V. Illustration: Keynesianism

THE HARM wrought through the failure of economists to bring political economy and vote-gaining imperatives realistically into the study of economic problems can be further illustrated by the Keynesian phenomenon. The clash between Keynes and those he called 'classical' economists arose ultimately out of issues clouded by vague tacit assumptions on both sides about the 'politically possible'.

The classical analysis and prescription

The 'classical' economists can be said, broadly speaking, to have diagnosed economic depression as caused by repression of aggregate purchasing power (the flow of wages and other income). The income constriction was caused, they held, through input prices (costs) and output prices having been forced higher than the people (as investors or consumers) were able (or willing in the light of price expectations) to pay out of uninflated income for the full flow of productive services and products. In simpler terms, goods and services (including labour) were being priced at levels which people found beyond their pockets, so that unsold stocks piled up in the shops and warehouses, workers were laid off, factories had to work below capacity, and equipment had to stand idle. While this condition persisted, the flow of profits and wages was held down. Because prices were too high, people simply found themselves with insufficient income to make normal purchases in the absence of inflation. Then as now, high prices meant low 'real income', and that meant in turn low money incomes as long as (to take Britain) the pound sterling was to continue to be convertible into gold and allowed to retain its purchasing power.

The 'classical' prescription for the cure of such a condition was, firstly, prevention of its emergence, through avoidance of an inflationary boom (in which the price structure of a community became distorted), and, secondly, if a depressed economy had

inadvertently come about, to rely on 'economic pressures' to force the required value re-adjustments. It was thought that the unwillingness of people to remain unemployed, and the unwillingness of the owners of assets to see their resources idle or idling, would gradually force a downward shift of costs (wage-rates and interest on capital) and product prices. This would in turn restore both the ability and the willingness of people to absorb the full flow of inputs (whether of labour or capital) into the replacement of stocks consumed, or into replacement and accumulation of fixed or longer-life assets. That is, reduced money costs would enable manufacturers to use their assets more intensively and bring back laid-off workers into their jobs; for the manufacturers could then charge prices at which their customers could and would make their normal purchases. And 'customers' here meant not only final consumers but also other manufacturers buying outputs of capital goods to replace or add to their stock of assets and outputs of materials to add to 'work in progress', and merchants buying goods of all kinds to replace or add to their stocks.

Moreover, the 'classical' economists recognized that governments had some responsibility for the defence of, or the facilitation of, this co-ordinative process of costs and prices and hence for the downward cost and price adjustments needed. But they tended to rely heavily upon the assumption that those who were *mainly* responsible for unemployment and depression, namely, trade unions that forced the price of labour in some important sectors of industry too high, were most severely punished by their members' privation, worry and shame of being without jobs. The pre-Keynesian economists thus relied in part upon 'individual' incentives which, they believed, would tend to bring about recovery. Some of the economists whom Keynes would have termed 'classical', such as Edwin Cannan, recognized also and spoke out strongly against political aggravation of depression via 'unemployment benefit'. In Britain in the 1920s and 1930s it had taken a form which was alleged to be 'subsidizing the occupation of being unemployed', as Cannan once put it.

Economic adjustments thought politically impossible

Nevertheless, pre-Keynesian economists seemed loath to draw attention, with adequate explicitness, to the neglected role of government in suppressing anti-social monopoly pricing practices, whether by trade unions or the price rings of businessmen. That was understandable enough in Britain where nothing resembling anti-trust laws existed save mere remnants of the old common law against restraint of trade, and where a long tradition (which began back in 1824) of non-interference with trade union activities stood in the way. But the harm caused by the chaos due to strike-threat power was clear enough to all dispassionate observers. And if British economists had been able to speak with some unanimity in the late 1920s and early 1930s, more or less in the following terms, subsequent history would, I suggest, have been quite different.

1824

> 'The present hardships of the unemployed are inevitable in view of a situation which ties the hands of all political parties. The temper of the unions today is such that collective action to restore the flow of wages through wage-rate adjustments in competitive markets would arouse so much indignation in trade union circles, and so many opportunities of political misrepresentation, that no government could survive the attempt. Hence the transition to prosperity, instead of being rapid and planned, will have to be haphazard, long drawn out and painful. Contemporary institutions – the practice and tolerance of monopoly by labour and capital – destroy any hope of a rapid and orderly rehabilitation of the economy. Political realities (due to governments' conviction that the true position cannot be explained to the nation or their unwillingness to risk the unpopularity accompanying an attempt to explain) force the community to be resigned to a long and arduous path to recovery.'

