THE WORLD ECONOMY IN REVIEW: THE FATE OF THE REVOLUTIONS

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In popular perception this is an age of revolutions - an Information Revolution; a High Tech Revolution; an Automation and Robot Revolution. In the United States we have a revolution for every day of the week; so elsewhere. The very word has lost its ancient meaning. However, there have been three great changes in this century, three revolutions that are worthy of the name. There was the massive change in Russia during World War I and its counterpart in China after World War II. There is the revolution we associate or should associate with the names of Bismarck in Germany, Lloyd George in Britain and Frankin D. Roosevelt in the United States. And there is the one that is associated with the name of John Maynard Keynes. All of these three revolutions involved very great change. All deserve the designation. All too had a common source: all derive from the nature of the 19th and early 20th century capitalism.

We shouldn't doubt that capitalism, as it came to be called in the last century, was a quite extraordinary thing. It brought an enormous increase in the productive power of men and women. Keynes once observed that in the 2000 years before, say, 1776, the date of the publication of Adam Smith's Wealth of Nations, there had been no great change in the condition of mankind. There was some improvement and, with war, famine or other disaster, sometimes drastic diminution; but, as economists would say, no secular change. Then in the latter part of the 18th century, with the Industrial Revolution and proceeding out from Britain, there came a truly phenomenal increase in the productive powers of the industrial ecnonomies and in living standards. There also came with that enormous increase in production some major, even insufferable hardships, the sources of mass resentment. There were four in number.

First, the new system reposed inordinate power in one small part of the economic world - in the owners of property - the capitalists. Great power was associated with the ownership of property; in contrast, there was a total, visible and much-resented absence of power on the part of the workers, those employed. There was a deep resentment of this asymmetry of power.

Second, there were very specific cruelties in he society in which capitalism was the central motivating force. The old were discarded without income when they could no longer work; workers were discarded - unemployed - again without income, when they were not needed; children who had no means of support in the absence of parents were herded into orphanages or exploited with special cruelty in industry; and in many, although not all, countries there was notable ill-treatment of minorities. In the United States there was the exploitation of the newly arrived Irish, Italians and Jews; and even more particularly of the slaves, and later the former slaves and their descendants. The case was the same, in greater or lesser measure, in other industrial countries.

Third, there were the areas of default, the things that capitalism did not do. There was no industrial country where it provided good health care as the knowledge in this area developed; or decent housing, a continuing area of failure even to our own time. Transportation in all countries was beyond the scope of capitalism; it was undertaken with a greater or lesser measure of public participation - through either direct public construction or large public subsidy. And in all the industrial countries capitalism was very hard on farmers and farm workers. In no industrial country in the earlier decades of this century did farmers, peasants, feel themselves other than an exploited class.

Fourth and finally, there was what economists refer to as the increasing failure of macroeconomic performance - the increasing violence in the late 19th century and the early part of the 20th of the booms and busts. These were what Marx was moved to call "the capitalist crisis"; he believed that they would sound the death knell of capitalism. In the great depression of the 1930s Marx's bell was at least distantly heard. This, it was evident, was a disaster that capitalism could not long or again survive.

The three revolutions that I earlier mentioned all addressed in one fashion or another the flaws, failures, resentments and suffering I've just described; they can be understood only in that light. The revolution that we associate with the names of Marx and Lenin, and that manifested itself in Russia, China, Cuba and, if under some external compulsion from the Soviet Union, in Eastern Europe, responded specifically to the role of property and the resulting maldistribution of power. This was not exclusively the power associated with industrial property. The adverse effect of landlordism - of the way agricultural land in Russia, in China and Cuba as also now in Central America, was concentrated in a few often incompetent and corrupt hands - was a more important cause of revolution than the adverse effects of the holding of industrial capital. The revolutionary impact against the latter was never decisive, always stronger in doctrine than in fact. But this revolution responded, nonetheless, to the inequality in the exercise of power associated with the ownership of property. And the thrust of the revolution was a complete transformation in property ownership; all productive property was taken over by the State.

