A conflict model, with rational expectations, of the disinflation of the early 1980s

Graham Dawson
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Economics Research at The Open University

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1 Introduction

Why is the disinflationary process associated with a greater increase in unemployment in some economies than in others? Can macroeconomic policies and labour market institutions be revised to reduce the unemployment cost of disinflation in economies where it is high? The purpose of this paper is to construct the foundations for a theory of disinflation which would answer these questions.

The theory of disinflation adumbrated here is based on a critique of the rational expectations hypothesis, which is found to rest upon an inadequate conceptualization of the behaviour of economic agents (workers, firms and the government). The rational expectations model self-destructs in the sense that it is incompatible with the concept of a rational agent to assume that his or her attitude to the future is confined to forming expectations about it in the light of initiatives taken by other rational agents. A rational agent, one might say, seeks to change the world rather than merely predict it.

The policy implication is that the way to prevent unemployment rising as a consequence of anti-inflationary policy measures is to pursue disinflation only to the degree that there exists a consensus in its favour. Building such a coalition is facilitated by corporate labour market institutions and also by moderate disinflationary ambitions on the part of policy makers, reflecting the relatively little damage done by inflation compared to unemployment (Dawson, 1992).
The structure of the argument is straightforward. The first step is to outline a partisan theory of disinflationary policy making which sees it as the expression of preferences concerning the distribution of the costs of eliminating inflation. Confrontation and consensus approaches to disinflation are then distinguished, on the assumption that each of these perspectives has its own characteristic set of conditions under which the unemployment cost of disinflation is minimised. These sets of conditions are derived from rival interpretations of rational expectations theory.

The next step in the argument is a critique of the confrontation interpretation of rational expectations theory. From the perspective of this understanding of rational expectations theory, it is in the interests of economic agents to discover the policy rule which the government is following and incorporate it into the formation of their expectations about the future course of inflation. The implication is that, in the absence of shocks, rational agents correctly identify the policy rule and adjust their behaviour accordingly. However, there is an unwarranted assumption being made here, namely that agents could exhibit behaviour that failed to anticipate the effects of policy only if they committed a systematic mistake in seeking to determine the policy rule. This assumption is unfounded because it overlooks the possibility that behaviour that fails to anticipate inflation reflects agents' resistance to the disinflationary policy rule rather than the unreliability of their procedures for identifying it.

The implication is that rational expectations theory is valid only under a consensus interpretation, according to which disinflation is painless only to the extent that agents do not merely know the policy rule but share the objective to which it is the means. A corporatist macroeconomic policy making culture, incorporating consensus on, rather than resistance to, the disinflationary policy rule, is therefore likely to reduce the unemployment cost of disinflation.

The paper concludes with an examination of the two approaches to macroeconomic policy making in the light of some data concerning the unemployment cost of disinflation in selected economies, classified as corporatist or non-corporatist, in the early 1980s. The unemployment cost of disinflation is found to be lower in corporatist than in non-corporatist economies, other things being equal.
2 A sketch of a conflict model of disinflation

Inflation is best understood, not as in itself the problem, but as an attempted solution to the problem of changes in the distribution of income which are perceived to be inequitable (Dawson, 1992, pp. 27-31). The rate of inflation is the outcome of the best efforts economic agents can make to protect their own interests by voluntary indexation, their interests in this context being defined in terms of the perceived redistributive effects of changes in relative prices. If, for example, a monopoly increases the price of its products, income is redistributed from consumers to the monopoly. Since the consumers are themselves producers in markets exhibiting different degrees of monopoly power, they try to reverse the redistribution of income by raising the prices of their own goods, some of which will be purchased by the beneficiaries of the initial monopoly price increase. The inflationary process is under way.

At the macroeconomic level of analysis it is useful, particularly in a two-party representative democracy such as the UK, to see this process of conflict over the distribution of income in terms of a struggle between workers and capitalists (Rowthorn, 1977, p. 224). Workers seek to shift the distribution of income in their favour by demanding higher wages, capitalists raise prices in an effort to preserve the initial income distribution and a wage-price spiral evolves. Or capitalists, perceiving the current income distribution as unacceptable, raise prices, only to encounter higher wage demands as workers try to hold on to the initial distribution and a price-wage spiral takes off.