1917?

One reason why economists did not speak out in this way was that, as the difficulties of the 1930s were looming ahead and encountered, the idea was growing that there might be a *politically* easier economic solution, which would not imply that it was government's duty to risk sacrificing votes. The notion began to catch on that, if aggregate purchasing power was deficient because aggregate supply was deficient (owing to input prices and output prices having been forced – by trade union or other monopolistic pressures – above full employment levels) this deficiency might be

remedied in some manner by the stimulation of aggregate demand.

In Britain the writings of A C Pigou, Hubert Henderson, Dennis Robertson, Henry Clay and others contained passages in which the responsibility of unduly high wage-rates (in some industries) for recession, and hence for an unduly low flow of income and wages, was clearly stated.[1] But these economists appeared to speak with two voices. They all significantly fought shy of explicitly recommending the market-selected price and wage-rate adjustments needed to restore the income flow in an economy suffering from value disco-ordination, or some cruder method of mitigating it along 'incomes policy' lines.

For instance, Pigou alleged in 1927 that the current wage policy was 'responsible for adding some 5 per cent to the volume of unemployment', a 'post-war development' which he regarded as 'an extremely serious matter'.[2] At that time he did recommend reducing labour costs, although with supplementation of wage-rates by income transfers. But later, having dropped his wage-subsidies proposal,[3] he still conspicuously refrained from recommending the only remaining non-inflationary solution, that of pricing labour's inputs lower so that they would be within reach of final consumers' pockets. Before the Macmillan Committee of 1931, in spite of agreeing that at reduced real wage-rates 'you would employ more people', he insisted that he did not suggest, 'as any form of remedy, lower real wages in the depressed industries'. Instead, he suggested, unemployment would be diminished 'if the conditions of demand could be so altered that there should be a higher demand'.[4]

'Practical difficulties and frictions'

Now demands for outputs in general (and hence for inputs) can be raised under the conditions Pigou was postulating only through the reduction of input prices or via inflation. Yet he insisted that he was 'not advocating a reduction of real wages'.[5] And in 1933 he embraced the opinion that 'for prosperity to be restored either money costs must fall or money prices must rise'. But, he contended, 'The practical difficulties in the way of the former solution have proved so serious and the friction to be overcome so great that the main body of instructed opinion has turned towards the latter.'[6]

Here we run into the crux of the matter. What 'practical difficulties', what 'frictions' were met with in attempts to increase the wages flow via market-selected wage-rate and price adjustments. When and where was such a policy tried out? Certainly there were union resistances to market pressures. But Pigou was discussing the role of government in recession. I suggest that no 'difficulties' or 'frictions' were encountered by the Government because no attempts were made; that the prospective 'difficulties' which discouraged such attempts were all concerned with vote-acquisition, and that the prospective 'difficulties' were magnified *precisely because the majority of economists were talking with two voices*.[7]

Professor Hutchison scathingly criticizes Professors R Lekachman, E A G Robinson, L R Klein and Mr M Stewart for having unfairly charged Pigou (and others) with having advocated wage-cuts and non-inflationary policies.[8] But they always stopped short of doing so. The trend of the analyses criticized suggested again and again that Pigou and the rest were about to grasp the nettle and advocate reforms conducive to price and wage flexibility, but they did not go further and do it. There is thus something to be said in defence of Professor Lekachman and the others, because they were misled through glaring inconsistencies between the analytical findings and the policy recommendations of the pre-Keynesian economists whom they attacked.

Far from questioning Professor Hutchison's contention, however, I am giving it a special emphasis. Keynesian ways of thinking were quite widespread in Britain (and, indeed, in the United States) before the publication of Keynes' *General Theory*. What has caused misunderstanding is that in 1936 Keynes turned on many of his former supporters precisely because they had, directly or indirectly, argued that wage-rate reductions could restore the flow of wages and income, although they had always been careful to insist that such a solution was 'unrealistic' (for unexplained reasons), and to make it unchallengeably plain that they were not advocating unsophisticated remedies. Keynes and his young advisers felt uncomfortable at having to rely upon the argument that (my wording) 'a little inflation would be much better'. It was this that inspired Keynes (or his young advisers) to invent the 'unemployment equilibrium theory'.

