurs only once, what is the sense of insisting on wage push. The primary purpose of a theory is to unveil the *systematic* forces at work; not the occasional or random ones. As to the union militancy appearing in different clothes, this argument is equivalent to rationalize any outcome as supporting the wage push hypothesis.

Is history eclectic? Does the 19th Century differ from the 20th Century in that unions were either weak or not existing at all? Lipsey (1960), covering the same period as Phillips (1958), found that the impact of prices on money wages fell in the range from 0.2 to 0.4; and that the residual variance fell by 17 percent when using the price variable. This evidence contradicts in part the PSL proposition that different periods require different models. We say in part, because the coefficient below unity suggests money illusion. There is an explanation for this. Information is not a free commodity: gathering and processing information absorb resources. Rational individuals tend to invest in information up to the point where the additional cost of new information is matched by the additional benefit derived from it. The 19th Century is a period of relative monetary stability. The gold standard ensured that the rate of inflation would move from positive to negative values within three years or so. Under such circumstances the low price coefficient is justified by the fact that inflation was not only a long-run problem but also self correcting (i.e. over the duration of one's wage contract the inflation rate could just as likely be positive as negative). Or differently stated, investment in forecasting future inflation had a small payoff, given the understanding people had about the working of the gold standard.

II. On Sociology and Inflation

PSL finds that Fratianni's (1980) criticism of the sociological explanation of inflation is inconsistent with the observation that an autonomous wage push can on occasion take place. As we have already indicated above, a general theory of inflation must be able to explain the *sustained* increase in the general price level and not the occasional or random rise. Crop failures, oil embargoes,

civil disorder and so on can account for once-for-all changes in the general price level; but by themselves they cannot explain the *sustained* increase in the price level. A theory of inflation based on crop failures or civil disobedience is bound to tell us why crop failures and riots on the street are serially correlated. In sum, what PSL assesses to be an inconsistency can be easily reconciled in terms of the fundamental distinction between systematic and non-systematic forces affecting the general price level.

III. The General Price Level

PSL objects to our use of the general price level "on the ground that the behavior of various important categories of prices differ considerably both in the short and in the long run". Implicitly, we seem to be guilty of aggregating apples and oranges. To begin, aggregative economics concerns itself with the behavior of the general price level as distinct from the behavior of individual (relative) prices which is instead the domain of disaggregative economics. This is a time-honored distinction which has been widely accepted by the profession. Second, the rate of inflation, as measured by percentage changes in the consumer price index or the personal consumption deflator, is a major concern of economic policy. Hence our interest in explaining it. Third, misaggregation is a never ending problem. One cannot simply move a couple of steps down from the pyramid of prices, for one can easily demonstrate that moving down another step reveals that there are still differences in behavior, albeit minor. This type of reasoning has led to the construction of econometric models containing hundreds of price equations which can predict inflation no better than a model containing the "general price level".

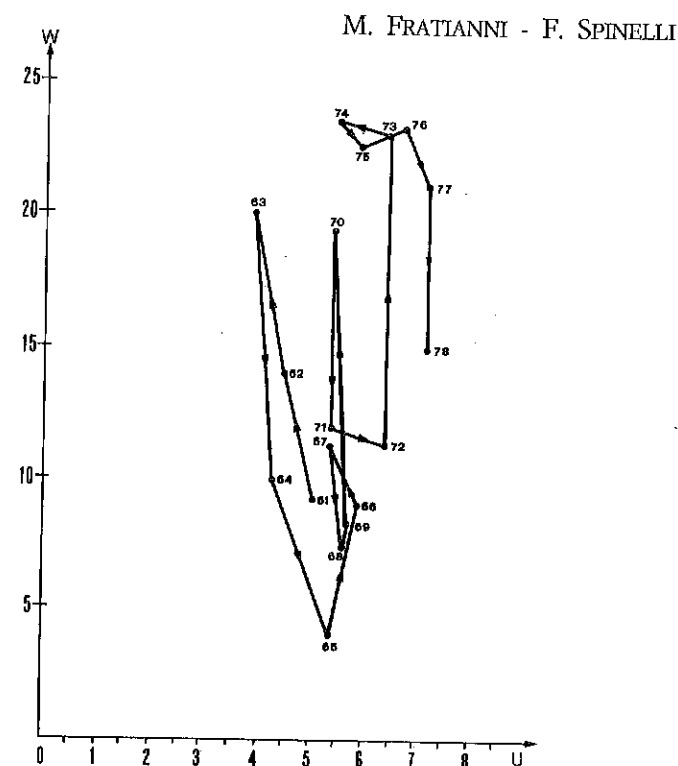
Having said that, we recognize that more efforts should be made in distinguishing between changes in the general price level resulting from all prices rising proportionally and changes in the general price level emanating from changes in relative prices. Recent papers indicate that the profession is moving in this direction.

IV. Aggregate Demand and Output

PSL states that over the relevant range "changes in demand determine changes in output, not in prices." The statement is correct if applied to the individual firm; less so if applied to an industry; and incorrect if applied to the aggregate. From the viewpoint of our research the issue is not so much whether a particular market, say shoes, responds to changes in aggregate demand but

whether the rate of inflation is affected by demand. In more familiar terms, the issue is the shape of the Phillips Curve. And here the evidence is quite abundant in negating an exploitable long-run trade-off between inflation and unemployment. Even a cursory look at the enclosed graph reveals that for Italy, as well as for other countries, this trade-off has vanished in the 1970s.

Washington, Milano



U = the rate of unemployment. Source: ISCO
W = the rate of change of wages of dependent workers.

REFERENCES

- FRATIANNI, M., 1980, "Money, Prices and Wages in Italy", in this *Review*, 135, 515-537.
LIPSEY, R.G., 1960, "The Relationship Between Unemployment and the Rate of Change of Money Wage Rates in the U.K. 1862-1957: A Further Analysis", *Economica*, 27, 105, 1-33.
PHILLIPS, A.W., 1958, "The Relationship Between Unemployment and the Rate of Change of Money Wage Rates in the U.K. 1861-1957", *Economica*, 27, 100, 283-299.
SPINELLI, F., 1980, "Wage Inflation in Italy: A Reappraisal", in this *Review*, 135, 483-514.
SYLOS LABINI, P., 1981, "Spinelli and Fratianni on Inflation: A Comment", in this *Review*, this issue.