



Notes on
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Notes are prepared in response to reader queries by the
Strategic Decision Analysis Group, SEEL-Systems
Engineering Economics Lab, Hampshire, UK.

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Sustaining growth in real wages by investing in results

Summary

Introduction

Real Incomes Policy (RIP)¹ is a policy based on a demonstrably transparent and distinct macroeconomic theory, and which can eliminate inflation, raise productivity and achieve a sustained growth in real wages.

Having been involved in describing this policy at the theoretical level there are invariably communications issues related to entrenched preconceptions that dominate macroeconomic economic theory and derived policy perspectives. As a result, progress in expositions is invariably bogged down by counter-arguments, usually from economists, which in reality have no theoretical foundation but are assertions that are carry-overs from their understanding of their university economics courses. As a result, it is often difficult to get to the point of describing what RIP actually does.

Therefore, this short document dispenses with theoretical preambles and analysis and simply describes what the policy does. Since this is simple and transparent, it is a more productive way to introduce RIP.

This is the first document in a series which will progressively provide more details of the required policy framework, policy instruments, business rules for operating under RIP. The practicality of this operation

¹ RIP-Real Incomes Policy was developed in 1976 specifically to control stagflation in the 1970s following the OPEC international price sanctions on petroleum importing countries. RIP is based on the Production, Accessibility and Consumption theory of the economy as opposed to the Aggregate Demand theory which dominates all current theory and policies.

establishes that the theory of the Real Incomes Approach to Economics is coherent, logical, demonstrable and quite distinct from current economic theory and policies.

What is the purpose of RIP?

RIP sustains growth in real wages by investing in delivered results by bringing about three principal effects:

- It moderates prices and reduces or eliminates short term inflation
- It sustains medium to longer term increases in physical productivity
- This results in a sustained growth in real wages²

Real economic growth, a definition

Real growth results from price moderation and physical productivity increases in supply side production, resulting in more-for-less which in turn enables producers to gain reasonable margins while moderating or even lowering unit prices. The reduction in unit prices, as a generalised state across an economy, means that more can be purchased using current disposable incomes so the overall effect is a rise in real national economic growth.

The process of price moderation or reduction

An example of the mechanism

Imagine an incentive structure in which any company that reduces their prices will pay less tax to the degree that they lower unit prices. This means that it is then possible for a company to lower unit prices and end up with the same margin as would have been earned at the old price.

The main difference is that under inflationary conditions the companies that reduce their unit prices will attract more business and sell more. Therefore, in addition to gaining the same margin, the volume of sales and revenue will also increase.

On the side of the work force and consumers, unit price reduction specific to one company would be occurring across all sectors, by other companies participating in the same incentive scheme. Therefore, there would be a general rise in real incomes and national real economic growth.

Why does the incentive work this way?

Under conditions of inflation, people on lower wages often end up being unable to purchase basic essentials. This is why policies need to prioritise a process to encourage companies to lower unit prices.

The only other alternative is to subsidise wage-earners to alleviate their suffering but this is unsustainable because it is based on a rising government debt or future taxation. In the meantime, this approach does nothing to bring unit prices down but facilitates market transactions at rising unit prices. As a result, companies are under less pressure to improve productivity.

Sustaining increases in productivity

The sustainability of reducing unit prices

² Real wages signifies what can be purchased for a given nominal wage. Increased real wages results from reductions in unit prices and/or rises in the nominal wage.

In order to sustain the ability of companies to lower unit prices, it is necessary for corporate processes to become more efficient by producing more physical output for less physical input.

What is the source of sustained real economic growth?