We ought to be careful not to attribute Keynesian-type ideas to the economists who, just after the British devaluation of 1931,

were prepared frankly to recommend 'inflation' in the United States as an *emergency* measure, and to *call* it 'inflation'.[9] The distinguishing attribute of what I have called 'Keynesian-type' thinking before *General Theory* was the impression that cheap money is not inherently inflationary. That impression was left so successfully in Keynes' *Treatise on Money* in 1930 that Roosevelt's monetary policy of 1933, reflecting the policy implications of that book, could claim that the aim was to 'maintain a dollar which would not change its purchasing power during the succeeding generation'. Keynes' policy prescriptions were always clearly intended as *generally* applicable for incipient recession.

Keynesian error provoked by political anxiety

The economists who (before 1936) supported Keynes in rejecting the policy of working for more efficiency in the co-ordinative mechanism of the pricing system (by eliminating the arbitrariness due to restrictive practices, including strike-threat influences) did not explicitly say: 'The virtue of a "cheap money" stimulus rests primarily in its *political* practicability. It will not lose votes for a government which adopts it.'

In most cases, economists who inclined to a cheap money solution seemed oblivious of any bias towards 'the politically acceptable'. On the face of it, they were simply believing, in increasing numbers, that a deficiency in aggregate demand meant something different from a deficiency in aggregate supply. Nevertheless, the root cause of such thinking in 'the new economists' (the Keynesians') inhibitions is to be found in vote-procuring considerations. Groping for some means of getting the economy's wheels turning again, without being so 'unrealistic' as to refer to a supposedly 'politically impossible' solution (market-selected price and wage-rate adjustments), they came to abandon the view of *production* (to replace consumption or to add to the stock of assets) as the source of demands (for the services of men and of assets). They fell instead into the serious error of thinking of *consumption* (often conceived of as 'spending')[10] as in some sense the origin of the ability to demand. Confused by their recognition that the *form* of consumption determines the *form* in which production may be expected to replace (or add to) what is consumed, they were led into the fallacy that the *volume* of consumption is the source of the *volume* of demand for production. Instead of thinking in micro-economic concepts and relationships they thought in macro-economic totals.

The thesis that underconsumption is the origin of recession is, of course, tailor-made for political acceptability. It meant an enormous advantage for the popularity of 'the new economics' against the old. It implies that income transfers to 'the poor' will restore a declining economy because 'the poor' are less thrifty than 'the rich', and so will 'spend' not 'save' the income diverted to them. And this notion having once been accepted, it was easy for the venerable but naïve idea of the 'monetary cranks' (such as Silvio Gesell and J A Hobson) to become respectable, namely, that men and assets were idle because insufficient was being spent on them. The 'old-fashioned' pre-Keynesian economists (such as Edwin Cannan, L von Mises, Lionel Robbins, Theodore Gregory, and F Lavington and Benjamin Anderson) had regarded as platitudinous the notion that in depression there was insufficient uninflated money income to ensure the purchase of normal outputs; they held that the whole point at issue was the reason why *outputs* in general were insufficient to generate the required uninflated money income. The new ideas implied that a fiscal or monetary policy which, superficially viewed, could seem inflationary, might prove non-inflationary by drawing forth larger outputs via enhanced entrepreneurial optimism due in turn to boosted prospective spending. If so, it could bring about the restoration of aggregate output – the very reaction on which the 'classical' theory itself relied for recovery.

This was the type of thinking which was tending to win growing sympathy in British official circles during the late 1920s and early 1930s although (possibly because of opposition from the Treasury and old-fashioned bankers) deliberate inflation had not yet become a 'politically possible' policy. It became respectable only when the sophistication of Keynes' *General Theory* (published in 1936) conferred stronger apparent authority on such notions. There was, of course, no controversy whatsoever among economists about the ability of 'a little' inflation to induce a restoration of output. (But so could 'a little' wage-rate reduction – a corollary which no Keynesian ever thought it expedient to mention.)