There is an intuitive appeal to the idea that economic agents involved in the inflationary process are not engaged in a purely defensive, zero sum game but are attempting to secure what they regard as their rightful share of the gains from the positive sum game of economic growth. Workers want to be rewarded for improving labour productivity or reducing X-inefficiency, while capitalists want to be recompensed for having taken what have turned out to be justifiable risks.

It is reasonable to expect a plausible theory of inflation to shed some light on the process of disinflation. The major difference between the two processes is that disinflation, rather than being the unintended consequence of conflict over the distribution of income, can be deliberately sought by a subset of economic agents, the government.
The decision to pursue a disinflationary policy objective is complicated by the fact that it involves, at least in the short run, a fall in the rate of economic growth, in some cases to the wrong side of zero. Just as there can be a conflict over the distribution of the real income gains from economic growth, so there is likely to be a struggle over the distribution, or incidence, of the costs of the below trend or negative growth associated with disinflation.

The government, then, is a protagonist in the conflict over the distribution of the costs of disinflation, being not merely one agent among others in the disinflationary process but its instigator. Partisan theories of macroeconomic policy recognise the government’s role in the distributional conflict, for they argue that governments pursue policies which redistribute income towards their supporters (Alesina, 1989). According to Hibbs (1987), an increase in US unemployment is associated with a fall in the income shares of the two poorest quintiles and a rise in the shares of the two richest quintiles. Minford (1985) argues that inflation has the opposite effect by eroding the real value of nominally denominated assets which are most likely to be held by the upper middle class. So the first priority of left-wing governments is to seek to cut unemployment, while right-wing governments are mainly concerned to reduce inflation.

However, the choices made by policy makers are not quite so simple. As Dornbusch and Fischer (1990) put it, ‘policy makers do not choose between inflation and unemployment, but rather between adjustment paths that differ in the inflation–unemployment mix’ (pp.580-1). This insight can be easily incorporated into a conflict model of disinflation. The left-wing government of partisan theory can be re-designated the consensus approach to macroeconomic policy making, which informs a gradualist disinflation policy involving a relatively slow fall in inflation in order to minimize the increase in unemployment. The right-wing government of partisan theory becomes the confrontation approach, which relies on a cold turkey strategy seeking to eliminate inflation rapidly even at the cost of a sharp rise in unemployment.

The disinflation of the early 1980s appears to reflect a preference among Conservative policy makers in the UK and the US for cold turkey, for buying lower inflation quickly with persistent mass unemployment. But was this outcome really intended or was it the unforeseen consequence of a policy embarked upon in the confident belief that it would eliminate inflation painlessly, without a serious
unemployment cost? What did policy advisers believe about the sacrifice ratio, the rate at which unemployment had to rise to reduce inflation? The lower the sacrifice ratio, the less will be the pain of disinflation.

3 The theory of painless disinflation
In the extreme case the sacrifice ratio is zero; there is no unemployment cost of reducing inflation even in the short run; disinflation is painless. Rational expectations theorists claim to have identified the conditions for minimizing the sacrifice ratio to this ultimate extent. However, there are two incompatible sets of conditions for painless disinflation in the rational expectations literature. The first interpretation of rational expectations can be integrated into the confrontation approach to macroeconomic policy making because it implies that disinflation is painless provided only that the disinflationary policy rule is known. If, for example, the government unambiguously signals its determination to eliminate inflation whatever the unemployment consequences, the policy rule is known and economic agents, whether they like it or not, take it into account in making price changes or wage settlements. So Minford and Peel (1983) argue that if the government changes the money supply rule output will not be affected because the new monetary stance is ‘incorporated into people’s expectations.... and cannot cause any surprises (p. 19).’

What is being claimed here is that expectations are rational to the extent that they are unbiased and efficient. A prediction does not have to be correct to be unbiased; it is enough if systematic errors are avoided. The minimum requirement for a prediction to be efficient is that it embodies readily available information including knowledge of the policy rule. The argument is that, unless policy is random, it must be informed by a rule, which must be discernible in current and past values of economic variables. So rational expectations theorists believe that ‘not only is government policy guided by such a rule but that the rule is known to all agents in the economy (Carter and Maddock, 1984, p. 98).’

