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What has become of employment policy?

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The wartime coalition government of the UK published a White Paper, *Employment Policy* (Cmnd. 6527, 1944), which boldly declared that it is the responsibility of government to maintain a high and stable level of employment. Sure enough, from 1945 to 1966 (with the exception of the hard winter of 1947) unemployment in Britain, as represented by official statistics, never rose above 2·5% of the labour force, and in some years hovered around 1%. This was quite a surprise. Sir William Beveridge (Beveridge, 1944) estimated that the attainable minimum would be an average of 3%, varying between 2 and 4% from time to time, and Keynes thought this much too optimistic (Kahn, 1975). The expected post-war slump never came. Twenty years of near-full employment was something new in history. Indeed, in some capitalist countries demand for labour overtook supply and foreign workers flooded in.† It seemed that the ghost of the trade cycle of the pre-war variety had been exorcised, apart from accidental disturbances such as the Korean war boom and slump. Continuous prosperity began to be taken for granted. Workers came to expect real-wage rates to rise from year to year and shareholders began to look forward to unending capital gains.

Over the period as a whole, annual growth rates in *per capita* income in the rest of western Europe and in Japan ranged between 4% and 10%. Average real consumption per head grew at more or less the same pace but, since inequality was, if anything, slightly reduced, there was probably a greater rise in the level of consumption for the broad mass of the population (see Table 1, p. 13). Even in the poorest third world countries, *per capita* GNP grew at 1 or 2% per annum, but there it was associated with growing inequality and a great increase in misery.‡

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† For instance, the proportion of foreign workers in the West German labour force increased from less than 1% in the 1950s to some 10% in the 1970s (Böhning and Maillet, 1974).

‡ In the third world countries, during the period 1950–52 to 1964–66, the growth rates of product *per capita* averaged about 1·7% for Africa, 1·8% for America, 1·6% for South Asia, 2·6% for the Far East and 4·4% for the Middle East (as compared with 5·0% in western Europe over the comparable period) (see OECD national accounts). Recent empirical studies have established substantial support for the hypothesis that relative inequality increases in the early stages of development (Ahluwalia, 1976; Chenery, 1974). Ahluwalia's evidence suggests that 'the stronger hypothesis of declining absolute incomes for large sections of the population is not so unequivocally established by cross-country data as to be uncritically accepted as one of the "stylised facts" about development' (p. 135). However, this stronger hypothesis does seem to hold, for example, in the case of the Indian economy, where the percentage of rural people below the 'poverty line' increased from 38% in 1960–61 to 45% in 1964–65 and to 54% in 1968–69 (Bardhan, 1974).

In the USA *per capita* growth from the early 1950s to the mid-1960s was only 2·5% per annum, but starting from a higher base, mass consumption swelled prodigiously, which made poverty all the more annoying for those who did not get much of it. The UK was at, or near, the bottom of the league table, with a growth rate slightly less than that of the USA, but even so, the general standard of life was indubitably rising. Disgruntled elements in the middle class began to be annoyed to see workers' families encroaching on their former privileges, such as private cars and holidays in Spain, but conservative views were generally supported by the experience of prosperity. The spokesmen for capitalism were saying, in effect: we have to admit that the unemployment that prevailed before the war was a serious defect in the free-market system. Now we are giving you capitalism with full employment, so what have you got to complain of?

In the inter-war period, while capitalism was wallowing in the slump, full employment and rapid growth were being maintained in the USSR. (Perhaps it was the desire to avoid a repetition of this contrast that made conservative opinion accept the Keynesian doctrines, which were formerly considered subversive.) Now the boot was on the other foot; the spectacle of luxury consumption spreading among industrial workers in the West aroused envy and doubt in the socialist world.

In Great Britain, 1966 was disconcerting—a so-called Labour government deliberately causing unemployment in order to maintain the exchange value of sterling (and thereafter failing to do so). But British troubles were put down to special circumstances or to peculiarities in the national character.† In the capitalist world as a whole, activity revived after a setback, and ran high for another seven years (see Table 1). Belief in perpetual prosperity was restored.