Copious quantitative evidence exists and several analytical studies have established that most real economic growth is the result of:

- Learning by doing;
- As a result of operational experience and analysis of process performance, a *first stage in entrepreneurship* is the realization that a process can be made more efficient;
- As result, sometimes by trial and error, a *second stage in entrepreneurship* as a process of innovation occurs through the development of a more efficient process;
- The resulting operations have a higher physical output per aggregate unit of physical input;
- Lower relative prices are possible and used to penetrate the market while uplifting the real incomes of consumers

Learning, entrepreneurship and innovation and unit costs

This cycle of learning, entrepreneurship and innovation takes time. However, in the case of learning alone, which as a result of completing repetitive tasks, there is a rise in personal competence or skill. There are precise quantitative formulae that can project the trajectory of unit costs according to the number of tasks completed or volume of output. This makes use of the *learning curve* which has a characteristic cost savings depending upon the mix of people and technologies and the volume of throughput. Therefore, it is possible to determine at what point in the future, unit costs will decline to a level which will result in a company gaining the same margin as was realized before unit prices were reduced.

The entrepreneurial and innovation components are usually a direct result of having become used to handling state-of-the-art technologies and identifying, sometimes quite marginal, ways to improve productivity, as opposed to being related the results of long term basic research. Thus, innovation, is a constant factor in companies involved in making things such as industry and manufacturing.

A working incentive

There are therefore benefits for policy to encourage short term price reductions and to adjust unit costs downwards over the medium to long term. Since the learning-entrepreneurial-innovation cycles take time and in the case of learning alone it provides a basis to project future unit costs, companies can determine when future unit costs will reach levels that provide the same margin as was realized at the current higher unit cost and the higher unit price. As a result, the intervening revenue arising from market penetration can also be calculated depending upon the known relationship between unit prices and amounts sold³. It is therefore possible to calculate the cash flow resulting from the reduction in prices in the absence of any incentives for price reductions. To encourage companies to lower unit prices the incentive needs to be designed to make this move worthwhile.

Investing in results

Rather than provide a loan or grant on the basis of a “project” or “proposal” that promises to lower prices and raise productivity sometime in the future, RIP only provides the compensation against

³ Based on the price elasticity of consumption or demand

actual delivery of price reductions. In order for a company to remain viable under competitive conditions, they need to deliver on the subsequent rise in productivity or receive no further benefits.

RIP is very different from the normal systems of grants and loans designed to “encourage” investment, many of which receive no evidence that the monies will be invested in higher productivity actions. For example, the so-called “super-deductions” for the purchase of goods for companies provide a tax relief which is not checked against any progress in productivity. Indeed, like many development projects, those in receipt of funding quite often consider this as income as opposed to funding to bring about beneficial change. Even in those cases where investment projects are funded against detailed project proposals, the World Bank figure on their own project portfolio have registered a 35% failure rate and, in the case of agricultural projects around a 45% failure rate. This failure rate is the percentage of projects that were unable to deliver the promised benefits. The annual waste worldwide on development projects is around \$79 billion. On the other hand, the World Bank has admitted that whereas in the mid-1960s around 85% of WB projects were subjected to Cost-Benefit Analysis as a basis for approval, by 2010 this figure had fallen to 20%.

RIP is unique in that rather than risk such failure and waste of funds, the delivery of actual results as the degree of unit price reduction achieved is what controls the degree of incentive funding in the form of a reduced levy to compensate the company for enhancing real incomes growth of the workforce and consumers.

Summary

RIP sustains growth in real wages by investing in delivered results through the provision of an incentive to moderate or eliminate inflation in the short term while also sustaining medium to longer term increases in physical productivity through innovation. This provides an operational basis for a policy to sustain growth in real wages.

Other Notes in this Special Edition sub-series:

- The RIP framework
- RIP policy instruments
- RIP business rules for operating under RIP
- The Real Incomes Approach Theory
- A summary of theoretical gaps in current macroeconomic theory

OTHER NOTES

[*No.1 - 19th February, 2022 Some aspects of inflation*](#)

[*No.2 - 08th April, 2022 From earned income to pauperism and back*](#)

[*No.3 - 15th April, 2022 Why the Bank of England cannot solve the cost of living crisis*](#)

[*No.4 - 17th April, 2022 Technology, technique and real incomes*](#)