It was the *other* consequences feared which gave rise to non-Keynesian resistance. The 'old-fashioned' pre-Keynesian econo-

mists doubted, firstly, the ability of any country adopting a policy of spending itself into prosperity to fulfil its obligations to convert deposits or currency into gold (and failure to do so was regarded as national dishonesty or akin to the incompetence which caused private insolvencies); and, secondly, the possibility of avoiding inflation under any 'cheap money' system. But the economists who became influential and gained coveted reputations (Keynes and his early disciples in Britain and the 'New Deal' economists in the United States) were those who could encourage governments to think there *was* a politically easier way of maintaining sufficient popularity for re-election than that of eradicating by governmental action the privately contrived obstacles to the restoration of the wages-flow – not least monopolistic trade unions and industrial associations.

'Political' presentation of inflation

The 'new economists' were careful not to advocate inflation openly. Indeed they showed exceptional ingenuity in presenting their proposal in such phrases that its inflationary foundations were hidden. Even in the 1930s, open advocacy of 'mild inflation' in Britain and America would have gravely weakened the vote-winning virtues of the policy. Voters and, even more important, opinion-makers (including bankers) had become obsessed in their bias against any breach of monetary obligations with the world. The sheer prejudice of the intelligentsia, and especially of 'old-fashioned' bankers, against purposefully engineered 'debasements' (as they regarded deliberate depreciations of currencies), however innocuous or gentle the 'debasements' envisaged, was the obstacle to the only 'politically possible' means to recovery. 'Inflation' was politically suicidal. But an inspired insight enabled the Keynesians to perceive that, if called something else, 'the maintenance of effective demand' for instance, it can become respectable and even respected, like 'family planning' for 'birth control'.

In wisely obscuring the inflationary essence of their proposals, 'the new economists' recognized also, although less clearly, that any openly declared inflationary policy would be largely self-defeating. The co-ordinative merits of a depreciating money unit depend upon the maintenance of 'the correct climate of opinion', i.e. upon misleading the public about the planned speed or dura-

infl = maintenance of effective demand,

tion of any inflation deemed expedient (in the light of developing circumstances) from time to time. For otherwise costs would rise in anticipation of increased product prices, and interest rates would rise so as to frustrate the intended exploitation (Keynes said 'euthanasia') of the *rentier*.

To view the course of events in perspective, it is important to repeat that Keynesian ways of thinking had been powerful in Britain and the United States long before the publication of Keynes' *General Theory*. The so-called 'monetary cranks' like C H Douglas and J A Hobson do not seem to have commanded much respect in influential circles in Britain, although the arguments of Foster and Catchings had a real impact in the highest circles in the United States.[11] Nevertheless, the notion that 'cheap money' could bring prosperity and mitigate unemployment without serious contra-effects was growing in industrial and business circles in both continents. And all this time ideas such as Keynes had expressed in his *Tract on Monetary Reform*, 1923, in his *Economic Consequences of Mr Churchill*, 1925, in numerous articles and speeches, and in his *Treatise on Money*, 1930, were making the 'cheap money' way of trying to cure recession seem plausible. Keynes could not be dismissed as a crank. Either his ideas or similar ideas had kept in circulation the hope that there might be an easy way out of recession. These ideas had encouraged government passivity or procrastination in the economically fundamental but (supposedly) politically dangerous steps required to mitigate the depressive effects on the wages-flow of the private use of coercive power in strike-threat form. Through this influence, Keynesian notions may have been more responsible than any other factor for Britain dishonouring the gold standard in September 1931, and indirectly for the prolongation of the depression. Keynes' personal influence during the late 1920s and early 1930s is difficult to assess. Perhaps the extraordinary publicity he then received was due to his swimming with the tide. But what his *General Theory* did was to give explicit academic status to ideas which had already been rapidly gaining general approval in influential, governmental and business circles. Immediately after its publication I was moved to comment on its 'alluring and politically easy suggestions' and to refer to Keynes having 'for years believed and preached . . . what many persons of influence in finance and politics have found it easy

to believe', and that it could 'prove to be the source of the most serious blow that the authority of orthodox economics has yet suffered'.[12]

It did indeed have that consequence. And yet, if Keynesian criticisms of governmental policy in Britain had been couched in terms which placed adequate explicit emphasis on 'the political factor', the ultimate consequences of otherwise identical policy recommendations would have differed radically. Suppose Keynes, in 1930 or 1931, had said more or less something like the following. Would not the response in the press and parliamentary debates have been radically different?

