Keynesian comeback

RONALD REAGAN's threat of tariffs on $400m worth of Common Market exports has moved the world into a dangerous phase of the downward economic spiral.

War has begun in earnest. Following news that last year's trade deficit would exceed $170 bn, Senate Majority Leader Robert Byrd urged "comprehensive legislation that will restore jobs and halt the erosion of our industrial base".

Counter-measures by European countries will probably be met by new action from a beleaguered White House that needs a safe issue on which to reassert its Rambo style on domestic politics.

A compromise was reached over the EEC crisis, but economic conflict is now inevitable. For politicians are unable to define rational policies to restore full employment.

"Restore" full employment? Equilibrium, or long-term stability, has never been a condition of normality for industrial societies. The command economies of the eastern bloc can disguise structural defects (between 13-19m people would be jobless if under-employed workers were sacked). For market economies, however, painful adjustments through unemployment have been a cyclical feature for the past 200 years.

Economics as a theoretical discipline, it appeared, had failed to solve the problem of structural unemployment. Then came John Maynard Keynes.

THE GREAT disservice done by Keynes was to lead people to believe that it *was* possible to banish this feature of industrial society without a radical reform of the structure itself.

Keynes contended that unemployment was the result of insufficient demand, so employers were unable to produce goods and services at levels consistent with full employment. Solution: the government should take up the slack, and spend enough to take the economy back to full employment.

There is nothing that governments enjoy more than the encouragement to stack up votes by spending peoples' money!

Keynes offered an apparently scientific rationale for this process, but it didn't work. The graph illustrates what happened in Britain: an inexorable rise in unemployment since 1955, despite enthusiastic public sector spending programmes matched by soaring tax rates.

By the 1970s it was apparent that the cost — escalating inflation — was too high a price to pay for the policy that was patently not working. The scene was set for the supply-side conservatives, who abandoned Keynes in favour of the Chicago School brand of free market economics.

President Reagan and Premier Margaret Thatcher were in the vanguard of the new approach to political economy. But because they, too, lacked a coherent theory of employment, they dragged — through muscle (the USA) and example (the UK) — other OECD countries deeper into recession.

American workers avoided the worst effects because the White House Administration's vastly increased military spending, combined with a record inflow of foreign capital, turned out to be a covert Keynesian policy. But the price, again, was too high: a budget deficit which the book-balancing Ronald Reagan would have deemed incredible on the day he took the oath in Washington and which he described as "outrageous" in his State of the Union message on January 27.

Britain, however, did not have the scope to live off money loaned by other countries, so unemployment accelerated. This enforced idleness was financed by the North Sea oil rent bonanza and the sale of public sector companies. Selling the family silver, as the late Lord Stockton (Harold Macmillan) put it.

Britain's £4 bn surplus on manufacturing trade was turned into a deficit of about £8 bn last year. "The jobs created have been abroad," lamented Labour MP Jack Straw.

AS YET, there is no effective counter-revolution to the now-discredited strategy of the New Conservatives, for the minds of economists and politicians are still trapped within the Keynesian conceptual framework.

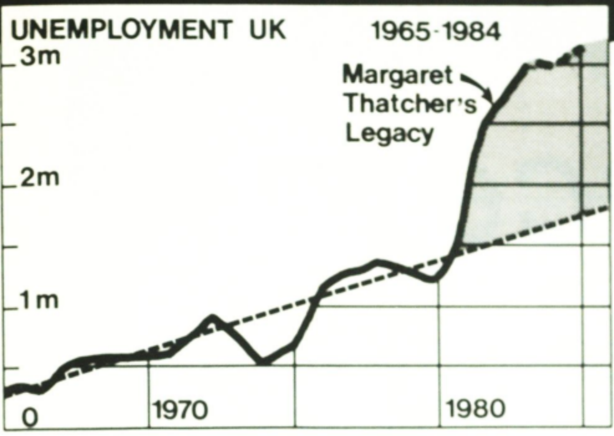
Opposition parties still analyse unemployment in terms of the need to increase demand through public sector spending. In doing so, they expose a fatal weakness in economic theory.

A century ago Henry George, the American economic philosopher, pointed out the blindingly obvious: that workers create their own demand in the process of manufacturing new wealth or undertaking the provision of services to customers.[1] It is nonsense, then, to talk in terms of workers not being able to *find work* because of the absence of some pre-existing demand.

