

**Innovation for sustainable economic growth**

Towards feasible alternatives

CAMBRIDGE ECONOMICS NETWORK



Closing the gaps in theory & practice

Options worth considering  
to solve the cost of living crisis



*Clare College and King's College Chapel Cambridge*

CEN Publication 001

Title: Options worth considering to solve the cost of living crisis

Author: Hector Wetherell McNeill

Issued by: Cambridge Economics Network

<http://www.cambridge-economics.net>

Received: 26/05/2022;

Reviewed: 30/05/2022;

Published: 31/05/2022

Published by: Hambrook Publishing Company

ISBN: 978-0-907833-64-2

Copyright: © 1975-2022, Hector Wetherell McNeill

# Contents

Issues that have shaped the cost of living crisis .....	5
Inappropriate solutions .....	6
Productivity .....	6
A flawed theory is the foundation of ineffective derived policies.....	7
The significance of productivity .....	7
Where do we want to end up? .....	7
Nicholas Kaldor and the significance of manufacturing .....	9
An omission in Rostow's Stages of Economic Growth .....	9
Unconvincing governance of financial affairs.....	9
Companies set prices, not the Bank of England .....	11
Interest rate policies normally have perverse impacts .....	11
The determination of prices.....	11
The motivation for the development of an alternative approach.....	12
The Price Performance Ratio .....	12
Relying on established practice .....	13
Manufacturing and service sector productivity differentials .....	13
The Price Performance Levy – a productivity incentive .....	14
Obtaining a short term policy impact on prices .....	14
A policy to tackle inflation and sustainable real growth .....	15
Raising real wages .....	15
The Phillips Curve .....	16
Notions of relationships between productivity and the Phillips Curve.....	16
Risk issues for investors .....	17
Removing the loss from a loss-leader approach .....	18
The need to manage the possible.....	18
Our ongoing costs .....	19
Options .....	19
Concluding .....	21
The author: Hector Wetherell McNeill .....	22
Comments made by the author concerning RIP in response to APE correspondent queries: .....	22

# Options worth considering to solve the cost of living crisis<sup>1</sup>

Hector Wetherell McNeill

Director

The George Boole Foundation Limited, London

*Since the last energy resources price crisis in the 1970s arising from the members of OPEC raising their prices, Britain did not develop substantial options to reduce a heavy reliance on petroleum and gas. At the time, Britain faced a cost of living crisis characterised by stagflation, the combination of high price inflation with falling employment. This crisis endured for 20 years. Macroeconomic policies in Britain gravitated towards a reliance on monetary policy, or monetarism in general, to manage demand and inflation. In reality, the policy decisions to address stagflation actually depressed the economy and accelerated the process of investment in offshore engineering to make up for low productivity within the United Kingdom by moving production centres to low income countries. This process failed to develop alternative processes within the UK economy itself to lower reliance on petroleum and gas. This was because the high international prices made North Sea oil a feasible proposition.*

*Now, close to 50 years following the previous energy resources price crisis and stagflation, the United Kingdom now faces a similar problem.*

*Currently, although the problem is rising prices, none of the policy propositions by government include techniques to immediately impact unit prices by stabilizing or reducing them. As in the 1970s-1990s all "solutions" proposed, including those requested by various constituent groups, fail to tackle directly the main issue of constantly rising prices. Some solutions involve providing cash support of some kind for lower income constituents. However, this type of action is palliative having no impact on the causative factors of rising prices.*

*This predicament is exacerbated by the very approach to macroeconomic policy that has created the debt-taxation trap that severely constrains policy options.*

*The only macroeconomic theory and policy that offers the option of tackling unit prices directly and in the short term is Real Incomes Policy (RIP) which makes use of totally different policy instruments.*

*This paper reviews some of the macroeconomic options that can help tackle this cost of living crisis.*

London

25<sup>th</sup> May, 2022

---

<sup>1</sup> This paper is a reduced version of a presentation delivered by the author on Saturday 14<sup>th</sup> May, 2022, to the Agence Presse Européenne Correspondents' Pool workshop on the "The Cost of Living"

## Issues that have shaped the cost of living crisis

A review of the current economic predicament of the UK presents us with a range of critical issues including:

- Fiscal "solutions" using government debt only increase the need to increase taxation
- Monetary "solutions" such as financialization and inflation targeting applying interest rates and money injections have decimated manufacturing and reduced real wages
- Quantitative easing has generated an asset bubble which in the case of land and real estate has exacerbated the housing crisis
- Quantitative easing has generated an asset bubble which in the case of many commodities has created rising input costs for companies
- Full employment is only achievable on the basis of very low average wages and purchasing power of the employed
- Productivity is low, resulting in an inability to pay compensatory wages. Some 25% of wage-earners are entering a "poverty" status
- The "poverty" category is characterized by this group facing difficulties in paying for their basic essentials
- Government revenue-seeking through taxation reduces disposable incomes and consumption
- Corporate taxation norms place labour in the corporate accounts cost's category creating a tension between shareholders and labour
- By categorizing labour as a costs component there is a disassociation of labour forces from decisions on acquisitions, mergers and disposals. As a result, companies are often viewed as purchasable and disposable assets to enrich buyers at the expense of labour forces
- The notion that the sole purpose of banks and companies is to generate profits and "shareholder value" was promoted by the Chicago School and in particular by Milton Friedman
- Share-holder value emphasis, under quantitative easing, was transformed into a sacking of the economy at the expense of those who are not shareholders.
- Companies have bought back shares to raise shareholder incomes while making no investments in productivity.
- Banks have given preference to loans to purchase assets, or have made direct purchases of assets themselves to bolster their own shareholder values as opposed to making loans for productive supply side investment.
- The emerging cost of living crisis took off with the impacts of quantitative easing and, as a result, the economy was poorly prepared and lacked resilience to handle the economic impacts of the Covid-19 pandemic.
- The cost of living crisis has become more extreme as a result of rises in prices of energy resources in a development similar to that in the 1970s. This time this

was not a decision by OPEC but rather the result of decisions in the foreign affairs domain linked to the UK and other countries supporting sanctions against Russia in the context of the Ukrainian affair

## Inappropriate solutions

So far "solutions" have failed to address the short term urgency facing at least 25% of the population in meeting their essential needs. This problem, being a need to provide some form of support in the short term, is trapped by the situation created by the government policies implemented over the last several decades. This trap is an imposed trade-off between debt and taxation as highly restrictive options that impede productive solutions.