As there was a concentration of power residing in property when it was in the hands of capitalists, so there was now, inevitably, a concentration of power in government as all property came into the possession of the state. This was not foreseen by Marx and was seen by Lenin only in the last years of his life. It is a matter of no slight importance, but it is not part of my present concern.

We have no agreed name for the revolution we associate with the names of Bismark, Lloyd George and Franklin D. Roosevelt. Perhaps, as an American, I might call it the Roosevelt Revolution. However, I will denote it the Welfare Revolution. It began in Germany with Bismarck in the 1870s as a way of calming the revolutionary tendencies of the German workers in that time. Its more dramatic manifestation was with Lloyd George in 1910 and 1911 in Britain, where it involved two elections and a major constitutional crisis. Ant it involved the high drama of the New Deal in the 1930s in the United States.

This revolution did not touch the problem of property. That remained in private hands, in the capitalists or landlords' hands as before. Instead, this revolution separated off and addressed the specific cruelties and defaults of the capitalist system. And it sought to equalise the power of workers and employers, more or less. It gave support to the trade unions; trade union power then countervailed that of the capitalists. This was the purpose of legislation in all the industrial countries legitimising and protecting the role of the trade unions.

Mostly, however, the Welfare Revolution addressed the cruelties of the system. Through social insurance, old age pensions and unemployment compensation, it gave income to the old and the unemployed. It prohibited child labour, regulated the employment or women and legislated a minimum wage.

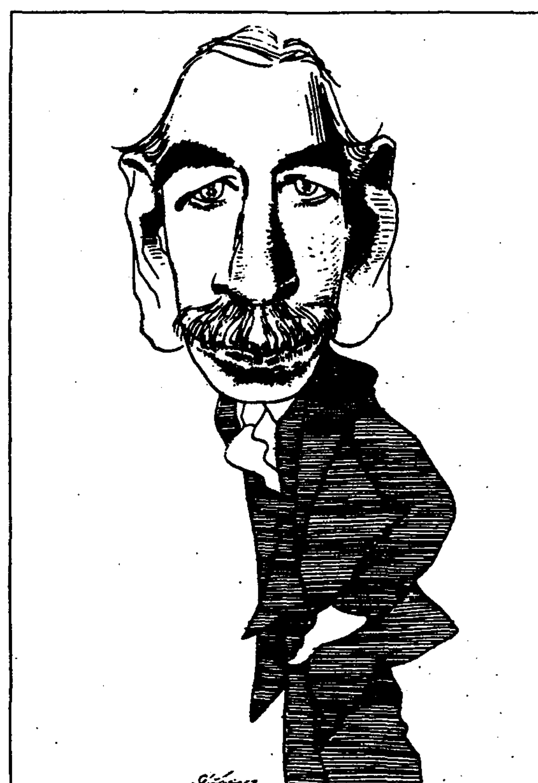
In all the industrial countries this revolution also put a floor of one sort or another under agricultural prices so that farmers were no longer subject to what they saw as exploitation by market forces. Sometimes, if more reluctantly, it gave support to the wages of farm workers.

Finally, the Welfare Revolution moved to action in the areas of default - it provided housing for middle-income people and below, provided health care for the impoverished and the old, and it provided transportation, including mass transportation in the cities.

Third, there came the Keynesian Revolution. This was a much more specialised thing. It addressed only the problem of booms and busts, the grave threat to capitalism of massive depression or inflation.

The particular economic target of the Keynesian Revolution was what anciently in economics had been called Say's Law. J. B. Say was the brilliant French interpreter of Adam Smith in the latter part of the 18th century. Say's Law involved an all-but-religious commitment of belief by economics and economists. It held that out of any sale of goods or services would always come the wages, salaries, profits, interest payments and rent that would provide the wherewithal to buy what was produced. Given by all, price was the income to pay that price. Some adjustment in price, interest and wage levels might be required. But in the modern economy, Say's Law held, there could not be a shortage of demand. Production would always supply its own demand for what was produced.