While prosperity ruled, the deeper insights of the Keynesian revolution were lost to view. The bastard Keynesian doctrine, evolved in the United States, invaded the economics faculties of the world, floating on the wings of the almighty dollar. (It established itself even amongst intellectuals in the so-called developing countries, who have reason enough to know better.) The old orthodoxy, against which the Keynesian revolution was raised, was based on Say's law—there cannot be a deficiency of demand. Spending creates demand for consumption goods, while saving creates demand for investment goods such as machinery and stocks. Keynes pointed out the obvious fact that investment is governed by the decisions of business corporations and public institutions, not by the desire of thrifty householders to save. An increase in household saving means a reduction in consumption; it does not increase investment but reduces employment.

According to the bastard Keynesian doctrine, it is possible to calculate the rate of saving that households collectively desire to achieve; then governments, by fiscal and monetary policy, can organise the investment of this amount of saving. Thus Say's law is artificially restored, and under its shelter all the old doctrines creep back again, even the doctrine that a given stock of capital will provide employment for any amount of labour at the appropriate equilibrium real-wage rate. If so, unemployment occurs only because wages are being held above the equilibrium level. (In the third world, it is just too bad, because the equilibrium wage corresponding to full employment is far below the level of subsistence.)

Keynes was diagnosing a defect inherent in capitalism. Kalecki, who developed the same theory independently, went much further and held that without radical change

† See, for example, Caves (1968), especially chs. 7 and 8.

capitalism was incapable of rectifying the defect. But the bastard Keynesians turned the argument back into being a defence of *laissez-faire*, provided that just the one blemish of excessive saving was going to be removed.†

Against this background, the slump of 1973–74 was a considerable shock. We were told, in early 1976, that a revival was gathering momentum and that soon the United States and West Germany would be pulling us all up into a new boom. At best, then, we appear to be getting back into the clutches of the old trade cycle;‡ perpetual steady growth has proved to have been a daydream. The bastard Keynesian economists are quite disconcerted and the spokesmen for capitalism have got their brief muddled up.

The complacency of the age of growth covered up what, in the legal phrase, may be called *inherent vice* in the free-market system, which has now broken out in the unprecedented combination of inflation with unemployment, along with increasing tension in international economic relations and growing distress at the social consequences of unregulated capitalist accumulation.

I

A major point in the analysis of Keynes and Kalecki, which the complacent economists seem to have overlooked, is that there is no meaning to be attached to the concept of equilibrium in the general level of prices. The Keynesian revolution began by refuting the then orthodox theory that there is a natural tendency in a market economy to establish equilibrium with full employment. If men in fact were out of work, on the orthodox view, it must be because wages were above the equilibrium level and profits were too low. Unemployment on this view was 'voluntary' because trade unions could easily get rid of it by accepting lower wage rates. Keynes agreed that a rise in profits would increase employment, but he argued that a general cut in money-wage rates would reduce the price level more or less in proportion, so that neither profits nor employment would increase. If this argument is correct, it must follow that to raise money wages will increase prices, even if there is unemployment.

It was easy to predict that a long run of high employment and high profits, without any change in the mechanism and psychology of wage bargaining, would lead to continuously rising prices. Keynes foresaw that it would be a difficult political problem to prevent free wage bargaining from generating inflation in conditions of continuous

† Thus, typically, Samuelson argues:

The finding of our macroeconomic analysis rejects both the classical faith that *laissez-faire* must by itself lead to utopian stability and the pre-World War II pessimism that classical microeconomic principles have become inapplicable to the modern world. Instead we end with the reasoned prospect that appropriate monetary and fiscal policies can ensure an economic environment which will *validate* the verities of microeconomics—that society has to choose among its alternative high-employment production possibilities, that paradoxes of thrift and fallacies of composition will not be permitted to create cleavages between private and social virtues or private and public vices.

By means of appropriately reinforcing monetary and fiscal policies, a mixed economy can avoid the excesses of boom and slump and can look forward to healthy progressive growth. This being understood, the paradoxes that robbed the older classical principles dealing with small-scale 'microeconomics' of much of their relevance and validity will now lose their sting. The broad cleavage between microeconomics and macroeconomics has been closed by active public use of fiscal and monetary policy (Samuelson, 1970, p. 348).

By 1976, Samuelson's faith in macroeconomic policies (but not in the verities of microeconomics) had been badly shaken. Compare the passage quoted above with the corresponding passage in the tenth edition of his textbook (p. 373).