During Bill Clinton's 1992 campaign one of his strategists, James Carville, coined the phrase "*The economy, stupid*", as one of the messages campaign workers needed to concentrate on. The other two were, predictably, "*Change versus more of the same*" and, of course, "*Health care*." All of this was shaped to win him the election in a period of economic difficulties.

Unfortunately, the Clinton administration introduced an excessive amount of financial sector deregulation including bank deregulation formalized through the repeal of the Glass-Steagall Act (1933) in 1999 by the Gramm-Leach-Bliley Act. This effectively removed the barrier between retail and investment/trading activities in banks. This created a cascade of financialization and criminal activity within the financial intermediation sectors with London becoming one of the global centres for fixing deals other centres were loath to execute.

This cascade culminated in the 2007-2008 financial crisis and has since been exacerbated through an additional financial cascade created by the "*crisis solution*" in the form of quantitative easing.

Over the last 40 years, one of the principal impacts of financialization in the USA and Britain has been the hollowing out of industry and manufacturing as petrodollars<sup>2</sup> went into offshore opportunities leading to plummeting balances of payments. Currently the USA and UK hold the two most negative balances of payment on the global balance of payments league table.

## Productivity

The most enduring characteristic of this experience has been the lack of attention given to supply side production productivity.

---

<sup>2</sup> The processes giving rise to the petrodollar-driven financialization are described in some detail in the 2022 edition of the "[British Strategic Review](#)".

## A flawed theory is the foundation of ineffective derived policies

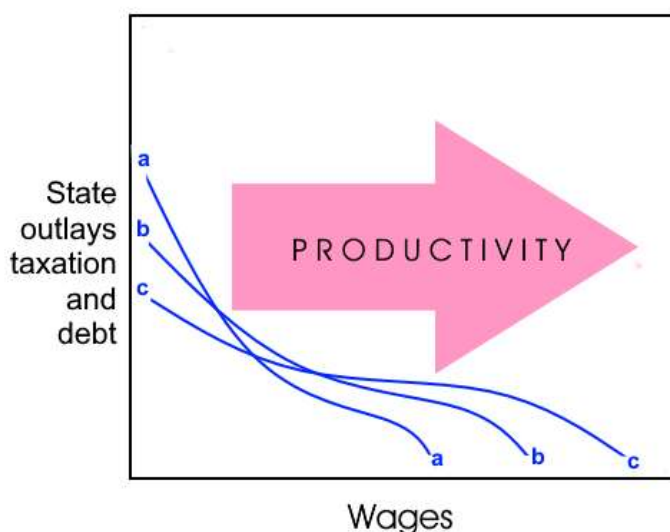
The solution, therefore, cannot be provided by the current paradigms applied to economic planning and oversight because there is a practical problem. The economic theory being applied is flawed. As a result, policies have no traction because of a debt-taxation trap created and maintained by government policies. The explanation of why monetary theory is flawed has been set out in the 2022 edition of the "[British Strategic Review](#)" and the BSR Note "[Why the Bank of England cannot solve the Cost of Living Crisis](#)" provides an overview of this issue.

## The significance of productivity

Productivity tends to be associated with medium to long term investments which pay off, if ever, sometime in the distant future. A review of government committee minutes on productivity and innovation indicate that the over-riding presumption is that innovation leading to increases in productivity, is a long term affair. It ranges from the funding of basic research and the follow up issue of venture capital to bring promising new developments, technologies and techniques to market to earn inventors and venture capitalists some income or profit. As a result of these limited perspectives and in the context of the cost of living crisis, "productivity" is not the first thing to be considered. This is because the problem of a rapidly rising cost of living crisis creates a need for an effective means of slowing down and reversing price rises in the short term.

## Where do we want to end up?

It is important to describe an extreme scenario of where we want to get to in order to understand more clearly the sense of direction required for policy to tackle the cost of living crisis. The extreme end point scenario is that if everyone had a higher adequate income, most things that are currently paid for by government, could be paid for by the public directly leading to a situation where taxation could also be lowered



considerably. Under such a state of affairs, even lower income segments would be able to pay for essentials and the main characteristics of "poverty" would be eliminated. The transition described is represented in conceptual form in the diagram on the left and by the movement, over time of the curves from position a-a, through b-b to c-c.

The default instinctive reaction to such a proposed scenario is that higher wages put companies out of business. But this, of course, is why

productivity levels need to rise as an imperative. Germany pays its workforce higher wages than Britain and has had the world's highest balance of payments during the last 25 years.

Innovation, leading to rises in physical productivity is a continual process within certain companies and especially those that make things in the supply side manufacturing sectors. Thus, industries and manufacturing companies that handle the whole production cycle from design through to manufacture to sales, usually improve their productivity through an ongoing process of shop floor innovation (SFI) which have immediate impacts on productivity as well as incremental, but sometimes major design changes, leading to a constant refinement of how things are done.

The combination of workforce learning and the ability feedback suggestions on how to improve processes results in a constant addition to worker skills and tacit knowledge and a constant advance in productivity.

Each year incremental SFI decisions can result in rises in productivity of between 2% and 30% depending on the sector and the nature of the technologies and techniques deployed.

