Another Nail for Orthodox Economics

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(A review of T. Balogh's The Irrelevance of Conventional Economics, Weidenfeld and Nicholson, 1982).

As unemployment in the world capitalist system approaches the worst levels since the 1930s, inflation rates stay stubbornly high, the system of international payments and capital flows becomes increasingly fragile, the rate of increase of world trade shrinks and interest rates soar, disillusionment with the economic polities of governments and the theories which underlie them in emerging at an accelerating pace. A new book written by Harold Wilson's former economic adviser, Thomas Balogh, contains a lucid, absorbing account of the principal objections to those policies and theories.

It also contains highly individual and sometimes idiosyncratic additions of Balogh's own, including what he thinks needs to be done.

Balogh strips away the jargon and squiggles which characterise most discussions of modern economic theory and policy and goes straight for the conceptual issues involved. His credentials for this task are probably unique - he has been a financier, a banker, an Oxford don, a director of The British National Oil Corporation and a Minister of State - and he was born in Hungary. His arguments deserve to have a considerable impact. It may be lessened by his engaging but Quixotic habit of hitting his potential allies as hard as his enemies. For example, recently there have emerged some effective theoretical arguments which serve to undermine the system of thought to which Balogh most objects. But Balogh rejects the critique because it uses the same techniques and framework as the theories it attacks.

The short list of Balogh's heroes of modern economics does not get into double figures. It includes Ken Galbraith, Nicholas Kaldor, Joan Robinson and Balogh's collaborator of many years. Paul Streeten, all unfashionable figures within the profession itself but to the humane and the discerning, admirable and enlightened.

Balogh's villains hail from Chicago - Friedman and the monetarists, including the most up-to-date variety, the 'rational expectations' school. He blames them for pushing economic theory back to its pre-Keynesian irrelevancies, and for pursuading governments and their advisers to adopt correct understanding of the theories. Balogh is not an uncritical admirer of Keynesianism either, at least of Keynesianism in the form in which it got into the textbooks and the policies of the Treasuries in the post-war period. Keynes himself receives some of his harsher barbs, especially for having disagreed with Balogh about international trade and capital movements.

Balogh particularly dislikes the yearnings of the premier social science to be thought of as 'scientific', to produce a determinate, universalist system in which are embedded harmonious laws and outcomes - a self-correcting, shockproof system provided governments apply a few simple and well understood rules, for example, that the money supply increase at a particular rate. Orthodoxy argues that the natural resting place of the system is a fully employed one where people - agents as they are called in modern theory - are all to be found in their preferred positions. (We have to take as given their initial endowment of resources.) The theory supposes that our world may be viewed 'as if' it were made up of people who have no discretion over the prices that they charge for their products or their services, i.e. that economic and political powers are diffused equally between all, and no one person, or group, has any substantial power - an idealised not to say vulgarised version of the powerful benefits of competition in Smith's Wealth of Nations. All required information is provided through prices over which only market forces have any influence. Provided only that we all follow our own self-interest, we are led by an invisible hand to create a solution which is also socially optimal. There are a few provisos about the arbitrariness of the initial endowments (which end up as important influences on the distribution of income and wealth) and the divergences of private costs and benefits from their social counterparts, (which comes under the heading of externalities.)

Superimposed on this real system of production and exchange (in the orthodox view) is a monetary system which does not affect its workings in any permanent way, but does serve to determine the general level of prices, and therefore the money prices in which the relative prices of the system are expressed. Both nationally and internationally, the orthodox theorists see a long-run equilibrium of the forces of demand and supply, adjusting appropriately when tastes and technology change. Change comes best from the initiative and enterprise of dynamic businessmen, who flourish best in a system where institutions guarantee that it works in reality 'as if' it were the harmonious theoretical system sketched above.