‡ See Table 1. The old trade cycle was associated with actual reductions in GDP, whereas, as is well known, cyclical downturns in the period since World War II in most industrial countries have merely meant a slowing down of the rate of growth of output.

high employment (see Robinson, 1973), but he did not suggest how to solve it. Orthodox economists do not like to discuss politics. The old-fashioned monetarist doctrines enabled them to ignore the political causes and consequences of inflation. They held that the level of prices is regulated by the quantity of money. Wage rates are prices like the rest. When there is an excessive creation of money, wages are bound to rise whether trade unions demand increases or not. The simple cure for inflation is to regulate the quantity of money correctly. This theory had a great success with central bankers, but even many bastard Keynesians found it too much to swallow. They prefer to discuss inflation in terms of demand pull and cost push.

The appearance of symmetry between demand and costs is deceptive. A sudden rapid increase in effective demand, with given productive capacity, runs output into bottlenecks and, even if prices do not rise, there is a sharp increase in profits. By itself, this does not cause continuing inflation, though it may set off a rise in wage rates which thereafter continues to feed on itself. A pure cost push—wages being raised, so to speak, in cold blood, without any preceding rise in profits—is logically possible though hard to distinguish in practice.

By the mid-1950s, however, the link between high employment and wage increases had become obvious and Professor Phillips' econometric study (Phillips, 1958) reduced this relationship to a simple formula. His analysis of the causal link between high employment and the rate of wage inflation was widely accepted, despite the doubtful quality of much of his data, and pressure in the labour market was brought to the fore as an explanation of inflation.

This view has now been embodied in a new form of monetarism. According to this doctrine, with non-inflationary equilibrium in the labour market, there is a certain amount of *voluntary unemployment*, of workers who prefer not to work at the ruling level of real wages. If government attempts to lower unemployment below this *natural level* by increasing the money supply, labour market pressures increase money wages. The increased prices which result are built into wage claims via workers' expectations of inflation and the rate of price increase accelerates. To cure inflation the increase in the money supply has to be adjusted so as to raise unemployment to the natural level—even beyond that if there is a large element of expectations in wage claims. When money wages continue to increase while unemployment is rising, this only shows that equilibrium in the labour market has not been reached and that unemployment should be further increased. By emphasising the importance of voluntary abstentions from the labour market as an explanation for unemployment, the new monetarists have arrived back at the point where Keynes started.†

One of the oddest notions produced by bastard Keynesians is that trade unions suffer from 'money illusion' because they do not bargain in real terms. In fact, negotiations about wages can only be conducted in terms of money. When inflation is already going on, the rising 'cost of living' is brought into the argument, but there is no way in which trade unions can operate directly on the level of real wages. Moreover, there is no point in preaching to workers that to raise the general level of money wage rates merely raises prices, so that they get no benefit from it. Any group of workers which

† For example, 'In one sense all employment could be regarded as voluntary because there is some wage level at which almost any individual could price himself into a job' (Brittan, 1975, p. 30). Brittan's list of reasons for voluntary unemployment includes trade unions, minimum wage and equal pay legislation and social benefits. It is worth noting that this list is remarkably similar to that in Pigou (1933), the book singled out by Keynes as 'the only detailed account of the classical theory of unemployment which exists' (Keynes, 1936 p. 7). See also Laidler (1975). Cf. Cripps, pp. 106–107 below.

secures a rise ahead of others does get higher real wages for some time, and any who fall behind suffer a permanent loss.

A rise of prices normally leads to a demand for a compensating rise in wages and a rise in wages leads to rising prices again. However, the ability of any group of workers to maintain their standard of life in an inflationary period depends on collective action. In industries where workers are strongly organised, trade unions are effective in protecting their members' interests and every rise in living costs quickly leads to increased wages. In other sectors, where organisation is weak or trade union leaders complacent, wages lag behind prices, so that real wages fall.† For a time, this helps to slow down inflation, since the rise in the aggregate wage bill for industry as a whole is less than proportionate to the rise in the level of prices. But for this very reason, organisation grows stronger and rank-and-file pressure on leaders grows more insistent. Soon, wages are following prices more quickly and inflation accelerates.‡

It is commonly said that trade unions cause inflation: however that may be, it is quite clear that inflation causes trade unions. In Britain for the last decade, organisation has been spreading not only among previously ill-organised manual workers and among the clerical grades, but also among the professional classes. Now respected servants of the public, physicians and judges, have to struggle, just like dustmen, to prevent their living standards from being undermined by the successful struggles of others.