Say's Law ruled in economic thinking down to the 1930s. The mark of a good economist was that he or she believed in Say's Law. And as there couldn't be a shortage of demand, there couldn't be an excess of demand; the economic system, accordingly, had a natural tendency to find its equilibrium at stable prices. From a shortage of demand for goods and services there could not be persistent, continuing, deep unemployment. And, given a stable monetary base, there could not be a continuing excess of demand and persistent inflation.



It was Say's Law that John Maynard Keynes attacked in 1936, fifty-one years ago, in his great work The General Theory of Employment Interest and Money. He held that there could be a shortage of demand and that such an insufficiency could persist until there was a sufficient reduction in output in the economy to reduce savings, unspent income, and bring them into equilibrium with what was spent. In his new equilibrium there would be unemployment, idle capacity or depression.

This, the tendency of the modern economy to an underemployment equilibrium, was the central idea contributing to the Keynesian Revolution. It carried with it a massive implication for policy; this was that the state should now take responsibility for the overall performance of the economy. It should break the underemployment equilibrium by supplying the requisite addition to purchasing power. This it should do by spending more than it was taking in in taxes - a deliberate budget deficit. By thus adding to private demand, it would bring the economy back to full employment. Similarly, if there should be too much spending and upward pressure on wages and prices, the state would then tax private income and expenditure and reduce public expenditure so that the equal and opposite risk of inflation would not occur.

An extraordinary change in economic attitudes followed the publication of Keynes' General Theory. The attention and belief of economists was strongly attracted. Until the middle of the 1930s, one could not get a PhD at my university, Harvard, unless one believed in Say's Law. After 1940 and Keynes, one couldn't get a PhD if one believed in Say's Law - one was now hopelessly obsolete. This was the Keynesian Revolution. To repeat, it placed the government for the first time in the responsible position of controlling the level of activity, the level of employment and the level of prices in the economy. In the course of only a few years all governments in the industrial world assumed this new responsibility.

These were the three revolutions. I come now to our own time. We will understand economic life and its problems today if we see that all three of these revolutions have now run into a measure of trouble. And they have run into some of the same troubles. More often than we think, in economics, ideology is assailed by hard circumstance.

The Soviet-Chinese Revolution has encountered problems, at least one of which was visible even before the death of Lenin in 1924. The first is that this revolution, in order to extend itself into the field of production, required an extraordinarily massive organisation controlled by a huge state apparatus. And this organisation, this bureaucracy, then developed the self-perpetuating rigidity that regularly characterises great organisation. Almost since the beginning of the Russian Revolution there has been concern with the stiff, unresponsive bureaucratic apparatus that comprehensive socialism, all production under the ultimate authority of the state, requires. In Russia the discussion of this problem has been renewed in these last months by Mikhail Gorbachev; it was a major theme of his address to the Central Committee of the Communist Party in January 1986. The bureaucratic apparatus of socialism has also become a major topic for discussion in China.

Second, there is the problem imposed on socialism by the modern consumers' goods economy. This, unlike the problem of organisation and bureaucracy, is less discussed. In 1917, the productive apparatus of the economy of Imperial Russia was concerned for the people at large with the production of a mere handful of things: elementary food, elementary shelter, elementary clothing, transportation, fuel, and not much else. This simple bill of goods could be addressed with ease as a matter of socialist planning. Anyone could grasp the needs, their magnitudes and the inter-relations - what one industry supplied to another in production. The problem was still manageable in the early stages of socialist industrialisation.

The modern consumers' goods economy, that of the United States and Western Europe, has, in contrast, an extraordinary range of goods. And within that range of goods there are a vast number of different styles, designs and supporting services. And this array sets the standard for the performance of the economy in Russia and to a lesser measure in China. It is a standard which the planned economies have great difficulty achieving - its multiplicity of varieties and designs is beyond the scope of even their most capacious computers; or, in any case, of action from the printouts. And yet, to achieve the kind of consumers' goods diversity to which Western Europe and the United States are accumstomed has become the test of performance in the Soviet Union.

