Markets, Madness and a Middle Way Revisited

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Introduction

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I

May I thank the original inhabitants of the land on which we now meet, for their courtesy in having us as their guests?

Just over 14 years ago, I gave the second Donald Horne Address on 'Markets, Madness and a Middle Way' (I have a horrible feeling it was also the last Horne Address). Tonight I want to revisit some of the themes and issues I raised then. February 1992 was a strategic time in which to reflect upon and assess the emerging or emerged effects of the Monetarist experiment in many advanced capitalist economies, together with the rise to dominance of neo-liberal policies backed up by the arguments of economic rationalists. It was also an appropriate time to try to persuade the then Prime Minister, Paul Keating, to have second thoughts about some old-fashioned theories and policies which the ALP government had jettisoned almost entirely but nevertheless were still maintaining relatively open minds about, as the law of unintended consequences began to emerge explicitly and openly.

Though Mrs. (as she then was) Thatcher and President Reagan were credited with being the first to implement the 'Monetarist Revolution,' as far as policy is concerned, in the 1980s, I would argue that they were preceded by yet another great Aussie first in the last year of the Whitlam government (1975) and then again in the years of the Fraser coalition government prior to the election of the Hawke ALP government in 1983. Years of thorough preparation culminated in the ideas advanced through the late 1970s ALP National Committee of Enquiry (on which I was the economist). These ideas were preceded years earlier by the courageous stances of Ralph Willis in the political sphere and Laurie Carmichael in the industrial/union sphere. They were taken on board by academics such as my great mentor and friend, the late Eric Russell, and had a significant influence on policy at least for the first years of the Accord. As I often remark (at 75, a legitimate procedure) the broad suggestions of Discussion Paper No. 6 on 'Economic Issues and the Future of Australia' (1979) were accepted by Bob Hawke for at least half an hour after he became Prime Minister.

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In the 1970s I was openly critical of those Australian economists who, largely innocent of the insights bequeathed to us by Marx, Keynes and Kalecki, provided 'respectable' academic support for Monetarist and like-minded policies. At that time, Paddy McGuiness was critical of those he dubbed 'Kindergarten Marxists'; I adopted his phrase making in talking of our 'Kindergarten Macroeconomists' (no names, no pack drill). In doing so, I was joining forces with Tommy Balogh and Nicky Kaldor in the UK. Balogh called Monetarism 'the incomes policy of Karl Marx': the need to recreate a reserve army of labour and make the sack an effective weapon again after the years of the Long Boom (the Marxist description) or Golden Age of Capitalism (Julie Schor's, Alan Hughes's and Ajil Singh's description) had swung economic, political and social power from capital to labour. This swing resulted in the relatively short-lived but powerfully irresponsible behaviour of trade unions in many advanced capitalist economies, which was at least partly responsible for the accelerating inflation and then the stagflation episodes of those years. These developments explicitly illustrated the extraordinarily prescient insights of Kalecki's 1943 (!!) classic, *Political Aspects of Full Employment*. Kalecki distinguished sharply between the political economy of getting back to full employment after a prolonged slump, when all classes and pressure groups were in at least temporary agreement about its desirability on the one hand, and sustaining full employment on the other, when profound differences emerged cumulatively (I have discussed these issues more fully in a recent paper on what would Marx and Keynes have made of the last 30 years and more).

Tonight I want to concentrate on three issues of topical interest in Australia and elsewhere: the systemic effects of the new objectives and industrial relations legislation of the Howard government; some systemic aspects of the so-called pension crises facing advanced countries, especially those in which population growth is stagnant or declining; and the role of monetary policy in package deals of policies designed to secure full employment, reasonable rates of growth in a stable environment (shades of Gordon Brown) and equitable distributions of income and wealth, not least through the public sector. 'Call me old-fashioned but … '

II

Before discussing these three topics, let me make a brief but vital methodological statement. What are considered to be to the dominant processes at work in individual markets and indeed whole systems (including ultimately the world as a closed system), make a great difference to the sorts of policies that logically may be advocated. As some of you know, I like to illustrate the two dominant 'visions' of how markets/systems work by a wolf pack analogy. I always add the proviso that as I am not a zoologist I may be completely up the creek about wolf pack behaviour. But as I am also an economist (even though half the people at Monash Economics in 1982 thought I was a sociologist), let me assume that I am right. The mainstream 'vision' (even allowing for path-dependent processes) views market systems as a wolf pack running along. If one or more wolves stray, very powerful forces come into play and quickly (or at least ultimately) bring them back to the pack. The other 'vision', which, though alternative, has most respectable ancestors in Adam Smith, Marx, Allyn Young, Kaldor and Gunnar Myrdal (in fact even the New Testament: 'For unto everyone that hath shall be given, and he shall have abundance; but from