A crucial factor in this process is the continual exposure of the workforce to repetitive processes which, as throughput grows, results in production involving less waste, shorter execution times and lower costs and therefore higher margins and an ability to lower unit prices and gain market share. The countries that deploy this approach as a general culture within a manufacturing tradition are shown in the table on the right. These countries also take up the poll positions in the global balance of payments league table.

Top balance of payments (BOP) (2020)	
Country	BoP \$billions
Germany	280
Japan	186
China	171
Netherlands	90
Switzerland	80
Russia	65
Taiwan	65
Singapore	63
South Korea	60

An important element in this subject is that countries with this manufacturing culture are in a better position to respond more quickly to change than those who are less involved in manufacturing.

The more recent examples have been Russia's response to an increasing range of economic sanctions over the last decade, where rising productivity in affected sectors, or even initiating new operations within sectors, has enhanced the ability of the economy to become more resilient in resisting the impacts of sanctions. This process has augmented the contribution of Russia's internal market to the national cash flow.



## Nicholas Kaldor and the significance of manufacturing

In 1966, Nicholas Kaldor, Professor of Economics Cambridge University, described in his inaugural lecture why Britain needed to expand its industrial and manufacturing sector. When Denis Healey, the Labour government Chancellor, switched to monetarism in 1975, Kaldor predicted that we would end up where we are now. Kaldor became the leading critic of the Thatcher administration's subsequent ventures into monetarism. However, a vital point to Kaldor's reasoning appears to have remained beyond the comprehension of many economists because it is usually seldom referred to. In basic terms, Kaldor's position was that the larger the manufacturing sector the more products, devices and capital equipment manufactured within the country can supply all other sectors with their needs. As a result, the rate of overall economic growth arising from innovation and rises in productivity across all sectors is a function of the quality and productivity-enhancing effects of manufactured products made in this country. The manufacturing sector has therefore an enormous potential to be the driving force of the productivity and growth of the whole economy as a result of the quality of manufacturing production driven by innovation.

## An omission in Rostow's Stages of Economic Growth

The 2022 edition of the British Strategic Review sets out the reason for any doubts concerning Kaldor's position arose from changes in economic development theory. This was influenced an erroneous notion contained in Walt Rostow's book, "*The Stages of Economic Growth*", published in 1960. Rostow based his thesis on the model of British economic development up until that time. Growth in the service economy was seen as a natural development to take up the majority of employment while manufacturing employment would "naturally" decline. However, the normal hegemonic cycles of the rise and fall of what were colonial countries do indeed pass through Rostow's stages of economic growth, but the last phase of Britain's hegemonic cycle had not even started when Rostow published his book. Previous hegemonic cycles of other colonial powers involved a rise in financialization, investing in offshore lower wage locations, the collapse of manufacturing and increasing speculation and inflation and a general state of ruin. Between 1960 and 2022 Britain has been passing through this final hegemonic cycle phase while, China, for example, is in the middle phases of expansion of manufacturing and rapid growth.

## Unconvincing governance of financial affairs

The recent exchanges between Bank of England (BoE) representatives and the Treasury Committee and other parliamentary committees, have been disappointing. BoE representatives commented on the fact that the government's super-deductions do not appear to have had the impact on investment and productivity that was imagined by government. This lack of impact was entirely predictable, based on past evidence and over 40 years of Real Incomes Policy development. Any practical experience in real world investment project design, appraisal, management and post-funding evaluation should conclude that super deductions would have little impact. As a result of this

experience, it is very apparent that any initiatives such as super-deductions are, in many cases, regarded as convenient give-aways because they are not associated with any undertaking on the part of those receiving them to raise productivity. Such initiatives are more a vote-harvesting technique than a serious attempt to increase investment geared to increased productivity. If it was not such a cynical move, it was, on the other hand, extremely naive reflecting a lack of practical experience with the real world of corporate investment and cash flow management.

In the parallel attempts by both the Reagan and Thatcher administrations to introduce so-called supply side economics<sup>3</sup> of reducing marginal tax rates, a large proportion on the windfall funds ended up in the pockets of executives. To be fair, some gains in productivity were obtained in some specific companies, but the associated raising of interest rates to unprecedented levels killed off any serious raising of finance for productive investment. In fact, in both cases, these policies resulted in severe prejudice with thousands losing homes and family farms as a result of repossessions.

The naivety concerning practical economic circumstances also appeared in the government's insistence that a £200 payment would help people pay their energy bills which they expect to be paid back annually in nominal tranches of £40. Under inflationary conditions, inflation is equivalent to a tax or interest rate which discounts the value of money as a function of the rate of average price rises. Therefore, the public are expected to pay back the nominal sums, which are fixed, from a diminishing disposable real income. Therefore, these payments are the equivalent to an imposed loan which in fact prejudices consumers. A more detailed explanation of the calculations involved can be found here: ( See: "[From earned income to pauperism and back](#)" ) It would seem that the government has now realized this fact and have proposed to change this advance from a loan to a grant.

Conventional macroeconomic policies applying interest rates and money injections cannot address the short term problem of rising prices. This is why people demand assistance in the form of grants. However, grants have no effect on unit prices.

The issue is to see what can be done to arrest unit price increases and, in some cases, reduce them, in the short term.

The answer lies in the set of factors that control the mechanisms that govern the relationships between productivity and unit prices. With an innovative manufacturing sector, any type of innovation and cost reduction in all other sectors using manufacturing output (devices and equipment), can be disseminated and sustained across all sectors. Therefore, in the medium to long term the quality of manufacturing output has a direct impact on the ability of the economy as a whole to moderate or even reduce unit prices as a result of rising productivity. All sectors deploy quite different technologies, techniques and skill sets, so it is not possible for conventional policies

---

<sup>3</sup> Supply side economics is essentially a misnomer in that it is a fiscal variant but provides no direct incentives for the supply side to invest in verifiable higher productivity investments

and their limited policy instruments of interest rates and money injections, to adjust to the needs of each company and its work force.