'The position in Britain has become desperate. Year by year the economy operates at well below its full capacity and the Government is unable to do anything effective about it. We all know that the unions have forced real wage-rates in several crucial industries too high to permit the good living standards and employment security which would otherwise be within our reach. But the union hierarchies control too many votes for any government to do anything about them. They act as "pigs", "sabotaging British industry",[13] yet nothing can be done. In forcing up wage-rates and labour costs, strike-threats and strikes cause outputs that can be paid for to decline and compel thereby the lay-off of many workers. The result is that high wage-rates bring about a reduction in the wages-flow. Therefore I advocate a little inflation to make up the deficiency in the wages-flow that unions have created, and hence restore general prosperity. It need not be much inflation – just sufficient to reduce *real* wage-rates to nearer their free market level. That is all that is necessary. But it will do the trick by reducing real wage-rates.

'Such a reform is politically possible: it will entail no loss of votes because its effects will be concealed. But "classical economics" stands in the way. Its exponents *hint* at union responsibility for unemployment and low average wages but dare not recommend, any more than their critics dare, action to curb strike-threat power. And so our economy limps along, crippled by spanners in the pricing system, and solely because we have not had the courage to resort to the only *politically* possible way out – mild inflation. The inflationary solution will satisfy not only see the General Strike of 1926/7.

the political parties but the union officials also, because they will be able to claim the credit for continuous increases in *money* wage-rates which the market will enforce as long as inflation continues. "Classical economics" has failed to give the answer because it has overlooked the vital factor, namely, that any acceptable policy has to be compatible with the business of acquiring votes.'

An attack on the 'classical economists' along such lines would have been justified, at least in part. Pigou's great book, *The Theory of Unemployment* (1933), hinted at but did not explicitly declare union responsibility for unemployment. And other economists (as we have seen) failed to speak out. They all felt that governments could not then be expected to legislate against the will of so powerful a vote-controlling institution. In 1971, as this is written, the present Government appears likely to do so in Britain.

Unemployment equilibrium

But Keynes' tactics were to destroy the whole authority of 'classical economics',[14] with no reference to the avoidance by its expositors of explicit reference to the basic vote-gaining issue.

The central prong of his attack was the wholly fallacious 'unemployment equilibrium' thesis – the idea that price reductions to restore full (or optimal) employment are somehow self-frustrating. Cutting costs means cutting aggregate demand, his theory implied. This fallacy, now almost universally recognized,[15] is the crucial originality of *General Theory*. Schumpeter felt that Keynes would have liked to rely wholly upon it but that he kept wage-rate rigidity 'in reserve', i.e., that Keynes regarded the method of pricing labour as a second line of defence. But Keynes himself did not consciously rely upon wage-rate rigidity or 'wage-push' in any passage in *General Theory*. It was critics like Professors Franco Modigliani, Gottfried Haberler and Don Patinkin who demonstrated that wage-rate rigidity was an assumption implied by the argument, although Keynes himself had been unaware of it. And it was his disciples who bolstered the rigidity assumption by reliance on the wage-earners' 'money illusion'.[16] My explanation is that Keynes was using all his ingenuity to escape having to base his thesis as a whole on a frank and categorical assumption about the 'political impossibility' of persuading any government to protect or

facilitate a labour-pricing process subject to the co-ordinative discipline of the market. This is what two British Governments, Labour and Conservative, have now accepted in principle must be done to tackle the curse of inflation, after 40 years of stop-gap policies ending with the discredited 'incomes policies'. I return to the significance of the apparent change in British policy (pp. 80–2).