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him who hath not shall be taken away even that which he hath' (St Matthew, 25, 28–29). Within it, if one or more wolves stray, they get further and further ahead of, or fall further and further behind the pack, at least for long periods of time. I hope there is an obvious resemblance between the first scenario and the argument in competitive situations for long-period stable equilibrium positions, in which the powerful forces responsible for existence are independent of those responsible for global and local stability. Similarly, I hope this scenario is also obviously related to the view that time series may be broken down into trend and cyclical components, with the factors responsible for each being largely independent of one another.

The other 'vision' of virtuous or vile cumulative causation processes rejects both the distinction between existence (whether unique or multiple) and stability, indeed often the concept of equilibrium itself, in describing economic processes. It sees, or is at least consistent with seeing, the cycle and trend as indissolubly mixed, separable at best only for statistical reasons, mutually determined so as to make for the cyclical growth processes. This view was pioneered by Richard Goodwin (1967) and Kalecki (1971), independently of one another.

As for the implications for policy, I like to illustrate this by referring to Milton Friedman's 1953 argument for floating exchange rates. Because of his strong Chicago belief in the existence of competitive stable long-period equilibrium positions, he argued that free floats would allow exchange rates quickly to find and then hold to their long-period equilibrium patterns. He argued that speculators, because of their superior knowledge and their greater willingness than mere mortals to take risks, would by their activities hasten both the attainment of such patterns and the return, should there be shocks which temporarily took exchange rates away from them.

But if foreign exchange markets are characterised by cumulative causation processes, not only is there not a stable long-period pattern out there to be found by the operation of competitive markets, but also speculators, by making fluctuations even more extreme and volatile than they otherwise would have been, are systemically harmful, not beneficial. I rest my case as to which scenario makes better sense of the happenings of the 30 years and more since the Bretton Woods rules were abandoned. We also have here a rationale for the various schemes based on the Tobin Tax proposals. My own variant was thought out quite innocently of Tobin's 1970s suggestions, i.e., I was not aware of them, but it is in some sense a generalisation of them. It may be found in my 1994 paper, 'A "Modest Proposal" for taming speculators and putting the world on course to prosperity'. It grew out of an equally modestly titled paper, 'The Harcourt plan to "save" the world', which I wrote in the early 1990s for the first issue of the Cambridge undergraduate Marshall Society's journal, *At the Margin*.

III

I have arrived in Australia this time just as the debates about the new industrial relations legislation and its implementation seem to have come to the boil, not least with the ALP's pledge to scrap AWAs if elected in 2007. Claims and counter claims abound but I want to concentrate on the possible systemic effects of scrapping our time-honoured institutions and encouraging extreme microeconomic bargaining arrangements over wages and other conditions. Let me remind you that our Pa-

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tron Saint, Adam Smith, stressed that competitive markets only work efficiently and equitably if power is diffused equally on both sides of the market with no one having any individual power at all (he provided many other provisos but this was fundamental). Clearly this condition is not true of Australian labour markets, not only because of their individual characteristics, but also because we have had levels of unemployment which, while not high relatively to much of Europe (for example), are still high enough to do the traditional job of the reserve army of labour. These unemployment levels are sufficient to make the sack effective and to allow the implementation of the 'let managers manage' philosophy so beloved of our political masters and our role models in U.S. capitalism. Incidentally, as Keith Hancock pointed out to me a few weeks ago in Adelaide, history seems to be a forgotten subject — unemployment rates of under five per cent and going down were evidently heralded in the media as the lowest rates ever! I reminded Keith that the remark that most dates my first book, *Economic Activity,* written with Peter Karmel and Bob Wallace and published in 1967, was the claim in Chapter 15 (on policy) that any Federal Government that allowed unemployment to rise above two per cent would be unlikely to survive. We had in mind the experience in the early 1960s when a credit squeeze left the Menzies government dependent, I believe, on Communist Party preferences in North Queensland, where Jim Killen was the MP, for the re-election of the coalition government with a tiny majority.