### Companies set prices, not the Bank of England

The fundamental issue is that price setting, through the economy, is controlled by companies. Therefore, macroeconomic policies need to provide incentives to align the objectives of the processes of price-setting with the policy objectives. The most logical objective is to encourage a general rise in real incomes achieved by moderating or lowering unit output prices. This process aims to raise the purchasing power of the currency and therefore of wages.

Under competitive conditions, corporate price-setting is usually designed to secure sales advantages over competing products of equivalent quality and utility being provided by other producers.

### Interest rate policies normally have perverse impacts

Normally, just as inflation rises and consumption levels begin to decline, and therefore production throughput is falling, conventional policy attempts to reduce inflation by raising interest rates as well as taxes. This helps reduce consumer disposable incomes and raises the cost of finance needed for investment, acting as a disincentive to productivity investment. With falling throughput, overheads rise per unit of output as overheads are shared over a lower volume of output; costs rise. Therefore, conventional monetary policy actually exacerbates the state of affairs because corporate margins decline, undermining corporate survivability.

In the Reagan and Thatcher administrations this scheme was applied and it further depressed the economy causing more people to lose their jobs and many to lose their homes and family farms as a result of repossession by banks and mortgage companies.

### The determination of prices

The establishment of unit prices is influenced by unit costs, overhead costs, and the specific objectives in terms of desired market share, and therefore, sales volumes. Sales volumes depend upon the price elasticity of consumption of consumers. This is the percentages rise in consumption associated with a percentage fall in unit prices. This varies with different products as well as levels of disposable incomes of consumers. Under the conditions of severe inflation, as is being experienced now in this country, the objective should be to encourage companies to take marginal productivity enhancing actions to enable them to moderate or lower the rates of unit output price increases, to arrest the rise and then initiate a process of unit price reductions. At first, such a statement, under conditions of high inflation, appears to be illogical and unrealistic. However, setting this as the objective, the focus of policy is shifted from the current emphasis on subsidy and grants for consumers. The essential requirement is to introduce a macroeconomic policy with strict microeconomic imperatives and providing across-the-board incentives to sustain ongoing increases physical

productivity but with an emphasis on short term unit price moderation or reductions. In this way it is possible to begin to relieve constituents of the pressures caused by rising prices on a sustainable basis.

### The motivation for the development of an alternative approach

The motivation to start the economic policy development work that gave rise to the alternative of Real Incomes Policy (RIP), was the realization, in 1975, that the existing theory and policy instruments<sup>4</sup> could not handle cost-push inflation and would cause significant prejudice for constituents and companies.

RIP, therefore, was the result of an effort to design a policy to address the circumstances we now face by enabling an almost immediate impact on prices rather than applying the conventional instruments that have to "work through" the economy and which, invariably, lose traction.

### The Price Performance Ratio

What is always required under such circumstances is to obtain an immediate price effect to arrest or slow down inflation.

To achieve this the real incomes approach makes use of a price-based measure of corporate performance known as the "[Price-Performance Ratio](#)" (PPR).

This is calculated by dividing the percentage change in unit output prices in response to percentage changes in unit input costs in each company over a set period.

$$PPR = \frac{\delta UP}{\delta UC}$$

The relationship of PPR to inflation	
PPR value	Inflation impact
> 1.00	Rises above input rate
= 1.00	Remains at input rate
< 1.00	Falls below input rate

Where:

PPR is the price performance ratio;

$\delta UP$  is the % change in unit output prices;

$\delta UC$  is the % change in unit costs.

The relationship of the PPR to the rate of inflation spreading through an economy via factor input and produce output supply chains is shown on the left.

It is evident that in order to stabilize or reduce unit price inflation it is

<sup>4</sup> These instruments, together with government loans and taxation, remain the core toolset of Monetarism, Keynesianism, Supply Side Economics and Modern Monetary Theory.

necessary to encourage companies to operate with a PPR of unity (1.00) or less than unity (<1.00).

This is possible by simply lowering the rate of unit output price increases. However, without a productivity increase, this would result in lower margins because unit costs are increasing at the rate of the input unit price inflation rate.

However, the objective remains to encourage companies to moderate and even reduce unit prices.

### Relying on established practice

Under a wide range of supply chains contracts as especially those linked to just-in-time operations, the contractual obligations on industrial and manufacturing suppliers can often include a continuing price discount. Thus, with volumes of production it is well-established that costs of production decline and efficiency rises enabling suppliers to lower their unit prices to contracted customers by pre-established decrements. There is, therefore, not only a natural decline in costs and unit prices based on the learning curve but also an effort on the part of suppliers to innovate so as to accelerate cost reductions so as to maintain or even increase margins even under the regime of declining unit prices. The associated effect is that by improving their performance on one contract they can open up opportunities for market penetration by becoming attractive competitive suppliers for other buyers.

### Manufacturing and service sector productivity differentials

It is worth noting that whereas the bulk of feasible cost reductions arise within the manufacturing processes, the service and logistics functions supporting these activities begin to run into a diminishing return to operations more rapidly because the “productive” effort is more concerned with reducing the costs and time frames of logistics operations. Once the existing appropriate optimization algorithms used in this field are applied across the supply chain logistics components, the overall activities have more limited means of sustaining productivity improvements. Any incremental gains tend to arise from a manufacturing innovation giving rise to a product that helps services reduce their operational costs, for example more fuel efficient vehicles or lower cost IT communications systems.