Third, there is the problem in the Soviet Union, as in all of the industrial countries, of low-prestige jobs. How do you get people to do hard, tedious, manual toil? How do you get people to pick fruit, harvest vegetables, do repetitive factory work, clean streets? The United States is rescued by the influx of workers from Mexico and the West Indies - workers who are escaping an even worse toil and tedium at far lower wages in their own countries and who are quite willing to do the work that Americans no longer want to do. In England, the West Indians, the Indians and the Pakistanis do the hard work. In Germany, the Yugoslavs and the Turks. France has been rescued by the return of the Moors.

The Soviet Union struggles with the harsh circumstance that its borders are not open, and there is no similar availabiity of foreign workers. There was a seminar partly on this problem a couple of years ago when I was in Russia. I proposed that they solve it the way they do in the United States. They have a long border with China; India is only a step away. Treat the border as we do ours with Mexico - accept that anyone can cross it at will. They would then have lots of people to do the work that is no longer willingly being done by their countrymen. My suggestion was not well received.

Finally, the Soviets struggle, as recurrently do the Western countries, with the problem of inflation. If you are going to attract people into low-prestige jobs, if you are going to reward productivity, if you are going to even up inequalities in pay, you do it by raising the lowest wage and thus raising income. But in an economy where prices are fixed - the price of bread in Russia was last raised in 1947 - this creates a tendency for income to exceed the supply of goods available at the fixed prices. The Soviet form of inflation is not higher prices but longer and longer queues at the stores. That is how inflation manifests itself in Moscow, Leningrad and the other Soviet cities. It is inflation nonetheless.

The Welfare Revolution has run into one of the same problems as the Soviet Revolution. That is the large organisational apparatus of the modern welfare state. In this revolution it was generally assumed in the industrial countries that when you had passed the necessary legislation, the problem had been solved. But we have come to see that a very large, complex and sometimes static governmental apparatus is required - bureaucracy again. And this, in turn, has served the attack of those who do not like the revolution. The term "welfare state" has come to carry the derogatory connotation of a heavy bureaucratic apparatus.

There is also in all of the industrial countries the self-liquidating character of this revolution. It has been weakened by its own success. The Welfare Revolution has helped make a very large proportion of the industrial population secure and comfortable. And as they hae become so, they have become more conservative, more suspicious of the state, as conservatives normally are.

They have also come to practice the psychological denial by which we all get unpleasant circumstances off our minds. By psychological denial we remove from our thoughts the terrible vision of nuclear war - we say to ourselves, "Let us think of more pleasant things." (This is perhaps the most damaging psychological tendency of our time. We need to think, and think constantly, of the danger of nuclear devastation.) And similarly we get the remaining poor off our minds by saying, "I have other concerns. I must stay with those." If one is poor, one is politically far more powerless in the United States today than was the case twenty-five or fifty years ago. As in the United States, so in the other industrial countries. The United States still has many poor people, but their political power has diminished, and psychological denial has allowed the happy, comfortable, contented majority increasingly to ignore them. Thus, to repeat, the self-liquidating character of the Welfare Revolution.

The Keynesian Revolution has also run into difficulty. If one had to pick out the years when this revolution came into full effect, it would have been those between 1945 and 1970 - the quarter century after World War II.As I have noted, all industrial countries in those years gave to the state the responsibility for the prevention of mass unemployment and of inflation. And in those years the effect of this revolution was quite wonderful. In the twenty years from 1950 to 1970 in the United States, there were only two when there wasn't a substantial increase in economic output - in the Gross National Product. Unemployment was very small, ranging from 3.5 to 5.5 percent of the labour force. And these were also years of relative price stability. Conditions elsewhere in the industrial world were equally agreeable. This was the Keynesian Revolution.

