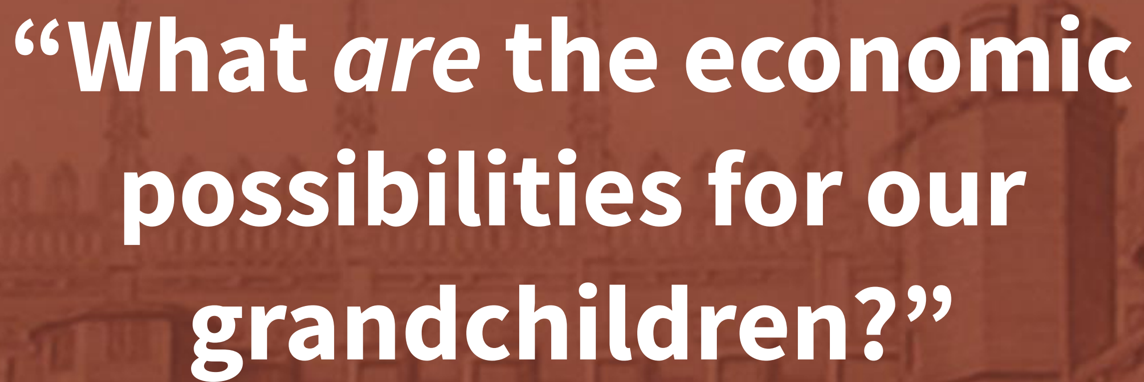

“What *are* the economic possibilities for our grandchildren?”

Ann Pettifor & Geoff Tily

November 2015

Prime

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Notes for a speech given by Ann Pettifor at a commemorative event organised by the King’s Politics Society at Kings College Chapel, Cambridge, on the 16th November 2015.

“What *are* the economic possibilities for our grandchildren?”

2015 is the 500th anniversary of the completion of the stonework of King’s College Chapel. As a part of a series of celebratory events held at the college, the King’s Politics Society is hosting two debates inside the chapel. The second of these commemorative debates, which in also is being held in memory of John Maynard Keynes, takes place on Monday 16th November 2015 and is entitled “What are the economic possibilities for our grandchildren?”

I am honoured to have been invited to make a presentation alongside my distinguished co-speakers - Lord Robert Skidelsky, Professor Andrew Gamble, Dr Catherine Hakim, Roberto Unger (via video-link) and Martin O’Neill.

The invitation continues as follows:

> “Writing in 1930, Keynes predicted that living standards in developed countries would be between four and eight times higher by 2030 – a prediction that has proved startlingly accurate. Even more ambitiously, Keynes argued that, within a hundred years of his writing, the solution to the economic problem which had hitherto plagued the human race – the struggle for subsistence – would be in sight. Was Keynes right?”

My full prepared speech notes are below. Please note that they will not be delivered in full, as I only have seven minutes for my presentation. I would like to acknowledge the generous assistance of Dr Geoff Tily, an expert in Keynes’s monetary theory, and author of *Keynes Betrayed* in preparing this presentation.

1. Ideas and Power

It is a great honour to speak at this celebration of Kings and Keynes. The greatest honour I can do to both Keynes and Kings College is to get down to business and speak frankly.

The world desperately needs to recover Keynes, but to do so it also needs to confront some deeply uncomfortable truths about the nature of power and the acceptance, or otherwise, of ideas.

In his 1902 *Imperialism*, John Hobson observed:

> “No one can follow the history of political and economic theory during the last century without recognizing that the selection and rejection of ideas, hypothesis, and formulae, the moulding of them into schools or tendencies of

> thought, and the propagation of them in the intellectual world, have been plainly directed by the pressure of class interests. In political economy… we find the most incontestable example.” (Hobson, 1902, pp. 218-19)

Given the pressure of class interests on today’s economic ideas, the long-standing neglect of Keynes’s ideas here in Cambridge does not come as a surprise.

The “moulds of schools thought” now dominant in both economics, but also wider society, have led to a vast and prolonged failure of the global economy. A failure to provide people with work, stability, a decent standard of living – and, in the light of this weekend’s events in Paris – security.

According to the ILO around 200 million people are now unemployed. The Middle East and North Africa has the highest rate of youth unemployment in the world. With the economic crisis adding 30 million, even before 2008, 170 million people had no work. The appalling conditions of the world today – in Europe, high levels of unemployment, the dominance of liberal, unfettered finance, an ‘independent’ central bank, political tensions and divisions, and the rise of right-wing and even fascist parties - are precisely those that Keynes sought to eradicate.