In a special issue of *The Economic and Labour Relations Review* of May 2006, Braham Dabscheck[1] brilliantly analyses the double think, Brave New World aspects of Howard's claims for his legislation. Dabscheck shows clearly how strong the employers' and weak the employees' positions in general are, again echoing Adam Smith's views on the nature of bargaining in labour markets. I do not think Marx would have found much strange or unexpected in Dabscheck's and the other essays on the detailed characteristics of what is proposed, all directed at maximising the potential surplus to be obtained from control of the lengths and intensities of working weeks. Of course, lip service is paid to the virtues of cooperation, of getting together as a team, but in reality it is almost always lip service only. The lot of those workers most directly affected is indeed not a happy one.

But the legislation and new institutions are just extreme characteristics of the creation of so-called flexible labour markets. Obviously, I am not against the creation of institutions which allow inevitable structural changes to be handled with a minimum of social disruption — something Scandinavian countries have been successful, overall, in achieving. They have always understood that social and economic changes take time, sometimes much time, and that the transition has to be underlaid and sustained by all sorts of retraining and relocating measures, as well as by measures to preserve historical communities and their associated infrastructures. As Eric Russell used to say, there is a world of difference between the precise algebra of models of economic phenomena, in which time enters usually only in so far as it has the same dimension as space, and the often painful, time-extended processes of reality. People who advocate major changes on the basis of such guides while holding tenured posts really should ask themselves, every now and then, what *exactly* are they doing.

The late Wilfred Salter, with Eric Russell, played a large part in setting the ground rules for changes in money incomes within package deals of policies in Australia.

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These packages were designed to maintain full employment without accelerating inflation, tending ultimately to take over and make untenable, on Kaleckian grounds, full employment.

Kalecki wrote:

> The *maintenance* of full employment would cause social and political changes which would give a new impetus to the opposition of business leaders … 'the sack' would cease to play its role as a disciplinary measure. The social position of the boss would be undermined and the self assurance and class consciousness of the working class would grow. Strikes for wage increases and improvements in conditions of work would create political tension … true … profits would be higher … and even the rise in wage rates … is less likely to reduce profits than to increase prices …. But 'discipline in the factories' and 'political stability' are more appreciated by business leaders than profits. Their class instinct tells them that lasting full employment is unsound from their point of view … that unemployment is an integral part of the normal capitalist system (Kalecki 1943, 1971: 140–1, emphasis in original).

He added: 'big business … would probably find more than one economist to declare that the situation is manifestly unsound' (*ibid* 144).

As ought to be known but is now too often forgotten, Salter published one of the great modern classics of our trade, *Production and Technical Change*, in 1960. The book was based on his PhD at Cambridge in the early 1950s, written under the supervision of Brian Reddaway and brought to fruition by a year at John Hopkins and then by Trevor Swan's careful guidance at the ANU.

Salter developed Marshall's analysis to explain why old and new machines of different vintages, when the latter had greater expected quasi-rents and were more cost-effective, could nevertheless operate side by side in firms and industries. Basically it was because the older vintages only had to expect to cover their variable costs (bygones are bygones) in order to continue operating whereas new machines have to be expected to cover *total* expected costs in order to be installed. The core of the macroeconomic and systemic consequences of this finding is that the overall productivity regime to be established, both level and rates of increase, depends upon the rate at which average wage levels (with their accompanying relative wage structures) increase over time. If they rise at the rate determined by overall productivity (plus prices) then high productivity industries will be encouraged to expand, and low productivity industries will be forced to contract or even shut down. The overall result will be the maximum rate of increase possible in overall productivity in the given situation, as well as in accompanying real incomes. By contrast, if money incomes were to be adjusted by individual levels and rates of increase of productivity, the expansion of high productivity industries would be discouraged while low productivity industries, often already declining, would be able to linger on well past their sell-by dates. The overall productivity regime would *not* allow nearly as high rates of increase of *real* incomes as could have occurred in the alternative scenario. This, in turn, would reinforce the coming into play of Kalecki's scenario and the creation of higher levels of unemployment via policy — so-called short sharp shocks — to push unemployment above its so-called natural rate and

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so change inflationary expectations, in reality, reversing the distribution of power between labour and capital. You will all remember 'the recession we had to have', to quote a well-known brand of Wrigley's chewing gum — PK.