The claim that policy is ineffective arises if the argument that expectations are rational is combined with the assumption that markets clear continuously. This means that any change of policy will provoke an immediate adjustment to prices in the relevant markets while quantities remain unaffected. Policy ineffectiveness can be advantageous or disadvantageous, depending on circumstances.
If the aim is to reduce or eliminate inflation, policy ineffectiveness means that the disinflation will be painless. The point about policy ineffectiveness is that, under rational expectations and continuous market clearing, policy has no effect on the 'real' economy of quantities of goods and services. So the announcement of disinflationary fiscal or monetary policies prompts an instantaneous revision of inflationary expectations, which shifts the notional short-run Phillips curve downwards. Since this makes the operative Phillips curve vertical at the natural rate of unemployment, inflation falls at once without any increase in unemployment and the sacrifice ratio is therefore zero.

In the disinflation of the early 1980s, sacrifice ratios were, of course, far from zero. The explanation to be put forward here is that the confrontation version of the rational expectations condition for painless disinflation, that the policy rule is known to all agents in the economy, is inadequate because it reflects an incomplete account of rational agency. A more convincing picture of rational agency is implicit in the culture of corporatist economies, which can be regarded as the institutionalization of the consensus approach to macroeconomic policy making. This approach incorporates an alternative interpretation of the condition for painless disinflation under rational expectations. The consensus interpretation evolves out of a critique of the confrontation version.

4 The standard objection to rational expectations theory
The inadequacy of the condition for painless disinflation implied by rational expectations theory, under its confrontation interpretation, can be clarified by considering the standard objection to that doctrine and the customary reply to it. Rational expectations theory generalizes the rationality assumption of consumer demand theory. A perfectly competitive market operates as if all consumers are rational, because irrational actions, being randomly distributed through a large sample, cancel out. This leaves the minority of rational agents to exert a decisive influence on aggregate behaviour. Minford and Peel define rational expectations as the belief that the typical individual 'utilizes efficiently the information available to him in forming expectations about future outcomes' (1983, p.4). They emphasize that this is a belief about the 'typical' individual and hence 'cannot be falsified by examples of behaviour by any actual individual' (ibid., p.5). As long as enough individuals to 'contribute a dominant proportion of the variability in aggregate behaviour' exhibit systematic rational behaviour in expectations formation, 'this would be sufficient to generate aggregate behaviour that exhibited rationality' (ibid.).
The standard objection, that people do not in fact form expectations rationally, is misguided in focusing on the behaviour of actual individuals, which is irrelevant because rational expectations theory does not assume that all or even most individuals form expectations rationally. What it does assume is that (a) some individuals form expectations rationally, and (b) those who do not form expectations rationally do not form them in any systematic way at all. The second part of the assumption is crucial because it is the random distribution of irrational expectations that allows aggregate behaviour to exhibit rationality. Irrationally high inflation forecasts roughly cancel out irrationally low inflation forecasts and so it is the rationally formulated expectations that exert the decisive influence on aggregate behaviour. So the 'as if' defence of rational expectations theory holds good against the standard objection. But it makes an assumption that will eventually destroy the confrontation version of the rational expectations model and with it the 'cold turkey' approach to macroeconomic policy making.

5 The social conflict objection to rational expectations theory

The fundamental assumption of the 'as if' defence is that labour market agents can fail to be rational only by succumbing to subjective, randomly distributed feelings. The essential weakness in this assumption is that, in trying to understand the actions of agents who see themselves in this context as members of a social group, it relies on a principle concerning the rationality of individual behaviour.

It is important to see how restricted is the conception of rationality implicit in the confrontation interpretation of rational expectations theory. It is as if its adherents, being professionally involved in making disinterested predictions about economic variables, assume that this is what all economic agents are trying to do. If that were true, they would not be agents at all but 'rational fools'. For this understanding of rational expectations theory implies that agents perceive their interests but act in a way that frustrates them. And that is irrational.

The fundamental weakness in rational expectations theory, on this interpretation, is the assumption that the only reason that agents' aggregate behaviour could be inconsistent with policy is that they have got it wrong. Of course the argument is that, being rational, agents do not get it wrong. They form expectations rationally and adjust their price and wage behaviour immediately. So policy leaves everything in the real economy as it is and disinflation is painless.
But perhaps agents do not form expectations with the sole aim of adjusting their behaviour to them. Perhaps their aim is to influence rather than merely forecast the future course of economic events.