It was, I may say, a very good time to be an economist. Those of us who were economists took full credit for our achievement. But we did not see that there were accumulating difficulties that would one day also bring the Keynesian Revolution under a serious shadow. The problem was asymmetry, an asymmetry in the political character of this revolution. The Keynesian Revolution in those good years was dealing with an economic system with a broad tendency to underproduction and price deflation. This was, among other things, the psychological legacy of the Great Depression. Under these circumstances the Keynesian Revolution called for increases in welfare expenditures. No politician found that politically very difficult. And it called on occasion, for tax reduction; that was not politically difficult either. And it called for a reduction in interest rates. That was not politically unwelcome.

In Washington in those years, the President, seeing that he had an appointment with his economists on his calendar, did not reflect adversely on the prospect. He knew they were coming in to talk about basically pleasant things. As noted, more spending, lower taxes, lower interest rates. But in 1970 and later, the principal problem for discussion became inflation. Then a President, seeing his economists on his calendar, knew they were coming in to talk about a tax increase to restrain the inflation or a cut in public expenditures or a move to higher interest rates; or, possibly, wage and price restraints. All unpleasant. A President would now wonder if that appointment couldn't be postponed for a few days, a few weeks or maybe forever. This was the political asymmetry of the Keynesian Revolution. It was something that my generation of Keynesians did not foresee. We assumed that the needed policies would work both ways in a reasonably fluid fashion.

Coupled with this political asymmetry was another problem paralleling the Soviet and also the welfare-state bureaucratic experience. That was the increasing evidence of inferior, nonoptimal performance by the modern industrial enterprise. Steel corporations, automobile companies, other industrial enterprises and the banks had become very large. In consequence, they had developed or were developing some of the same bureaucratic rigidity with which the Soviets struggle and that is associated with the welfare state.

Organisation serves its own purposes; one of those purposes is to multiply the number of people it embraces. Nothing gives so much pleasure and contentment to an organisation man as to have somebody else lower in the bureaucratic hierarchy to do his thinking for him. And that person then wants somebody to do his or her thinking, or tedious work. The result is persistent bureaucratic expansion. This, then, is combined with the tendency of all organisation to measure intelligence by what most resembles the people already there; and to measure wisdom by what most resembles what is already being done. The result is inefficiency and high cost combined frequently with marked self-approval. In the last fifteen years it has become increasingly evident in all the older industrial countries that this is the tendency of the modern large corporation - of the steel, automobile, textile and banking firms, as it is the tendency for the industrial bureaucracy of the Soviet Union. And it has opened these firms to the competition of younger, more alert, more efficient, and lower-wage, firms in Japan, Korea, Taiwan and even India. There is now, in consequence, idle capacity and unemployment in the old industrial towns of the United States and Europe that cannot be corrected by a Keynesian expansion of demand.

Thus the three revolutions, and thus the difficult days on which they have fallen. What is the answer? I am more concerned with analyses than with therapy; that is in accordance with the deepest instincts of my profession.And I am not going to make any detailed recommendations for the Soviet Union; I have not, alas, been asked. But I would like to make some recommendations as regards the Welfare Revolution and as regards the Keynesian Revolution.

As regards the Welfare Revolution, I cannot but think that we must stand firm in defence of our social services. These were not radical initiatives. They were, in their effect, highly conservative. Capitalism would not have survived in the United States or Western Europe if it had not had the civilising effects of old age pensions, unemployment compensation, aid to families with dependent children, family allowances. These took the harsh edges off 19th century capitalism, mitigated alienation, dulled the revolutionary thrust of the early years of this century, and made it possible for capitalism to survive. It is being suggested in the United States, Britain and in more muted terms elsewhere that the time has come to pare down this structure, even dismantle it. "The poor need the spur of their own poverty," George Gilder, a contemporary American philosopher favoured by American conservatives, has said. We will believe this in the industrial countries at our peril.

We must, however, address the problem of efficiency in the welfare state, recognising that there is always a danger of bureaucratic stasis. As it is our task now to defend the system, it is also our task to see that it is efficiently administered. And we must also be aware, notably in the United States, that there are still people who need help, still people who are not getting help. The poor, the very young and the old in our cities, the minorities, the farm workers, are all still outside. The need for compassion and the very practical matter of insurance against alienation remain. As in the United States, so in the other industrial countries.