The Russell-Salter rule thus may be seen to be both efficient and equitable. It is efficient, because it makes the most favourable productivity scenario possible. It is equitable because at the level of the economy as a whole, capital and labour are complements in the production of the national product, and so all classes should be able to receive, at least as a starting point, the same rate of increase of money incomes, to enable them to command the increase in the real fruits of progress forthcoming. Of course, there are all sorts of provisos and exceptions and modifications that need to be taken into account — that is why we had arbitration institutions for so many decades even if John Howard does not understand or appreciate this — but the major starting point needs to be those processes. And it is exactly that starting point that will become impossible under the new 'rules of the game' and Australia will enter — indeed, is more or less already there because of reforms such as enterprise bargaining — the second scenario sketched above. This makes the attainment and sustaining of full employment without undue or accelerating inflation a most difficult if not impossible task. (I am not claiming that the first scenario will *necessarily* go through and the Kaleckian dilemma be solved, only that it would offer a better chance for these desirable outcomes to occur.) Such is the price to be paid for transferring emphasis to narrowly self-interested behaviour from community-wide, cooperative attitudes of citizens in a democracy, acting together through appropriate institutions for the common good of all.

IV

Hazel Bateman and Geoffrey Kingston have most kindly allowed me to read their extremely informative 2006 paper, 'Comparative performance of retirement income schemes in the Anglosphere[2] : an update'. They give a comprehensive account of the retirement institutions and provisions, and of the policies, public and private, of these economies/societies and evaluates their performances, limitations and achievements. Their very careful and detailed analysis puts the so-called pension crisis of the western world into perspective. There are clearly problems that have to be tackled but the orders of magnitude, even when there are declining rates of population increase relatively to those of the Baby Boomer era, do not involve insuperable problems.

Because most of the analysis in this whole area implicitly at least assumes a neoclassical world of full employment, the emphasis is mostly on how to raise saving ratios, both private and public. Much of the detailed analysis makes good sense and there is no doubt that some increase in both public and private saving and in taxation rates will need to occur. All this is discussed carefully and in great detail by Bateman and Kingston and also in the recent Turner Report in the United Kingdom (Turner 2006). The latter is noteworthy for arguing for the restoration of the adjustment of state pensions by the rate of increase of earnings (under certain conditions this is the equivalent of following the Russell-Salter rule) rather than by the rate of increase of prices, a 'reform' disgracefully brought in by Mrs. Thatcher near the start of her reign (remember she once said: 'We are a grandmother'). Turner also suggests that the retirement age will have to be modestly increased, a perfectly sen-

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sible reform in the round for as longer lengths of life come to be expected, it seems sensible to keep the ratio of working life to retirement life constant, with provisos, of course, for the special needs of specific occupations.

Because of the neoclassical setting of the arguments, one vital consideration is often overlooked, a consideration which though old-fashioned is nevertheless highly relevant. It comes obviously under the rubric of the paradox of thrift — from Mandeville through Malthus and Keynes to the present day. There is no point in devising all sorts of fancy schemes, public and private, for raising the overall rates of saving out of *given* levels of income if we ignore the fact that achieving them *by themselves* may well result in no increase at all in aggregate saving (as opposed to rates) or, indeed, even in a fall in aggregate saving unless steps are taken simultaneously to induce greater rates of investment in both the public and private sectors. It cannot be stated too often that both in industrial economies and in the economic world as a whole, investment leads and saving follows, and that this is as true (with suitable provisos) of situations of full employment as it is of those with unemployment: a simple but profound point, I believe, put beautifully by the late James Meade in what must have been one of his last published statements. Meade wrote:

> In a national closed economy, an increase in investment which takes place in one county (e.g. Somerset) may cause a regional movement of capital funds, and a regional movement of goods from another county (e.g. Dorset), the net movement of capital funds of one kind or another being necessarily equal to the net movement of goods and services. The world economy is a closed economy, and this same net movement of capital funds and goods and services takes place from one country to another, the total multiplier being simply what happens in a closed world economy (Meade 1997: 82).

This paragraph, vintage Meade, succinctly states the themes of Dalziel and Harcourt (1997); Harcourt (2001), which it took the former sixteen pages to make!

Coupled with this is the distinction that should always be made, when discussing the process of accumulation, between finance, investment and saving. It is finance that makes investment possible, given satisfactory expected private (and social) returns and sufficient productive capacity; investment in turn creates the saving that accompanies it by induced changes in income. So all the fancy funds being set up in various pension schemes and so on will require the saving created by investment which was prior created by finance as possible vehicles to hold and absorb the new securities so issued (as well as take part in rearrangements of existing portfolios). And it is the level and rate of growth of real resources and capacity to produce which make these possible that has to be matched by the consumption, investment, government spending and net exports occurring, regardless of whether given pension schemes have been 'fully funded' or, in the case of state pensions, met by redistributive taxation, taxing the active to support the previously active who are now having a well-deserved retirement. The latter should be a characteristic of any decent society, as opposed to the view of 'Poor old Dad, too old to work, so we took him outside and shot him.'