Consider the early years of Mrs Thatcher’s first administration. From the confrontation perspective, unemployment rose because trade unions misjudged the government’s determination to pursue disinflationary policies. Wage claims appeared to embody a higher inflation forecast than was warranted in the light of policy statements. If expectations were rational, this could have happened only because the government failed to convince labour market agents that there would be no U-turn. If policy makers had sent the right signals, rational agents would have adjusted their behaviour in such a way that policy would have reduced inflation without increasing unemployment. The problem with this model of economic behaviour is that it assumes that all economic agents, including the government, possess common interests and goals.

A disinflationary policy rule announced by a right-wing government is likely to be perceived as ideological in the pejorative sense that it seeks to sustain a putatively unjust or exploitative distribution of income (Geuss, 1981, pp.12–22). More specifically, in the context of the monetarist experiment, it was likely to be perceived as an attempt to deflect the costs of disinflation away from a right-wing government’s constituency, which was to be the principal beneficiary of the swift achievement of price stability and was expected to be relatively unscathed by a sharp rise in unemployment.

The implication of this line of thought is that even if the Thatcher government’s commitment to its disinflationary monetary and fiscal policies had been beyond doubt, private agents might still have behaved as if they were unsure of its resolve. If trade union members believed that disinflation would adversely affect their collective interests, they had a reason for acting as if they expected inflation to continue unabated. For they might have caused the downfall of a policy which they perceived to be against their interests. Rational agents will act as if they expect inflation to fall only if they share the government’s desire that it should do so.

In a world of rational economic agents, collective interests and partisan governments, the partisan nature of policy-making will be perceived by trade unions and used in the formation not so much of expectations as of policies. The distinction between policy makers
and other economic agents effectively collapses. If working-class representatives who are aware of the conditions for painless disinflation believe that inflation increases the share of wages in national income at the expense of profits, they have a reason for acting as if they expected the current rate of inflation to continue. In the right circumstances such behaviour will induce a rise in unemployment sufficient to cause a reversal of the disinflationary policies. It is therefore reasonable to interpret trade union policy as if it were the outcome of a systematic attempt by members to weigh the benefits of reversing disinflation (a higher share of wages in national income) against the costs of reversing disinflation (the regressive redistributive effect of higher unemployment).

Real wage rigidity is best understood as a form of policy resistance rather than as the product of misjudgement of the strength of the government’s determination to defeat inflation. In so far as wage push inflation is a trade union policy instrument for securing a redistribution of national income, disinflationary policies will encounter opposition rather than incredulity. UK inflation in the 1970s appears to have increased the share of wages in national income at the expense of profits (Brown, 1985, pp.273–4). So trade unions could reasonably see the Thatcher government’s disinflationary policies as a partisan attempt to restore the share of profits in national income.

The confrontation politician’s picture of economic behaviour commits economic agents to irrationality. The phenomenon to be explained is a power struggle, a conflict over the distribution of national income, not a failure to make efficient use of available information in the formation of inflationary expectations. An efficient and unbiased prediction of inflation entails that on unchanged policies the share of wages in national income is going to decline. Rational trade unions must therefore be presumed to know that adjusting their behaviour in line with ‘rational expectations’ will be inimical to the interests of their members. So, acting on the basis of rational expectations is irrational. The rational course of action is to act as if inflationary expectations were formed adaptively or even extrapolatively, unless there are grounds for believing that the costs of reversing disinflationary policies outweigh the benefits. Only the consensus approach to macroeconomic policy making recognizes the fact that economic agents might be trying to change the future course of inflation rather than adjust their behaviour in the light of inflationary expectations.
The consensus approach indicates the conditions for reducing the unemployment cost of disinflation. It is futile to aim for painless disinflation because labour markets do not clear continuously. But it is worth minimising the pain of disinflation by building on the valid insight of rational expectations theory, that the sacrifice ratio is correlated with the degree of bias in the formation of expectations. However, expectation is only one element in a rational agent's attitude to the future; there is also intention. The rational 'agent' of the confrontation version of rational expectations theory is all intellect and no will. The implication of the consensus interpretation of rational expectations is that policy will be optimal to the extent that it is the product of negotiation rather than a game in which one side announces a policy and the other has to guess whether it really means what it says. The policy rule does not have to be discovered by non-government economic agents, because it is their rule as much as it is the government's. Consequently, sacrifice ratios ought to be lower in economies where policy making is informed by the consensus approach.