Professor Samuelson, referring to the unemployment equilibrium notion as '. . . the most shocking view in the *General Theory*,' comments that

> 'what is most shocking in a book is not necessarily most important and lasting. Had Keynes begun his first few chapters with the simple statement that he found it realistic to assume that money wage-rates were sticky and resistant to downward price movements, most of his insights would have remained just as valid.'[17]

The truth is, of course, as Professor Haberler has pointed out, that 'as soon as we assume wage rigidity and wage push . . . the main difference between Keynes and the classics disappears', while without that assumption 'the Keynesian system simply breaks down.'[18] That is, it was the 'classical economists' (the pre-Keynesians) who had pin-pointed the source of a constricted wages flow and income in 'wage push' (i.e. collective bargaining pressures) and resistance to wage-rate adjustment, although they failed specifically to recommend the policies needed to remove the constraint they diagnosed because they thought them 'politically impossible'. But Keynes, perceiving that it would be politically suicidal to mention the unmentionable, saw a way out through the most successful conjuring trick in history which, deceiving an audience that wished to be deceived, led to its being hailed as a great discovery, as revolutionary and important as Einstein's theory of relativity. I am not accusing Keynes of intellectual dishonesty. He deceived himself with his 'conjuring trick'. That is how I have come to regard his 'unemployment equilibrium' notion, together with the subsidiary theories with which it was bolstered. Professor Harry Johnson says that classical economics stood in the way of a 'sensible' solution in the 1930s.[19] Certainly it hindered the policy which in the event proved to be 'politically

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possible'. But the 'classical economists' were to blame only for their reluctance to *explain* why acceptably rapid co-ordination through price adjustment was 'politically impossible'. They would never have resisted on *theoretical* grounds any policy recommendations put forward by others based on an assumption that, because trade union influences on money wage-rates were reducing the wages flow and causing depression, the only 'politically possible' way out was 'inflation', which could mitigate the situation by reducing real wage-rates, thereby crudely restoring co-ordination in the economy.

Keynesian macro-economics unhelpful for political decisions

Although other fallacies confuse the *General Theory* the remainder of it is primarily devoted to an examination of the mechanisms through which money expenditures are believed to bring about reduced real wage-rates (in terms of 'wage-goods'), higher prospective yields to investment, and hence fuller employment. And much of what has become modern economics consists in the elaboration or development of this part of Keynes' contribution. It seems almost as though most economists who write on what we now call 'macro-economics' have been trying to devise an apparatus which can be used by fiscal and monetary authorities to judge the optimal rate of depreciation of the money unit. The concept of 'optimal rate' here really means a speed of inflation so adjusted to emerging circumstances as to maintain a delicate balance between the prospect of loss of votes through unemployment (or recession) and loss of votes through inflation.

The econometric and macro-economic developments of the Keynesian apparatus may help us in understanding how different ways of changing the number of money units in relation to changes in output (and in relation to the other causes of change in demand for monetary services) are likely to have different consequences. But they do not help one iota in the sort of practical decision-making by, say, the Governor of the Bank of England or the economic adviser to the British Treasury, or Professor A F Burns of the Federal Reserve Board or Professor Paul McCracken of the Council of Economic Advisers. Had the new methods which Keynes and his successors have put at the world's disposal assisted a

solution of the basically *political* problems of monetary policy, some consensus or unanimity would have crystallized about what steps ought to be taken in a given situation. But obviously there is not. For instance, Professor Samuelson seems to differ so fundamentally from these noted American economists that, in commenting on the award to himself of the Nobel prize for economics, he thought it appropriate to make clear (without mentioning names) that he regarded their recent decisions and advice as disastrous. He obviously felt that the inflation they have been able to bring about is too mild, and he charged them by implication with having created 'cruel unemployment'.

The phrases he used could not be better devised for electioneering purposes. 'You do not kill the patient to get at the tapeworm,' he said. 'There must be a better way than this cruel trade-off between unemployment and prices.'[20] '*A better way*.' This is what Keynes was telling the politicians in the 1920s and the 1930s. Keynes meant (my words) 'better than not inflating a little', or 'better than permitting deflation'. But when Professor Samuelson thinks of 'a better way' today, he means 'better than inflating too mildly'. What else can his strictures imply? In the 1930s mild inflation was enough. With the expectations which have been generated during the last decade and a half, *mild* inflation is no longer sufficient to prevent unemployment. The monetary experience of 1958 to 1970 amply confirms this inference. The expansionists are in time driven to advocating not merely more than *mild* inflation but *rising rates* of inflation, not only *high* but *accelerating* inflation.