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V

Finally, I want to make some remarks on monetary policy and monetary/real interactions generally which follow on from the finance → investment → saving nexus I mentioned above. I draw on a contribution I made to the volume in honour of the late Hy Minsky (Harcourt 2000b). For me, the essence of Minsky is the following, even though he attributed it — with generous poetic licence, I believe — to Keynes. Production, employment and, especially, investment decisions in firms *have* to be made on the basis of *expected* cash flows. The decisions lead (amongst other things) to financial decisions that imply the locking-in of *certain, inescapable* payments of interest and principal (or their equivalents) which are reflected on the liabilities side of the balance sheets of the firms involved. Expectations usually turn out to be wrong, even though, as Keynes argued, in order to *do* anything at all, rather than starve to death like the stupid ass of antiquity, we have to base our decisions on the convention that the future will be the same as the immediate past and present, unless there are very strong reasons for supposing otherwise. Because of the resulting discrepancies arising from over-realised or under-realised cash flows and committed payments, the consequent actions of business people turn out to be different, often vastly so, than they would have been had expectations been realised. This gives rise to an endogenous cyclical mechanism arising from financial and real factor interactions, with greater amplitudes and deeper and more maintained slumps that would be implied by the inescapable real rhythms in the economy. In recent years the extension of 'credit for all' to consumers has added another set of factors making for even greater instability.

Keynes though, is, as always, relevant: he followed up *The General Theory* with his important articles on the finance motive in 1937. Keynes saw the typical sequence in the accumulation process in a firm and then in the economy as a whole in his time and especially in the UK as follows. An investment project is evaluated by its would-be implementer. An approach is then made to a bank for a short-term loan in order to implement it. The loan may or may not be supplemented from the firm's *past* saving: yesterday's saving may help to determine today's investment and today's saving may help to determine tomorrow's investment, but it is today's investment which determines today's saving. If the expected profits and accompanying cash flows turn out to be correct, the loan may be repaid by floating new equities or debentures without adversely affecting their existing values on the stock exchange. The balance sheet then shows the new investment on the assets side and the short-term liability is transformed into a long-term liability or a rise in shareholders' funds on the other side.

If we generalise to the economy as a whole and postulate a *rise* in total planned investment expenditure, so that Keynes's revolving fund of finance which supports a constant flow of investment no longer suffices, part of the demand for the new flow of securities and debentures comes from the placement of new saving created by the higher levels of investment and induced higher levels of income generated through the multiplier process (remember it?).

As we saw, Minsky superimposed on the real cyclical processes the additional amplitudes associated with unrealised cash flows and the impact on confidence, the 'animal spirits' of business people. How may the banking system ameliorate these sources of instability? To answer, we draw on Marshall and a distinction which J. R.

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Hicks (as he then was) made in commenting upon Roy Harrod's work on imperfect competition in the 1950s. Hicks distinguished between 'snatchers', those firms that take up all short-term profit opportunities available in an imperfectly competitive environment, regardless of possible long-term adverse effects on their future profits, and 'stickers', those firms that keep long-term profits prospects always at the forefront of their minds and so willingly forego some immediate gains if they are felt to have undesirable long-term effects.

My contention is that trading banks and other providers of finance tend more to be snatchers than stickers. They amplify further Minsky-type fluctuations by being euphoric in the up turn, slack on credit-worthy requirements, but deeply depressed in the down turn, acting in ways that harm the activities of firms, the long-term prospects of which are almost certainly viable, despite their short-term situations. We should therefore encourage banks and other providers of finance to have well stocked research departments that can distinguish between the Marshallian short period and long period, expertly assess long-term prospects and recommend support in the down turn and caution in the up turn, so serving to reduce the effects and size of Minsky-type fluctuations. No one bank can step out of line and expect to survive so the system will have to be induced by Central Bank carrots and sticks to behave in the ways I have suggested.

No doubt much of this is old hat but I felt it a good idea to raise these issues and suggestions, some of which were implicit or even explicit in the Horne Address of over 14 years ago.

Notes

1. The examination of Braham's Masters dissertation on the payment of Aussie Rules footballers was one of the most pleasant tasks I have ever had to do.
2. The Anglosphere includes Australia, Canada, New Zealand, the United Kingdom and the USA.

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