Referring back to Nicholas Kaldor's position on the importance of manufacturing to Britain, it is a fact that the British economy is dominated by services and logistics functions distributing largely imported products. As a result, the metaphor of Britain being a “*nation of shopkeepers*” significantly characterizes the problem because of the limitations on the ability to generate productivity advantages. Industrial and manufacturing activities have a far wider range of opportunities to introduce cost cutting resources allocations decisions than “*shopkeepers*”. Importing and managing the logistics of distribution within the UK provides no opportunity to alter the price at the point of importation, let alone change a product to lower its costs, price and operational efficiency. In order for such cost and price-reducing productivity impacts

to be more readily available there is a need for an expanded national manufacturing sector and broader-based import substitution. In this way a larger proportion of the cash flow benefiting from such price declines flows within the country and manufacturing sectors. It is these sectors, as a result of an ability to innovate, that can provide a source of rising productivity and wages, leading to rising real demand and national growth.

### The Price Performance Levy – a productivity incentive

Because of the trade-off between unit prices and margins RIP makes use of this to create an incentive for companies to moderate or reduce unit prices. This involves the provision of a cash incentive for the degree to which the rate of increase in unit prices is reduced and eventually reversed. To achieve this, a levy is applied which is proportional to the reduction in PPR. In other words, as the rate of inflation passed on by a company is reduced, so the levy paid is also reduced, leaving the company with a higher net cash flow.

### Obtaining a short term policy impact on prices

The main logic behind this approach is that companies can reduce their prices immediately to benefit consumers while having enough cash flow to continue to progress in terms of costs reductions to eventually reach the levels of physical productivity to justify the price reductions.

Productivity investments have several objectives but one key objective is to secure the flexibility to be able to compete more effectively on the basis of price. However, there is normally a time lag between implementing an investment and being in a position to lower unit prices based on the rise in productivity.

Real Incomes Policy therefore encourages incremental investments which can involve modest costs to be costed into the calculation of the PPR. If the company then sets the unit prices at the level that will be feasible at the new productivity level, then the PPR will decline and so will the Price Performance Levy (PPL) resulting in a higher margin net of payment. In terms of business strategies, the objective is to reduce the incidence of the PPL and if possible reduce it to zero, thereby maximizing margins. In terms of business rules related to resources allocation decision analysis, the reduction in actual output prices should be assessed in terms of potential outcomes with respect to resulting sales volumes. A company can gain more sales as a result of consumption rising because of the unit price reduction augments existing disposable income purchasing power. The actual impact of this approach in a general inflationary environment is to raise real incomes of both the company and consumer. Depending on the price elasticity of consumption, overall revenues can rise as well as aggregate profit although the % margin might be reduced. Therefore, there are definite transparent business rules than can be applied in companies operating in a Real Incomes Policy framework.

There are several ways to calculate a Price Performance Levy (PPL) depending upon the degree of incentive policy makers wish to provide which will depend upon the severity of inflation - see [The Price Performance Levy](#).

### A policy to tackle inflation and sustainable real growth

The overall impact of this approach is to slow down the rate of inflation by acting directly on prices. This is a more efficient and effective way to tackling the cost of living crisis than providing consumers with grants and support. This particular approach provides no incentive for companies and manufacturers to moderate prices. However, if their net cash flows depend on their responding to policy and maintaining their cash flows, or increasing them by moderating prices and improving their productivity, then the monies are better spent. The incentive scheme should raise policy traction and the evolution in productivity and innovation should continue.

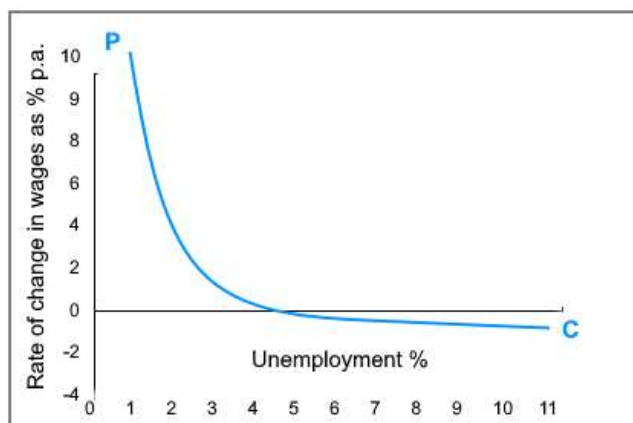
### Raising real wages

The other principal challenge to macroeconomic management is the question of income distribution and the fact that something like 25% of the working population have wages that are just sufficient to cover essentials but in the lower wage segments support is increasingly required. However, under conditions of inflation this income group faces serious issues in not being able to continue to provide for their essential needs. Whereas Real Incomes Policy aims to moderate and/or reduce unit prices in a counter-inflationary process, this alone, can help raise the purchasing power of people on the low end of wage scales. However, as the title of the policy suggests, the overall objective of policy is to raise real incomes. It is self-evident that if the real incomes of consumers rise so does their purchasing power resulting in increased consumption and throughput of companies rising.

If as part of the PPR calculation the productivity gains also involve a marginal rise in wage rates, while securing a low PPR, then the Price Performance Levy payment might be further lowered. This incremental process can end up with the PPR falling well below unity. Thus, the procedure of managing an operational PPR also enables companies to manage the levy they will pay while contributing to the policy objective of raising wages. As a result, such a policy has a long term traction. This is made possible because the whole process remains under the control of the company and workforce decision making rather than arbitrary governmental and policy decisions on interest rates, money injections, government loans and taxation.

The whole package is transparent but it needs a sound understanding of consumption schedules of corporate output by product line. This requires an understanding of the price elasticity of consumption of each product to be able to manage this optimally.