6 The disinflation of the early 1980s
If the critique of the confrontation version of rational expectations theory offered above is valid, the unemployment cost of disinflation ought to be lower under consensus than under confrontation. The distinction between corporatist and non-corporatist economies will be used as a proxy for that between consensus and confrontation approaches to macroeconomic policy making. It ought therefore to be the case that corporatist economies exhibit lower sacrifice ratios than non-corporatist ones.

In comparing the macroeconomic performance of corporatist and non-corporatist economies, the aim is to do two things: (i) to offer convincing grounds for believing that disinflation is always and everywhere a painful phenomenon; and (ii) to clarify the cultural and institutional framework which minimises the unemployment cost of disinflation. The questions to be asked are whether there is a trade-off between unemployment and inflation over periods of time relevant to policy making and, if there is, whether the sacrifice ratio, which measures the unemployment cost of disinflation, is lower in corporatist than in non-corporatist economies.

Corporatism is 'a mode of social organization in which functional groups rather than discrete individuals wield power and transact affairs' (Bruno and Sachs, 1985, p. 222). Corporatist economies are
characterized by a high degree of consensus on macroeconomic policy objectives. Sweden is cited as 'an outstanding example' of corporatism on the basis of factors which include 'a high degree of social consensus concerning the norms of wage bargains' (ibid., p.224), indicated by low levels of strike activity. The other factors reflect the conditions under which consensus is most likely to evolve; a high degree of unionization; highly centralized wage bargaining; national agreements as the basis of wage-setting in the whole economy; and high levels of government participation in the economy.

Bruno and Sachs (1985) constructed a corporatism rank order and a corporatism index based on four indicators: union movement centralization, low shop-floor autonomy, employer coordination and works councils. Austria and West Germany scored 4 on the corporatism index - having centralized union movements, low shop-floor autonomy, a high degree of employer coordination and works councils - and are placed first and second in the rank order. The US, exhibiting none of the four characteristics of corporatism, scores 0 and is placed last (Table 1).

### Table 1
**Sacrifice ratios in the disinflation of the early 1980s.**
Source: OECD (1988b) Tables 8, 1 (columns A and B) and 2, 15 (column D); Bruno and Sachs (1985), Table 11.3, p. 226 (corporatism rankings).

<table>
<thead>
<tr>
<th>Country</th>
<th>Peak/year</th>
<th>Low/year</th>
<th>Fall A-B</th>
<th>% increase in unemployment</th>
<th>Sacrifice ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>6.3 81</td>
<td>3.0 85</td>
<td>3.3</td>
<td>17.0</td>
<td>5.15</td>
</tr>
<tr>
<td>W. Germany</td>
<td>4.8 80</td>
<td>3.3 83</td>
<td>1.5</td>
<td>22.8</td>
<td>15.20</td>
</tr>
<tr>
<td>Netherlands</td>
<td>5.7 80</td>
<td>1.9 83</td>
<td>3.8</td>
<td>37.7</td>
<td>9.92</td>
</tr>
<tr>
<td>Norway</td>
<td>14.6 80</td>
<td>5.2 85</td>
<td>9.4</td>
<td>15.3</td>
<td>1.63</td>
</tr>
<tr>
<td>Sweden</td>
<td>11.7 80</td>
<td>6.7 85</td>
<td>5.0</td>
<td>17.2</td>
<td>3.44</td>
</tr>
<tr>
<td>Switzerland</td>
<td>6.9 81</td>
<td>3.3 83</td>
<td>4.2</td>
<td>3.5</td>
<td>0.81</td>
</tr>
<tr>
<td>Denmark</td>
<td>10.6 82</td>
<td>4.9 86</td>
<td>5.7</td>
<td>43.7</td>
<td>7.66</td>
</tr>
<tr>
<td>Finland</td>
<td>11.7 81</td>
<td>3.5 86</td>
<td>8.2</td>
<td>31.0</td>
<td>3.78</td>
</tr>
<tr>
<td>Belgium</td>
<td>7.1 82</td>
<td>3.7 86</td>
<td>3.4</td>
<td>60.9</td>
<td>17.91</td>
</tr>
<tr>
<td>Japan</td>
<td>3.8 81</td>
<td>3.2 81</td>
<td>0.6</td>
<td>4.2</td>
<td>7.00</td>
</tr>
<tr>
<td>UK</td>
<td>19.7 80</td>
<td>3.5 86</td>
<td>16.2</td>
<td>70.5</td>
<td>4.35</td>
</tr>
<tr>
<td>Italy</td>
<td>20.6 80</td>
<td>8.0 86</td>
<td>12.6</td>
<td>63.9</td>
<td>5.07</td>
</tr>
<tr>
<td>France</td>
<td>11.7 82</td>
<td>4.7 86</td>
<td>7.0</td>
<td>46.7</td>
<td>6.67</td>
</tr>
<tr>
<td>USA</td>
<td>9.5 81</td>
<td>3.4 83</td>
<td>6.1</td>
<td>26.5</td>
<td>4.34</td>
</tr>
</tbody>
</table>
The macroeconomic performance of corporatist and non-corporatist economies has been compared in a number of different ways with the results consistently favouring the corporatist economies (Metcalf, 1987).