There is, however, another aspect of wage bargaining which certainly does cause inflation. The trade union movement regards itself as charged with the right and duty to maintain for its members a proper share in the growing productivity of industry. In prosperous times, it is performing a useful function for capitalism. In the absence of trade union pressure, real wages would not rise in line with the increasing productivity due to technical progress, and stagnation would be induced by the failure of mass consumption to rise in step with productive capacity. The struggle over the relative share of wages in the product of industry interacts with the struggle over the relative wage rates of different bargaining groups. The strong technically progressive firms do not much object to granting money wage increases as real wage-costs fall. Prices for their products may remain more or less constant. Additional purchasing power from their wage bill tends to raise the demand for other commodities. Workers in the less progressive industries and services are now at a double disadvantage. Their share in consumption has been reduced and their relative position in the hierarchy of wage rates has been pushed down. They must demand rises and, to defend profits, their employers must put up prices.

Though this is the effect of their traditional function, trade union leaders bitterly resented the accusation that they were causing inflation and for a long time refused to admit that rising wage rates had anything to do with it. After all, they were behaving

† However, in some relatively unorganised sectors, such as domestic service and shorthand typing, wages have risen sharply, apparently in response to demand for labour.

‡ Research being undertaken by one of the authors indicates that the upsurge in militancy among important groups of workers, e.g. hospital ancillary workers, local government manual workers, teachers and, particularly, the miners in the late 1960s and early 1970s, was preceded by a period in which real take-home pay fell sharply. Moreover, a fairly common pattern of development of this militancy emerges; a rapid increase in unofficial strikes and other forms of industrial action was eventually followed by official strike action. The situation, therefore, is the opposite of the popular image of the militant leaders pushing the silent, and often reluctant, majority; in fact the militant majority tend to push the silent, and frequently reluctant, leaders (R. J. Tarling and S. F. Wilkinson, Wage differentials and incomes policy: an inter-industry study, *British Journal of Industrial Relations*, forthcoming).

quite correctly in trying to keep wage rates, each for their own members, from falling behind the cost of living. The British trade union movement had inherited a proud tradition and its central principle was the demand for freedom in wage bargaining. It was hardly their fault if modern capitalism could not accommodate itself to their using the strength that they had managed to build up over two centuries.

Moreover, it is not fair to say that trade unions have always ruthlessly followed their sectional interests at the expense of everyone else. Both leaders and members have demonstrated from time to time their willingness to co-operate with government policy, particularly when the Labour party is in power. In 1948, the trade union movement accepted a wage freeze and maintained it more or less intact for two years. Again in 1966, the movement broadly accepted the need for wage control. Both these efforts succeeded in securing their short-term objectives of improving the balance of payments and mitigating inflation for a time, but both soon collapsed into rapid inflation, mainly because of the government's inability to provide an adequate quid pro quo.

The violent inflation of 1974, running up to an annual rate of 27% in 1975, gave everyone a fright. This time the efforts of the trade unions to co-operate with a Labour government to check inflation have been more convincing than before. But, so far, union involvement has been largely confined to tinkering with the process of wage determination; in other spheres of government policy it has been narrowly limited. It was this failure to extend the influence of the unions beyond wage control that proved fatal to previous attempts at co-operation.

In 1943 Kalecki, looking forward, sceptically, to the possibilities of the post-war world, wrote:

> 'Full employment capitalism' will have, of course, to develop new social and political institutions which will reflect the increased power of the working class. If capitalism can adjust itself to full employment a fundamental reform will have been incorporated in it. If not, it will show itself an outmoded system which must be scrapped (Kalecki, 1943).

II

Class war was not the only element of inherent vice in the free-market system to disturb the age of growth. There were also the problems generated by the unevenness of development amongst various capitalist nations and the economic and political relationships between industrial countries and primary producers, particularly those in the third world.