## The Phillips Curve



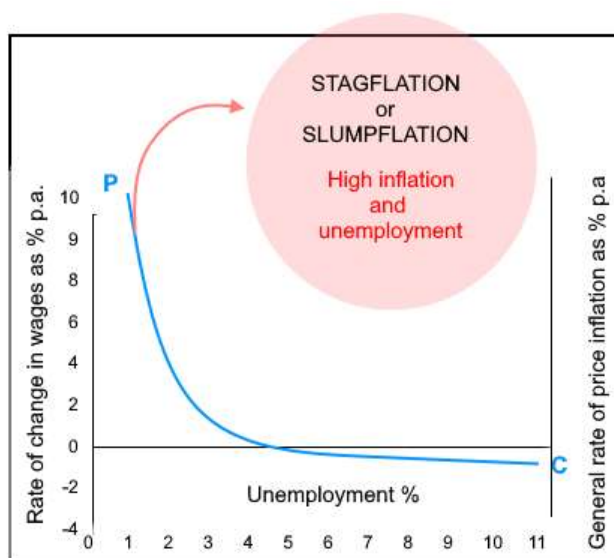
In 1958, Alban W. H. Phillips (1914-1975), published a paper in *Economica* entitled, "The Relation between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1861-1957" in which he set out the inverse relationship between money wage changes and unemployment in the British economy, based on the data set for that period. The general

relationship which came to be known as the Phillips Curve is shown on the left as P-C.

It should be noted that the demand for higher wages is related to nominal incomes compared with changes in prices or income purchasing power. As price rises cause a fall in purchasing power of nominal wages then pressure on wage demands rises. Therefore, there is a direct relationship between inflation, or the cost of living, and wage demands. Thus, wage inflation does not exist in isolation from general price inflation.

Based on the Phillips Curve, the impact of the petroleum price increases was unexpected because the coordinates of high inflation and rising unemployment moved off the P-C curve to a completely different location.

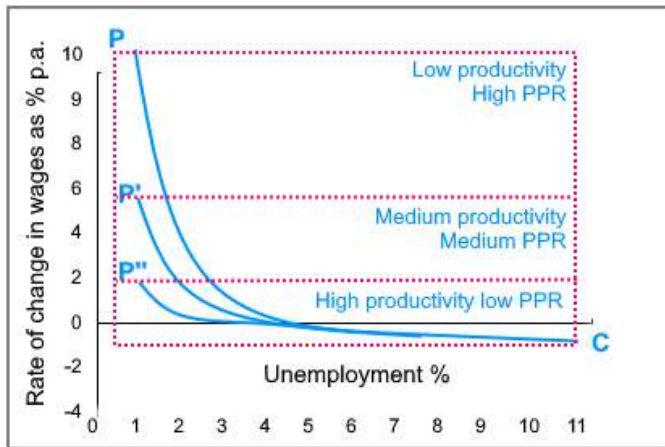
In the absence of adequate productivity gains, high unemployment resulting from high input cost-push inflation and absence of real increases in wages resulted in rising unemployment while maintaining a high level of inflation.



## Notions of relationships between productivity and the Phillips Curve

It is arguable that by raising productivity at a sufficiently high rates and applying these gains to lowering output inflation, the rises in wage rates associated with low unemployment would be lower because the purchasing power of the currency would





be higher and therefore the motivation for demanding higher rates of wage rises would be less.

In schematic form the original Phillips curve is used to set out different productivity and pricing curves in the diagram on the left.

Low productivity with high PPRs would be likely to produce the high wage raises

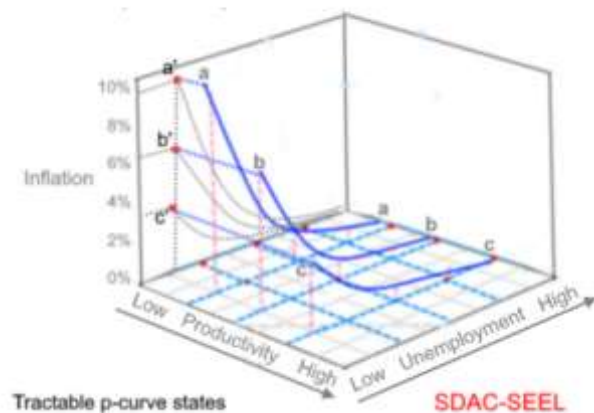
with low unemployment. This is the original P-C curve.

A higher level of productivity combined with a lower PPR is likely to result in a lower rate of wage rises with low unemployment as shown by the curve P'-L.

The objective of RIP is to encourage a combination of higher productivity with low PPRs and a curve approximating P''-C so as to contain the levels of inflation at low unemployment.

By bringing inflation down to lower levels there is an enhanced probability of these levels of inflation being absorbed by the next phase increases in productivity. This compound graph can be projected in a 3D representation as shown on the right showing the relationship between inflation, productivity and unemployment.

Low unemployment inflation rates a', b' and c' associated with three productivity levels a, b and c.



Where productivity is able to lower inflation the aim of Real Incomes Policy is to trade off *price productivity* against *physical productivity* which is essential to secure unit *costs control*. The degrees to which this trade off can be effective depends upon process technologies and the technique labour forces have learned to deploy.

### Risk issues for investors

The simple introduction of state-of-the-art technologies to a production process using out-dated processes can usually result in predictable quantifiable productivity impacts. This is because quantitative performance data in terms of operational costs and physical productivity of the technology concerned tends to be well-established and classified as good (efficient), average (less efficient) and poor (inefficient) practice. As

a result, the risks involved in introducing state-of-the-art technologies are readily apparent and therefore involve more predictable results.

### Removing the loss from a loss-leader approach

The usual investment practice is to carry out such an investment, complete procurement, select the best bid, take delivery and commission equipment and begin production. Usually production proceeds and as efficiency or scales of operation rise unit output prices are established against actual performance in terms of input costs, physical productivity and prevailing market prices.