Futility of inflation

Successive editions of Professor Samuelson's best-selling textbook seem to reflect his gradual perception of the ultimate futility of the inflationary nostrum. In the 1948 edition of his *Economics* he told his young readers that 'a mild steady inflation of, say, 5 per cent per year . . . need not cause too great concern'. In the 1955 edition he reduced it to 3 per cent; in the 1958 edition he came down to 2 per cent[21] and in the 1961 edition to below 2 per cent. In subsequent editions (the seventh and eighth), he specified no percentages at all.[22] Yet now, relying on the full authority of a Nobel prize-winner, he tells the world, by implication, that the heartless Nixon regime is inflating too mildly for the circumstances which its other policies have created. But in common with the rest of the neo-Keynesians, he avoids any explicit reference to the origins of those circumstances. The origins are to be discerned, as he knows well enough, in the political unpopularity of reforms calculated to arouse the opposition of a privileged sector of society – the highly organized labour unions – believed to wield decisive voting strength. This is the position in the USA and Britain today, just as it was in the early 1930s.

When challenged by Frank D Graham, Keynes himself eluded the issue of the political unpopularity of policy with characteristic finesse. Professor Graham had suggested[23] it was appropriate to refer to the labour unions as 'rackets', because Keynes himself had implied that they would always be responsible for unemployment (under any international monetary regime which required a common money unit of defined value – the topic of debate). But if unions acted anti-socially, Graham suggested, they constituted the problem which had to be tackled. Keynes was silent on the point.

Cruelty of inflation

In truth, the notion of 'a better way' ought not to be envisaged as 'a play-off' between unemployment and higher prices. The evil to be eradicated is the disease of disco-ordination in the pricing system, of which unemployment and inflation are *alternative* symptoms. More of the one may mean less of the other. But since the quiet abandonment of Keynes' 'unemployment equilibrium' thesis, every economist again knows that, if the disease is incurable, that is simply because of a supposedly irremediable defect in the institutions of representative government – the assumed 'political impossibility' of reform to establish a framework of law under which the disruptive price consequences of strike-threat power are curtailed or eliminated. It is the responsibility of economists always to assert this disturbing truth in every relevant context.

Professor Samuelson refers to 'cruel unemployment'. Inflation is equally cruel. The Nobel prize-winner's failure to mention also the cruelties caused by a depreciating currency reflects the contrast that people harmed by it are regarded as politically weak, whereas trade union leaders who fear that unemployment is likely to

generate pressures to wage-rate adjustments disadvantageous to their private interests are politically strong.

Is the 'politically impossible' becoming possible in Britain?

It is indeed a new awareness of these very cruelties which seems to be forcing a revolutionary change of outlook and policy in Britain. Recognition of the injustices suffered for so long by the politically weak – the old people and many of the lower-income groups – reinforced an awareness of the inefficiencies of an inflationary system. The misgivings aroused led to a full-scale investigation of the phenomenon by a Royal Commission.[24] The Commission's report was followed by a general welcome by the public of its proposals – *inter alia* for reform of the unions. Of course the Labour Government's Bill to curb the worst abuses of union power encountered bitter opposition and it was abandoned in 1969. But the Conservative Government's more far-reaching Bill appears likely to pass in 1971. Such legislation would reverse so long a tradition that undue optimism about the early achievement of more justice in the labour market could lead to acute disappointment and discouragement for those who have fought for it. But the point now at issue is that it was the 'cruelties' of inflation which eventually forced a reluctant Labour Government to take unpopular action and a Conservative Government to follow with more chance of success.

But suppose Professor Samuelson had stated his political assumptions openly, would he not then have been forced to say something like this?

> 'Although it is politically quite out of the question, there is an incomparably better method of achieving prosperity – one which could eliminate cruel unemployment without inflation. It would involve increasing the uninflated wages flow,[25] partly by raising the employment level but partly by absorbing a larger proportion of workers into higher paid kinds of work. This would be the consequence of downward market-selected wage-rate and price adjustments. But to allow such a solution would arouse the antagonism of the AFL-CIO and that would involve too many lost votes to any party advocating or adopting it. For that reason it is not worthy of further consideration.'