The pre-Keynesian theory of international trade required the balance of imports and exports for each country to be maintained by movements in relative price levels. After experiencing the attempt to return to the gold standard in 1925 (see Keynes, 1972), Keynes adopted the view that depreciating the exchange rate was much to be preferred to attempting to depress the price level. At the end of his life, feeling obliged to defend the Bretton Woods agreement against his better judgement (Kahn, 1976), he lapsed into arguing that, *in the long run*, market forces would tend to establish equilibrium in international trade (Keynes, 1946). He had forgotten his old crack, that in the long run we are all dead.

As it turned out, market forces generated disequilibrium. Differences in competitive power, whatever their origin, set up a spiral of divergence. A country such as West Germany, with growing exports, could maintain a high rate of investment and therefore of growing productivity, which enhanced its competitive power, and allowed real wages to rise so that workers were less demanding. In the United Kingdom, any increase in employment caused an increase in the deficit in the balance of payments

so that every hopeful *go* had to be brought to an end with a despairing *stop*. Thus strong competitors grow stronger and the weak, weaker.

Because of the size and strength of the United States and its overseas economy, trade plays a small part in national income, but not a small part in the world market. The USA can move from deficit to surplus without much disturbance at home, but with a great deal of disturbance to the other trading nations. Moreover, it was able to take advantage of the dollar being the world currency to run an ever greater outflow on capital account with an ever growing deficit on income account, until President Nixon, with the dollar devaluation of 1971, suddenly tried to reverse the position with a stroke of the pen. All this laid great strains on the international monetary system.

Keynes worked out the structure of the *General Theory* mainly in terms of a closed economy. When it is extended to take in the operation of international economic relations, a missing link appears in the argument. The rate of interest was to be used to regulate home investment, and Keynes believed that a secular fall in interest rates was both necessary for this purpose and desirable in itself. Exchange rates were to offset differences in relative labour costs. Then nothing would be left to regulate short-term capital movements. Traditionally this was the function of relative interest rates. Britain, and other countries with chronically weak payments balances, could not indulge in cheap money however much home conditions required it, and had to follow the interest rates of other countries up whenever they happened to rise. This was one more turn in the spiral of weakness weakening itself.

Over and above the strains set up by the uneasy relationships amongst the industrial nations themselves, there were the strains involved in the relations of the industrial countries as a whole and the third world. The formation of prices in the free-market system is in two parts—cost-plus in manufacturing industry and supply and demand for primary products.† A rise in the level of production and consumption in industrial countries normally increases demand for all kinds of primary products. When prices of materials rise, while money wage rates are constant, real wages fall and so generate a demand for rising money wages, which adds to the original rise in costs. Thus favourable terms of trade reduce class conflict in the industrial countries and unfavourable terms exacerbate it.

Commodity prices responded sharply to the pressure of demand during the Korean war boom, but this was soon over and during the 1950s the terms of trade moved in favour of industrial countries. However, the long boom, swollen by the Vietnam war, financed by the USA on the principle of guns *and* butter, caused an acceleration in the rate of increase in commodity prices and finally sparked off the great inflation of 1973.

In an economic model, it is possible to analyse the consequences of any one change by keeping other things constant. In real life a lot of things happen at once. During the long boom, an excess of demand over growth of capacity led to shortages of one commodity after another. The demonetisation of the dollar in 1971 drove speculative funds into commodity markets. The Moslem oil producers, temporarily bound together by hostility to Israel, suddenly realised the extent of their monopoly power. Inflation at what now seems a mild and acceptable rate had been going on for years all over the capitalist world, setting up expectations that inflation would continue and undermining the conventional belief that a dollar is a dollar. Injected into this situation, the sudden rise in the costs of materials, especially oil, blew the inflation sky high.

† See Robinson (1962); K. J. Coutts, W. A. H. Godley and W. D. Nordhaus, *Industrial Pricing in the United Kingdom*, Cambridge, CUP, forthcoming.

This concatenation of circumstances has been described as a historical accident. But it is the inherent vice in the free-market system of international trade which creates the setting for such 'accidents', from which it has no means to defend itself except by destroying prosperity and depriving the primary product sellers of their favourable terms of trade.