From the time of his rejection of the gold standard, Keynes was concerned with the *prevention* of economic crises. In the wake of the great depression, he wanted to establish conditions for the restoration of prosperity and to prevent such events *ever* recurring again.

In this Keynes clearly failed.

But this failure was through no fault of his own.

For the Keynes that survived into conventional wisdom and, most importantly, the Keynes that has survived into the lecture theatre, is a gravely distorted and diminished figure.

He is now associated largely with fiscal actions to combat crisis, when to prevent crisis he was concerned primarily with *monetary initiatives*. His objective was the reform of the international financial architecture on the one hand, and the setting of low interest rates on the other.

Managed finance and cheap money - on a permanent basis - was his central ambition.

It has to be our hope that the economics profession’s ongoing refusal to reform the monetary system along the lines proposed by Keynes does not reflect the same forces of class interest outlined by Hobson.

But either way it is time the profession woke up to the impossibly high stakes of its intransigence and neglect of Keynes. Most notably, it must be said, those here at Cambridge.

2. Theory

From a theoretical perspective Keynes was *a monetary economist*, understanding immediately that conventional or classical economics was irrelevant to an economy *based on credit*. He was concerned to devise a theory for what he called a 'monetary production economy'.

In the *General Theory* he finally understood that the critical point of departure of any such theory from the classical theory, was the long-term rate of interest. The rate that underpinned all private activity – especially investment.

Whatever the precise formulation, in the classical theory the rate of interest is a *passive* consequence of whatever real events are regarded as dictating outcomes. Today the most prominent of these events defined as "a global savings glut" changes in population growth and failing productivity.

In Keynes's theory it is the rate of interest that *dictates* events, and that unchecked is the 'villain of the economic piece'. Unchecked, high rates of interest vindicate two millennia of the condemnation of usury in both philosophical and religious doctrines. Ultimately Keynes understood the rate of interest *as a social construct*, set according to the balance of conflicting economic interests.

Keynes did not use the language of class, but his theory meant that the class struggle was very much a reality. But his was changed from Marx's account in this respect: Productive industry and Labour shared interests, and these were opposed by Finance. What Keynes called "vested interest" or the rentier class.

Low rates of interest or cheap money favoured Industry and Labour.

Dear money favoured Finance.

The progressive euthanasia of the rentier was for Keynes the price society paid for a) full employment, b) decent public goods and services, and c) economic stability. Given that the rentier was hardly likely to engineer his or her own demise, then the assertion of *public authority* over the financial system was essential.

Until Keynes, Finance had been jealously guarded by *private authority.*

Today such *public* authority is rejected by mainstream economists, and even many progressive economists, who use the imprecise and pejorative notion of *financial repression* to attack democratic management of the finance sector.

Financial "repression" is akin to regarding the emancipation of slaves as the repression of the rights of slave owners!

On a more mundane theoretical and practical level, the theory of liquidity preference led to the devising of the appropriate monetary and debt management arrangements that would enable any such authority to set the rate of interest across the spectrum. The ability of the public authorities to achieve low rates of interest across the spectrum is fact. As was Keynes's practical successes in reducing interest rates, both before and during the Second World War.

3. Events

From the 1919 Versailles conference after WWI, financial interests dictated the economic terms for the peace.

With scarcely any recognisable difference from the gold standard, finance's 'economic terms' back then can be equated with the usual orthodoxies familiar today. They included: independent central banks, restrained governments, unfettered mobility of capital, and high real rates of interest.

Soon after, by 1923, the arrangements had collapsed with a rapidity and severity that is astonishing. Depression began first in Germany and then moved to include the United States. Recovery and global monetary reform only began in the UK when membership of the gold standard was suspended on 21 September 1931.

Over the next five years Keynes orchestrated a major realignment of class relations, aided by a profound political shift to the left, from Roosevelt in the US in 1933 to Blum in France in 1936.

The gold standard was replaced by Keynes's scheme for currency management that he had first devised for his [1926] *Tract on Monetary Reform*.

Exchange rates were managed by central bank intervention in forex markets, using massive funds provided by governments, rather than by manipulation of central bank discount rates. These interventions were supported with a degree of capital control, and permitted a major reduction in interest rates (short and long, safe and risky and real rates) all over the world.

In Britain the scheme operated through the Exchange Equalisation Account. The immediate priority was then reductions of short and long rates, as individual economies so desperately required.