The specific question to be investigated here is whether corporatist economies disinflate at lower sacrifice ratios than non-corporatist ones, other things being equal. In order to answer this it is necessary to devise a valid method of measuring the sacrifice ratio and identify any factors disturbing the *ceteris paribus* clause the influence of which it is reasonable to exclude.

A crude method of measuring the sacrifice ratio is to define it as the slope of the Phillips curve and calculate it according to the formula

\[ SR = \frac{\text{fall in inflation 1980–3}}{\text{rise in unemployment 1980–3}}. \]

But this approach does not allow meaningful comparisons of sacrifice ratios. There are two problems: inflation did not peak in the same year in all economies, and the duration of the disinflation varied across economies. The first problem can be solved by measuring the fall in inflation for each economy from its peak in 1980, 1981 or 1982 to the lowest rate achieved, usually about 3 per cent, by 1986 at the latest. As for the second problem, the solution is to calculate the ‘sacrifice’ as the cumulative increase in unemployment during those years. The sacrifice ratio should be measured according to the formula

\[ SR = \frac{\text{cumulative rise in unemployment}}{\text{fall in inflation}}. \]

The use of the cumulative increase in unemployment means that this formula is the counterpart of Dornbusch and Fischer’s (1990) definition of the sacrifice ratio as measuring ‘the ratio of the cumulative percentage loss of GNP (as a result of a disinflation policy) to the reduction in inflation that is actually achieved’ (p. 540). GNP loss is a more reliable indicator of the costs of disinflation insofar as unemployment rates reflect national differences in labour market institutions (such as social security benefit regimes) as well as the effects of disinflationary policies. On the other hand, calculating GNP loss is equally problematic, in that it entails making an assumption about potential GNP.
The cumulative unemployment-inflation sacrifice ratios for the major OECD economies, ranked in descending order of degree of corporatism, during the disinflation of the early 1980s are shown in Table 1. The corporatism rankings are taken from Bruno and Sachs (1985, Table 11.3. p. 226).

The next task is to make the ceteris paribus clause operative, or in other words to ensure that other things were equal. In practice this means that the influence of the inflation rate with which an economy entered the 1980s must be discounted. The reason is simple. With the exception of Norway, non-corporatist economies tended to enter the 1980s with higher inflation than corporatist economies (Table 1, column A). If disinflation is interpreted as a downwards or south-easterly move along the stylized short-run Phillips curve which becomes gradually flatter as the rate of inflation declines, high inflation economies can be expected to exhibit lower sacrifice ratios. This effect masks the influence of corporatism on the sacrifice ratio. For example, the effect of West Germany’s high corporatism ranking is overridden by its very low inflation rate. It seems to be the case that, whatever the degree of corporatism, disinflation from an initial inflation rate of 10 per cent or less is likely to be achieved only at an above-average unemployment cost, perhaps on a sacrifice ratio as high as 10:1 or even higher. Since the relatively low initial inflation rates characteristic of many corporatist economies reflect their superior macroeconomic performance, it is appropriate to try to exclude their influence on sacrifice ratios. The cumulative sacrifice ratios of high inflation OECD economies are shown in Table 2.