If Professor Samuelson had spoken in this kind of way, bringing thereby the relevant – indeed vital – political factor of vote-acquisition into the picture, and if a sufficient number of his economist colleagues had supported him, such reactions as his authority commanded would have been diametrically different. A tendency for the vote factor to change would have been the consequence. People would begin asking, 'Why is the dismissed alternative "not worthy of consideration"? If the obstacle to what is desirable is simply the opposition of an identifiable group which is acting anti-socially, why should we put up with it?' The number of votes likely to be lost through advocacy of a policy aimed at boosting an uninflated wages-flow (and raising profits and prospects of profits also) would have been reduced. In other words, a return to what Keynes, shortly before his death, called (unexpectedly but respectfully) 'the old classical medicine' would have become less 'politically impossible'.

Keynes encouraged neglect of the cause

Keynes' dissatisfaction with the Cambridge economics of the 1920s is certainly understandable.[26] The economists' typical attitude to the continued appearance of depression apparently convinced him that they were encouraging mere passivity on the part of governments towards chronic idleness of men and assets. That his own kind of thinking had been far more responsible for that passivity would never have struck him or his young advisers. Yet governmental failure to take legislative steps to stop the strike-threat depletion of the wages-flow was certainly due mainly to a conviction which the Keynesian type of thinking was encouraging, namely, that there was a relatively painless remedy – 'a better method' – the reduction of real wage-rates via 'cheap money'.

My judgment of Keynes is that he himself would never have risked offending the unions, even in the 1920s. He was held in respect in political parties, and he knew that the remarkable influence attaching to his pronouncements would evaporate at once if he were so unsophisticated as to refer to politically unthinkable possibilities. In 1930 he had expressed 'grave doubts whether an indiscriminate public opinion, reinforced by the votes of the wage-earners, in favour of raising wages, whenever possible, is really the best means . . . for attaining . . . the betterment of the material conditions of the working classes.' It was 'inexpedient',

he said, to attempt to achieve this aim 'by the method which reduces the rewards of capital below what is obtainable in other countries. . . . It never pays to render the entrepreneur poor and seedy.'[27] If justice and charity required that the working classes should be better off, income transfers, not high wage-rates, were called for.

But Keynes refrained from translating this philosophy into unequivocal policy recommendations (such as appear now – February 1971 – to be contemplated by the British Government). I do not suggest that any political party would have been likely to give any support to such proposals at that time. But both Keynes and the economists he later criticized were to blame in the 1920s and 1930s for having inhibited more candid references to the political obstacle to recovery.

And so back to the central argument of this essay. The steps needed to reco-ordinate a depressed economy have throughout been 'politically impossible' largely because the economists did not frankly describe them before tacitly dismissing them on the grounds of currently adverse public opinion or the voters' collective ignorance or short-sightedness.

Footnotes to Part V

[1] Several pertinent passages are conveniently quoted in Hutchison, *Economics and Public Policy*, *op. cit.*, Appendix, pp. 277–301.

[2] Quoted *ibid.*, p. 278.

[3] Pigou continued to advocate a disguised wage subsidy in his recommendations of public works of a 'boondoggling' nature, i.e. provided for other reasons than that of collective entrepreneurship exploiting the least-cost time for investment in public goods – when labour for such purposes appeared to be exceptionally cheap.

[4] Quoted in *ibid.*, p. 283.

[5] Quoted in *ibid.*, p. 283.

[6] Quoted in *ibid.*, p. 288.

[7] Of the leading British economists of the 1920s and 1930s E Cannan, L C Robbins, F A Hayek, T Gregory, F Lavington and A Plant were among the minority pleading unequivocally for price flexibility.

[8] *Ibid.*, pp. 285–95.

[9] This was recommended by a group of eminent Chicago economists – F H Knight, Henry Simons, Jacob Viner, Aaron Director, L W Mints – together with the suggestion that the harmful drug should be dosed in the least dangerous form, through public works. (J R Davis, 'Chicago Economists, Deficit Budgets, and the Early 1930's', *American Economic Review*, June 1968.)