Under RIP companies are encouraged to review in some depth the likely productivity and unit costs projected to some point in the future. Rather than wait for production to reach specific levels before reducing output prices, the technique applied is to anticipate the unit price expected to be feasible at some point in the future. Rather than set this price at the point in time, when it is expected to be feasible, companies establish this price at the time of investment. The effort then goes into managing processes to meet the projected levels of productivity and turnover justifying the price set.

This has the effect of reducing the rate of rise in output prices or could even lower unit prices earlier in the process. In terms of constituents this means an earlier real income impact. In both cases, this move provides the company doing this with a competitive advantage vis a vis competing companies. However, this means that the per unit return of output in the initial production stages will be lower or even negative while the output penetrates the market and gains market share. The benefit, from the standpoint of policy is that a degree of control over inflation is secured and consumers have the advantage of being presented with relatively lower rates of price increases, price stability or even falls in unit prices, helping augment their real incomes.

The state of affairs for the companies depends upon the markets they serve, consumer income distribution, technologies and inputs deployed and consumption schedules established by the unit price elasticity of consumption.

### The need to manage the possible

In 1981, the author reviewed the RIP concept with Richard Wainwright, then the Liberal Party economics spokesman. He turned out to be one of the few politicians that had taken the time to read and understand the concept presented in a monograph circulated at the time within political party circles as the very first edition of "*Charter House Essays in Political Economy*". Wainwright was interested in the concepts and his reaction was to state: "*If we place this in our manifesto and we win the election we will be faced with the issue of implementing it.*" It is certainly the case that at that time, the internet did not exist and the challenge of introducing such a necessary change appeared to be daunting. The oversight of RIP concerning the calculation of PPRs and PPLs would require that all transactions pass through an IT system that sustained an oversight over

transactions to avoid “transfer pricing” and a string of possible fraudulent record keeping so as to exaggerate PPR reductions to end up not paying the PPL.

These requirements were made evident in 1981 by a senior partner of KPMG the audit company. He considered the proposal to be valid but he pointed out that under the then current regime the necessary information/data for companies to calculate PPRs is not collected by companies. This was an indirect confirmation of Wainright’s position. However, the data is part of corporate transaction records used in accounts. The basic requirements are known. During the last 40 years, the advance in database technologies, security interfaces, improved programming languages and the Internet and modern IT system design techniques, such as Data Reference Modelling, makes the establishment of a standardised system a relatively straightforward issue.

### Our ongoing costs

As matters stand, the costs of continuing as we are, are becoming too high with increasing numbers of people are suffering creating stress and a troubling state of affairs in the country’s social and economic conditions.

The constraints established by the current policy-induced debt taxation trap have imposed on government a need to resort to palliative “solutions” that alleviate the suffering of low income constituents, on a temporary basis, but these fail to solve the fundamental problem of the causes of inflation.

Having spent time in assessing the political challenges of introducing something like RIP this has given rise to considerations of several options to facilitate its introduction.

The potential benefits would appear to be self-evident and growing whereas the costs of introduction of what could be a “game changer” clearly need to be taken into consideration on the political front.

### Options

Below a review of some of the considerations and options available for the introduction of RIP are presented.

The advantage of RIP is that it contains a large range of operational options all of which help shift the operational basis for the economy away from the monetarist policy-created debt-taxation trap which has constrained all current government policy propositions to date related to the “solving” the cost of living crisis.

Within the Real Incomes development work many options for applying RIP have been developed. They include making the PPL a manufacturing sector run “Development Fund” where payments made remain tagged with the name of the companies paying their PPLs. Rather than build up a fund the operational objective is to attempt to minimise the size of the fund as a reflection of advancing corporate productivity.

This collaborative basis set at some distance from government overcomes some of the restrictions under the World Trade Organization which could interpret any government involvement as subsidy and a form of infant industry support.

However, a large number of developed nations with now, overbearing service sectors, face the same problem of income disparity becoming higher than in some developing countries. Because the average real incomes have been falling as a direct result of offshore investment largely in developing countries, there has been an effective displacement of former industrial and manufacturing employees in developed nations. This has been associated with a widespread loss of tacit knowledge and capabilities. There is, therefore, a need to base arguments for the essential transitions and expansion of manufacturing on the basis of poverty reduction.

It is apparent that as a so-called developed nation, politicians would be reluctant to classify a major change in macroeconomic policy as a poverty reduction measure but conveniently RIP is also a long term growth strategy based on a major investment in innovation,

Rather than making RIP a generalized macroeconomic policy it would be better to make it a voluntary scheme within which no corporate taxation would be applied and companies would be allowed to withdraw from the scheme and receive back any accumulated PPL funds on doing so if they are not satisfied with the results.

Initial calculations suggest that those joining a RIP scheme would be able to out-compete companies in the same sector who continue under the current policy schemes and taxation regimes. This is not an issue, since it would encourage increasing numbers of companies to transfer to operate under RIP.

It is likely that RIP would be better applied to different manufacturing sectors along the lines that operatives within the sector feel would be create the best levels of incentives required to transform the sector. This is because each sector deploys distinct technologies and techniques as well as operating in different input factor and output markets. By making RIP operations sector based there would be a better focus on the specific conditions and technologies of sectors leading to an improved shared knowledge on operational practice and ability to improve the quality of project appraisals.

In order to regularize the treatment of labour in a productive fashion so that the PPL operation is linked to PPR estimates that include wage rises, it is probably best to create incentives for the creation of *mutual manufacturing operations* including the facilitation of any manufacturing company transitioning from plc status to mutual status. This would be reversal of the tendencies encouraged by governments in the 1980s and 1990s of encouraging mutual to become plcs with disastrous results and a steady decline in real wages. This however, would be likely to meet with shareholder resistance except, perhaps in the case of failing companies.