**Table 2**
Sacrifice ratios in high inflation OECD economies by degree of corporatism. Source: As Table 1.

<table>
<thead>
<tr>
<th>Corporatism ranking</th>
<th>Peak inflation rate</th>
<th>Sacrifice ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporation high inflation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Norway 4</td>
<td>14.6</td>
<td>1.63:1</td>
</tr>
<tr>
<td>Sweden 5</td>
<td>11.7</td>
<td>3.44:1</td>
</tr>
<tr>
<td>Non-corporatist high inflation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Italy 11</td>
<td>20.6</td>
<td>5.07:1</td>
</tr>
<tr>
<td>United Kingdom 13</td>
<td>19.7</td>
<td>4.35:1</td>
</tr>
<tr>
<td>France 12</td>
<td>11.7</td>
<td>6.67:1</td>
</tr>
</tbody>
</table>
The cumulative unemployment cost of disinflating from a relatively high initial annual inflation rate to a rate of or approaching 3 per cent does vary according to the corporatism rankings (Table 1, column D). That is to say, corporatist high inflation economies exhibit lower cumulative sacrifice ratios than non-corporatist high inflation economies (Table 2). The figures show that in the early 1980s economies disinflating from a position of double-digit inflation achieved sacrifice ratios of between 1:1 and 7:1. If the economy was clearly corporatist, the sacrifice ratio was within the range 1:1 to 4:1, while a paradigmatically non-corporatist economy exhibited a sacrifice ratio between 4:1 and 7:1. Clearly, the cumulative unemployment cost of disinflation in high inflation economies is lower if policy making and institutions are corporatist.

There is more here than set of unexplained correlations. Metcalf qualifies his endorsement of the empirical research by claiming that 'the performance-consensus-corporatism nexus does not, however, identify the causal mechanism (1987, p.59).’ But the empirical data have been used here precisely as a test of a putative causal mechanism, derived from the consensus interpretation of rational expectations theory. The hypothesis is that the cost of disinflation will be lower to the extent that expectations are unbiased, that is to the extent that economic agents behave as if they were using the same economic model as the government. Under a corporatist regime, most economic agents actually do share policy makers’ beliefs about the structure and working of the economy and their objectives. Corporatism puts in place the conditions required for rational expectations formation, once it is realized that they include not only knowledge of the policy rule but also acquiescence in the disinflationary programme.

To sum up, for relatively high inflation economies, where disinflation is most likely to be the optimal strategy, the unemployment cost of reducing the rate of inflation is likely to be lower in corporatist economies where economic agents have not merely identified the policy rule but share a common set of policy objectives.

7 Conclusion
In this paper an attempt has been made to sketch a theory of the disinflationary process. It has been assumed that the main questions such a theory must answer are (i) why it is that disinflation involves costs in terms of below trend or negative growth and an increase in unemployment and (ii) under what circumstances these costs can be minimised.
The theory of disinflation outlined above is based upon the conflict theory of inflation, which is complemented in the disinflationary context by a partisan theory of macroeconomic policy making. A policy of disinflation may be undertaken for partisan reasons, to protect the interests of social groups which are threatened by continuing inflation or to promote the interests of social groups which have most to gain from price stability. But disinflation incurs welfare costs measured in terms of lost output and higher unemployment, the magnitude of these costs and the speed of the disinflation depending on the choice of adjustment path. So macroeconomic policy becomes essentially an instrument in the conflict over the distribution, or incidence, of the costs of disinflation.

Rational expectations are then introduced into this conflict model of disinflation. On one interpretation, which belongs naturally in a confrontation approach to macroeconomic policy making, rational expectations theory specifies an inadequate condition for painless disinflation. It is not enough for economic agents outside the government merely to identify the policy rule. For it might be in their distributional interests to discover the policy rule so that they can attempt to frustrate it. The principles of individual rationality in a market are of limited use in explaining behaviour in the macroeconomic policy making arena, which stages a conflict over the distribution of the costs of disinflation between labour and capital. So the conditions for painless disinflation under rational expectations are that non-government agents know the policy rule and share the objective of the disinflationary programme. This interpretation of rational expectations theory can be incorporated into a consensus approach to macroeconomic policy making.

The empirically observable counterpart to the consensus approach is the corporatist culture and institutional structure of macroeconomic policy making. If the analysis presented in this paper is correct, the unemployment cost of disinflation ought to be lower in corporatist economies than in non-corporatist ones. And in fact sacrifice ratios for the disinflation of the early 1980s were lower in corporatist economies, other things being equal.

It appears that the way to minimise the rise in unemployment as a consequence of anti-inflationary policies is to pursue disinflation only to the extent that there exists a consensus in its favour.
Bibliography


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