Of course, there has to be a demand for the goods and services that people want to sell, but that is not what Keynesians mean when they argue that unemployment is the product of insufficient demand. They mean that consumers and investors do not spend sufficient money to draw the unemployed into work, to finance the provision of new jobs.

Balderdash, as one of George's admirers (Winston

by FRED HARRISON



Churchill) might have put it. For every worker expands aggregate demand in the process of creating wealth.

Take the workers who were thrown out of work under Mrs. Thatcher's tutelage. Britain in 1986 was manufacturing 7% less than in 1979, and investment was 20% down on the year when the Conservative Party was returned to power.

Let's assume that Mrs. Thatcher's government was responsible for but half of the unemployment. According to Professor Richard Layard, Head of the Centre for Labour Economics at the London School of Economics, these people would have produced goods and services worth an additional £80 bn if they had remained in work.

Does it make sense to say that the British economy was "short" of £80bn worth of demand? No! Because that would be to assume that someone other than the wealth-creator was responsible for injecting the value into the system that leads to the employment of idle workers. To defend that position is to reintroduce the discredited Wage Fund Theory.[2]

But if workers create their own demand, to what do we ascribe the involuntary unemployment which Keynes described as "our normal lot".[3]

The New Conservatives attacked labour malpractices and high wages as a principal obstacle to economic growth. Reagan and Thatcher have been supremely successful in undermining the power of trade unions, but this has not been reflected in reduced wage rates (except at the lower end of the income scales), fuller employment or greater prosperity.

KEYNES' explanation boils down to psychological tendencies in human nature, as reflected in the behaviour of consumers and entrepreneurs. In his view, we have to accept these fundamental "psychological propensities of the modern world" as given and offset them through government intervention (in this case, through tax-financed expenditure).

Thus, we have to resign ourselves to an ineradicable defect in the structure of the system, which can only be ameliorated through constant fine-tuning of the economic variables through the exercise of centralised power and (presumably) the creation of an ever-increasingly large public sector and tax burden.

Henry George argued that while there were a range of obstacles to the wealth-creating process (such as border-blocking impediments to international trade), the greatest obstacle of the lot was the tax system which penalised those who earned wages and profits, and encouraged others to speculate in unearned income from land.

The New Conservatives have, indeed, argued that the tax burden needed to be reduced. But Mrs Thatcher has increased that burden, and President Reagan has condoned a "reform" which will actually perpetuate the destabilising features of the real estate market![4]

Keynes acknowledged that "there have been times when it was probably the craving for the ownership of land, independently of its yield, which served to keep up the rate of interest"[5], which in turn deterred new investment and employment.

He saw that "The high rates of interest from mortgages on land, often exceeding the probable net yield from cultivating the land, have been a familiar feature of many agricultural economies", and that "the competition of a high interest-rate on mortgages may well have had the same effect in retarding the growth of wealth from current investment in newly produced capital-assets, as high interest rates on long-term debts have had in more recent times". But this impact of the land tenure system was a problem of "earlier social organisations"[6], and was of no relevance to the modern world.

- Don't tell that to the bankrupted farmers of America's Middle West!
- Don't tell that to builders in the South of England who cannot fulfil the demand for new houses because of the price of land.
- Don't tell that to the families who cut back on consumption because rent and mortgage repayments are taking an increasing share of their incomes!

Keynes noted that people tended to be imprisoned by the views of defunct economists, and he would not be happy to know that his philosophy is now serving such a dead-end purpose. Economists need to return to their drawing boards, to sketch a theoretical framework that describes reality and scientifically explains why the system malfunctions.

There are real signs of economists resorting to old Keynesian principles and policies — a comeback which will only return us to a cul-de-sac.

In the meantime, a lot of innocent people are being hurt by the ignorance of those who think they know best.

REFERENCES

1. *Progress and Poverty*, and *The Science of Political Economy*, New York: Robert Schalkenbach Foundation, 1979.
2. R.V. Andelson, *Critics of Henry George*, Fairleigh Dickinson UP, 1979, Ch. 5.
3. *The General Theory of Employment, Interest and Money* (1936), London: Macmillan, p.250.
4. *Land and Liberty*, Jan.-Feb. 1987, p.3.
5. *Op. cit.*, p.358.
6. *Ibid.* p.241.