Depending upon the levels of impact of RIP the question of personal income tax could come into play with highly successful labour-management operations giving rise to significant controls of inflation, including reduction of unit prices, leading to income tax discounts.

One of the most successful roles for government in this system would be to help manufacturing sectors establish detailed and easily accessible information on state-of-the-art (SoA) technologies combined with adequate economic and financial analyses on potential performance supported by actual survey data on operational best, average and poor practice combined with analyses of the reasons for the differences in performance.

It is often the case that practice and performance tends to be linked to operational experience of the workforce and management. The actual difference in performance linked to the learning curve associated with different combinations of technologies and labour need to be collected on a regular basis. This can create data sets that companies can use to estimate the trajectories of their unit costs curves to guide their unit price-setting against likely gains in unit cost reduction. This type of activity needs to be manufacturing sector-based and it might involve teaching and research organizations such as universities. However, this operation should not be slowed up by academic publishing cycles but the raw data should be published regularly and made available to all. Academic institutions should not be permitted to make any claims over the ownership of such data sets which should be assigned a “Commons” open access categorization. On the other hand, the data should be made readily available engineering and teaching establishments.

## Concluding

Given the dire situation which has been exacerbated by sanctions on Russia, the government is left with little option now other than to provide constituents in need with direct financial support.

However, there is an urgent need for the government to act in such a manner as to bring about a change in policies to help the country escape the debilitating debt-tax trap built up by an inappropriate monetary policy dominating macroeconomic management.

Post-BREXIT, post-Covid-19 and recovery in a high inflationary environment trending towards stagflation cannot be solved through the manipulation of financial factors based on national accounts and notions of “affordability”.

Real Incomes Policy provides an alternative that is a relatively uncomplicated and transparent proposition. It holds the promise of a practical and sustainable approach to help solve Britain’s productivity and real wage crisis. It is not a top-down monolith but contains a range of options on how it might operate, some of which have been outlined.

## The author: Hector Wetherell McNeill



Hector McNeill is a British economist. Born in Portsmouth Hampshire. He completed undergraduate studies as a member of Clare College Cambridge completing the Agricultural Tripos at the Cambridge University School of Agriculture followed by post-graduate agricultural economics including biometry, project evaluation and economics at the Faculty of Economics. His dissertation was entitled, “*Defects of Commodity Control Schemes*”.

As a Fellow of the Food Research Institute at Stanford University he completed studies in economics at the Department of Economics and systems engineering at the School of Engineering.

He worked in South America as a member of the Plant Production Division of the Food and Agriculture Organization. He was a Senior Scientific Officer with the Information Technology and Telecommunications Task Force (ITTF) of the European Commission concerned with the development of applications on global communications networks and was the Environmental Economist for the G7 Brazilian Rainforest Trust Fund.

His economic research and development work has been largely oriented to the analysis of the causes and solutions to inflation and stagflation. His work on this topic started in 1975 when he observed the impact of the large rises in the international price of petroleum that started in 1973. His motivation for pursuing this line of research was that he had realised that all conventional policies and their policy instruments could not solve this issue without imposing significant prejudice on constituents. This is because, conventional policies were never developed to address cost-push inflation but rather demand-pull inflation. As a result, conventional policies were never evolved to address this type of inflation and stagflation in particular. This is why the government is at a loss in identifying the required actions to solve the cost of living crisis.

As a result of McNeill's work, Real Incomes Policy (RIP) was developed which represents both a cogent theory and a set of derived policy instruments which are quite distinct from those applied under conventional policies. RIP is unique in representing a transparent alternative to conventional policies.

### Comments made by the author concerning RIP in response to APE correspondent queries:

*“There is little that is unusual in RIP. It is largely based on the logic of applied decision analysis in the management of microeconomic units. This identified the significant gaps in conventional macroeconomic practice thereby pointing to gaps in theory. The final form of RIP provides a transparent reflection of how the economy works which conforms with the viewpoints of the economists Adam Smith, Jean-Baptists Say, Theodore Wright, Nicholas Kaldor, Kenneth Arrow and Robert Solow”.*



*“Adam Smith’s emphasis on “interests” and Say’s on the role of entrepreneurialism combine with Kaldor’s emphasis on the importance of manufacturing to Britain. Kaldor’s, Wight’s, Arrow’s and Solow’s focus on the role of technology and learning as the principal generators of advancing real economic growth complete the process of shaping a more appropriate basis for macroeconomic management. Their work helped place Say’s emphasis on entrepreneurialism and innovation as a more central function supporting productivity and real economic growth as the basis for the RIP paradigm.”*



*“The operation of RIP is not based on debt or taxation options that severely constrain conventional policy decision analysis. This is because the control of the outcome of policy rests entirely in the hands of companies and their workforces in responding to the needs of constituents. This model is a variant on public choice and, as such, I consider RIP to be closely related to the approach to constitutional economics developed by the economist James Buchanan. In this sense constitution includes law, regulations and procedural rules on the desirable ways in which social and economic activities are conducted. As Buchanan set out, constitutions are created for at least several generations of citizens. Therefore, they must be able to balance the interests of the state, society, and each individual.”*



*“The interest of each individual is to have the wherewithal to afford what they consider necessary to satisfy their needs and therefore, as a minimum condition, society needs to bring pressure on the state, through democratic means, to ensure that the constitution and macroeconomic policies ensure that such a state of affairs is maintained.”*



*“With a constitutional economic perspective on policy, integrating all aspects of government decision making, including foreign policy, cost of living crises, impacting specific constitutes as a result of income disparity, reflect a failure in our policy conduct under our current constitutional settlement. Therefore, the current ad hoc actions by government need to be replaced by a more permanent arrangement that ensures that policy sustains real incomes growth for all so as that income disparities do not result in any one being disadvantaged as a result of past and current policies”.*