Balogh points out that the neoclassical Keynesians (Joan Robinson called them bastard Keynesians) accepted this story - with two modifications. First, they did not accept that the system as a whole would tend to settle at a full employment position without the help of 'fine tuning' - fiscal and monetary measures designed to produce an overall level of spending that was consistent with full employment. Secondly, because of their yearning for determinate solutions and established laws, they believed that they had found a trade-off relationship between unemployment and inflation - the Phillips Curve - which would allow societies consciously to choose their own menu of overall levels of activity and rates of price increases. When the empirical estimates on which this was based broke down in the 1970s (Balogh doubts that it ever existed) and stagflation emerged, governments and their citizens were so disillusioned that the enemy was able to pounce, providing deceptively simple diagnosis and solutions - reduce government spending, cut taxes, keep the rate of increase of the money supply steady (and low), deregulate wherever possible and let the system work out its own solutions. The private sector became sacrosanct. The public sector bureaucracies and the unions became the devils of the piece, all enemies of free men and the competitive process.

Balogh sees this as an ideological rationalisation of more sinister purposes. He does not believe in grand overall designs and systems, suitable for all times and places, or in harmonious self-regulating systems of a determinate nature. His key word is indeterminate; he is a 'horses for courses' man. Systems are open; it is necessary to understand their past history, their political and other institutions, their sociological groupings before suitable models can be conceptualised for their problems and suitable policies be designed to tackle them. Processes are more likely to be cumulative than self-correcting. Moreover, a model in which power is assumed to be widely diffused is unable to illuminate the processes at work in systems where power is concentrated. For example, full employment upset the distribution of power between capital and labour - domestic servants became hard to get and shop assistants ceased to be servile, it "entailed grave social and economic drawbacks for the propertied and managerial classes" (p.52).

Monetarist policies, especially the inflation-first strategy, are explained by their proponents as pushing unemployment momentarily above its so-called 'natural rate' so that the self-regulating forces of the economic system may allow it smoothly to find its way back to its natural equilibrium in a changed, more healthy climate of lowered expectations about inflation. In reality, their objective is to shift the balance of power back to capital (including in the Australian case, international capital) and away from labour. Prolonged depression and rising unemployment are to cow the workers into accepting wage cuts or, at least, cuts in the rate at which money wages increase. As Balogh says (p. 177-8) "monetarism is the incomes policy of Karl Marx .... By deliberately setting out to base the viability of the capitalist system on the maintenance of a large 'industrial reserve army', monetarists may validate Marx's analysis".

Balogh does not minimise the dangers of inflation - he writes as cogently about its disrupting social effects as did Keynes in the Tract - but he does savage the packages of the Thatchers, Frasers and Reagans of this world as cruel and ineffective: ineffective because they are based on models which fail to illuminate the processes at work in a world characterised by oligopolistic industries and strong unions, by price-making rather than price-taking, by multinational corporations and oil cartels, by rich industrialised nations and poor undeveloped ones - that is to say, the world in which we actually live. It is a world, moreover, in which historically, actual movements have tended to be cumulative rather than stabilising or, at best, cyclical. He argues that economic and political factors are indissolubly mixed, that "'Science' has to give way to history and politics, a truly shocking prospect!" (p. 204). He believes that consensus policies and political education are the only sure ways to tackle problems such as stagflation. He fears that the disruptive spin-offs of the policies of recent years - embittered, despairing and angry youth and unemployed, destroyed industries, the sustained shock to the 'animal spirits' of the investing and managerial classes - may have come close to destroying those vestiges of good will which would allow progressive governments to try again.

Full employment is a necessary prerequisite. Balogh pays a grand tribute to the 20 or so years of the long boom when by and large we had it, together with unprecedented rates of growth and capital accumulation in the capitalist world. The psychological significance of full employment is that it makes people feel wanted and needed members of a dynamically advancing society - "Human dignity and satisfaction are incompatible with unemployment, even if the fear of penury has been completely eliminated by the social services - which it has not" (p. 151).

But full employment by itself is not enough. It has to be coupled with consensus policies on incomes - "free collective bargaining (is) the incomes policy of the jungle" - and a more equitable distribution of wealth, internally and, ultimately, externally.

Balogh believes in comprehensive economic planning, including controls and protection, not as a dogma or as a buzz word, but as a common sense response to national and international problems. He knows that checks and balances have to be provided for bureaucrats as well as for industrialists and powerful unions in the private sector. What worries him most is that the destabilising effects of Thatcherism and Reaganism, to which we should add Fraserism in this country, may already have made it too late for democratic socialism to try again, or possibly, try for a first time.