III

The hopes which accompanied the Keynesian revolution, of reforming capitalism so as to ensure continuous prosperity with full employment, are now all but extinguished. The slide into crisis in the capitalist world has re-established the pre-Keynesian orthodoxy as the conventional wisdom in economic policy-making at both national and international levels. The inevitable consequence of this is a much higher general level of unemployment and recurrent crises, involving a massive waste of resources and considerable human misery.

Important changes in the world economy have taken place over the last two decades, which have ended the era of near-full employment and exposed the inadequacies of the conventional Keynesian analysis. One of the most important of these developments has been the relaxation of tariffs and exchange controls and the resulting large increase in international trade† and capital movements; this has increasingly exposed national economies to the ravages of uncontrolled capitalist competition, in the way that they were exposed before the 1930s.

While the USA remained the predominant world economic and political power, and effectively acted as the world central bank, some semblance of order in international economic relations was retained. The use of the dollar as a reserve currency and the eagerness of the USA to lend abroad allowed international liquidity to expand to meet the needs of the growing volume of trade and facilitated post-war reconstruction and structural adaptation in the capitalist world. But with the emergence of Japan and western European countries as strong competitors to the USA, and the deterioration of the USA's balance of payments, unhindered capital movements became a major destabilising force. The IMF proved totally inadequate to its appointed task of protecting national economies from external shocks and assisting the correction of more permanent imbalances in payments. In fact, by establishing rules which threw the burden of adjustment mainly onto deficit countries, the IMF institutionalised an important element in the process of unequal development among capitalist countries.

Faced with growing international pressures, the governments of debtor countries have been obliged to adopt the deflationary policies acceptable to their creditors (including the IMF); policies which conflicted with the avowed aim of maintaining full employment and with the real-wage demands of the working class. Thus democratically elected governments of debtor countries, where the working class is well organised, have walked a knife edge between the international and internal disapproval of their economic policies. But the frequently imposed deflationary policies progressively weakened the competitive position of such economies, increasing their indebtedness and reducing the opportunities for advances in real wages. Unable to meet either internal or external demands, economic policy vacillated wildly; consequently growing economic crisis has been accompanied by increasing political instability and further destabilisation of the international economy.

† Exports of OECD countries as a whole increased from 11% of GDP in 1954 to almost 17% of GDP in 1973.

The world market system has run into a second, and much more general, impasse, caught between two interlocking conflicts—the demands of workers in the industrial countries for higher real wages and the demands of the third world for improved terms of trade.

So long as unemployment and slow growth continue, the relative prices of raw materials are kept down and this somewhat mitigates inflation in industrial countries. As soon as a revival begins, prices of raw materials and foodstuffs begin to go up and real wage demands become harder to resist; the authorities nervously pull back and the revival is checked. The orthodox economists, still repeating incantations about equilibrium, encourage the authorities to pursue these deflationary policies—the very same that Keynes in the thirties used to describe as sadistic.

It is ironic that after the great technical achievements brought by the age of growth, all we are offered is a return to large-scale unemployment and poverty in the midst of plenty, in an age of frustration. Kalecki was right to be sceptical; the modern economies have failed to develop the political and social institutions, at either domestic or international level, that are needed to make permanent full employment compatible with capitalism.

Table 1. *Rates of growth of* per capita *Gross Domestic Product and consumption, OECD and selected OECD countries, 1954–75 (constant 1970 prices and exchange rates)*

Annual compound rates of growth	Gross Domestic Product			Consumption		
	1954–66	1966–73	1973–75	1954–66	1966–73	1973–75
USA	2·5	2·7	−2·7	2·6	3·1	−0·7
Canada	2·6	3·5	0·4	2·5	3·8	3·6
Japan	8·4	9·1	−0·6	7·2	7·4	2·4
Germany	5·5	3·9	−1·5	5·6	3·9	n.a.
France	4·3	4·9	0	3·8	4·6	n.a.
UK	2·3	2·5	−0·5	2·3	2·5	−0·7
OECD Total	3·2	3·7	−1·6	3·1	3·7	n.a.

Sources: *National Accounts of OECD Countries 1953–69* and *1962–73*, OECD, Paris
Main Economic Indicators, OECD, Paris, 1976
Manpower Statistics, 1954–64, OECD, Paris, 1965
Labour Force Statistics, 1963–74, OECD, Paris, 1976
Note: GDP growth rates were adjusted to a *per capita* basis using population statistics from OECD sources.

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