We *must give increasing attention to the likelihood of nonoptimal* performance by the modern large industrial enterprise. We must understand the dynamics of the large private firm - its tendency to proliferation of personnel, its tendency to perpetuate its own incompetence. We must not see its failure as exceptional. We must also question the remedy we have applied in the past. That remedy has been to have speeches urging the sanctity of the free enterprise system and then a rescue by the government. So it has been in the United States. So also in France, Britain, Italy, Spain - and I assume here in Australia. We should not have any doubt as to the nature of modern socialism; it is the taking-over of the failed children of capitalism. We need a policy of protecting the workers in these firms; we should make sure that older workers have incomes for their lifetimes and that younger workers have systematic help in retraining and relocation. But we must recognise (as in the case of a good part of the steel industry in the United States) that they may not all be saved.

In all countries, also, we must have industrial leadership that recognises and deals with the tendency to corporate and bureaucratic incompetence. This is more easily urged than accomplished. But let us at least recognise the need. The warm self-approval with which industrial management has normally regarded itself in the past is far from justified. To see this is the first step toward improvement.

As to the Keynesian Revolution, we must specifically recognise the political asymmetry and take as a test of political good sense and good will that we overcome it; we must be as willing to increase taxes when that is needed as we are to reduce taxes when that course is indicated.

From what I have said about the welfare structure, it will be clear that I do not propose curtailment there. I do believe that in an age of nuclear overkill, we are overspending egregiously in the United States on the military establishment. We have large opportunities to economy here, for evading the Keynesian asymmetry by cutting expenditure where it does not hurt. But generally, to repeat, there must be a willingness to accept the need for increased taxes when that is the indicated course.

Where taxes are concerned, we must not resort, as we have in several of the industrial countries in these last years, to escape mechanisms. The escape has been to assume that somehow there is a magic in monetary policy that will get us out of the hard decisions of fiscal policy, including the hard decisions of taxation. Under the Carter administration and strongly in the early years of the Reagan administration in the United States, and in the same years in Britain, there was a heavy reliance on monetary policy - on control, by way of high interest rates and other restraints, of bank-deposit creation and through that of the money supply. It was thought by this means to avoid a politically more difficult tax policy. The great protagonist of these hopes was Professor Milton Friedman, a most influential economic figure of our time. There is no magic in monetary policy as we have now learned. As used in the United States in 1981 and 1982, it did suppress inflation. But it did so only by creating massive unemployment, much idle plant capacity, a weakening of our basic industry and by causing widespread farm disaster and bankruptcy - a remedy more painful by far than the disease. There has now been a retreat from this hope and policy in the United States, as well as in Britain. Our lesson for all the industrial countries is clear - there is no magic solution in monetarism.

We must recognise that in dealing with inflation, we must not rely exclusively on the Keynesian design, on what economists call macroeconomic policy. Inflation is caused in the modern industrial economy by the pressure of demand on prices. It is also caused by the pressure of trade union claims on prices, what we have come to call wage-price inflation. This requires that there be a social contract between the trade unions, the modern large corporation and the government that limits wage increases to what can be afforded out of existing prices. It must be part of the understanding that trade union restraint will also mean price restraint.

You will say that this is difficult. So it seems in the English-speaking countries - the United States, Britain and Canada. They, we, have been laggard in this regard. But what I'm suggesting is a commonplace in Switzerland, has reached a very high stage of refinement in Austria, the most successful of the post-World War II economies, and is accepted in Germany, Scandinavia and Japan. More than other countries in the industrial world, we in the English-speaking countries still enjoy a confrontation between labor and capital. It is also possible that we have more economists who do not want to recognise this microeconomic flaw. We should not be the model for other countries in this matter.

So much for this survey of revolutions in our time. The lesson is clear - no revolution is for ever. As old problems are solved, new ones emerge. We can reflect with approval on past change. We cannot stand upon it for the future. There is one great constant in economics. That is the need for constant accommodation to change.