When in 1934 at the world economic conference Roosevelt famously torpedoed gold as the 'fetish of so-called international bankers' he was inviting the rest of the world – not least the gold bloc of European nations – to follow Britain's lead. [But of course history records Roosevelt's action as nihilistic and ignorant.]

This was a vital imperative to the *General Theory*.

Keynes understood his theory as a framework for ensuring that market failure only occurred when it was improperly understood and wrongly operated. It is profoundly wrong to have Keynes as an enemy of markets and freedom. That is why he was in 'deeply moved agreement' with Hayek. His goal was 'not to defeat, but to implement the wisdom of Adam Smith'.

He confronted rival initiatives (including in the UK) that held the depression was due to the failure of laissez faire, and that this necessitated a retreat to authoritarianism of various kinds.

The most monstrous manifestations of the doctrines that rivalled Keynes, were the totalitarian economies and most obviously Hitler, who took power in almost exact parallel to Roosevelt.

In the United States, France and the UK, *democratic public authority over finance* was - de facto if not de jure - imposed on their respective central banks: the Federal Reserve, the Banque de France, and the Bank of England. [A decade later, one of the first acts of the British Labour government was to go all the way by nationalising the Bank of England.]

In Germany under Hitler, *private authority* over finance prevailed.

Contrary to conventional wisdom while Hitler may have initially determined to address the problem of unemployment, both he and his chancellor Hjalmar Schacht deliberately and explicitly turned their back on monetary reform and held out on the side of finance.

Furthermore, democratic governments had been freed from the restraints applied under financial orthodoxy, most triumphantly under FDR's New Deal.

When his book was published in February 1936, the final disintegration of the gold standard had already begun. His remarks to a July 1935 conference arranged when Belgium came off gold echo through history.

> "Stupid and obstinate old gentlemen at the Banks of Netherlands and France crucifying their countries in a struggle which is certain to prove futile."

The 'cross of gold' was finally lifted when France adopted currency management on the election of Blum in September 1936, at which point the whole of the gold standard caved in.

Under the Tripartite Agreement the British and US governments had agreed to support the French exchange, so that monetary reform was global and cooperative. Public authority over finance and cheap money prevailed over the great part of the world.

4. The modern age

With the exception of the stunning five years of the 1945 Labour Government in Britain, the decisiveness of this re-alignment of class interests was ruptured in the post-war age. The most obvious statement of intent was the United States' rejection at Bretton Woods of the British Government's proposal for Keynes's international clearing union.

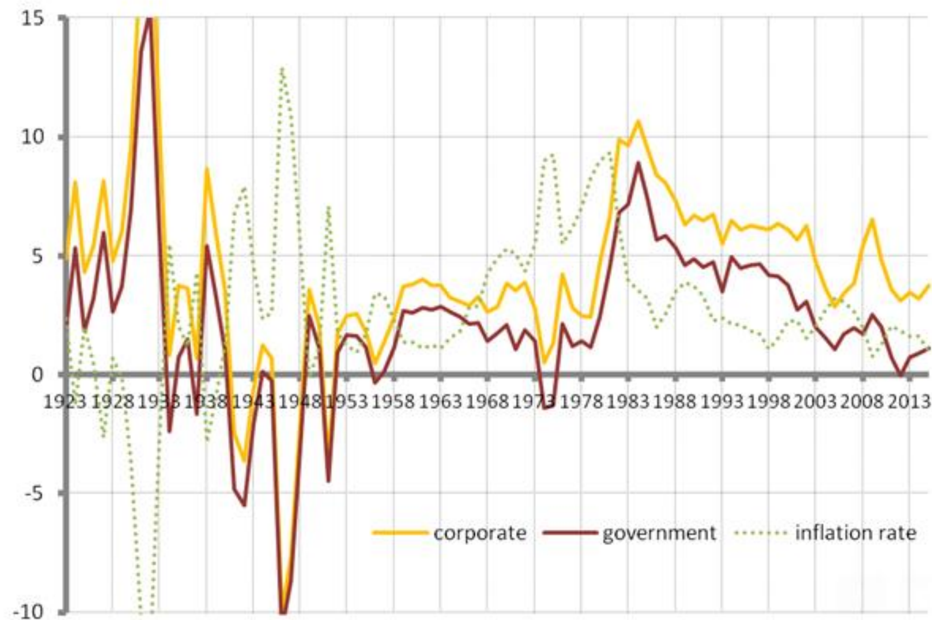
But even though the global trajectory was set to move away from Keynes and monetary reform, compromises toward expansionary policy (not least preserving restraints on finance, relatively low interest rates and an enhanced role for governments post-war) meant great progress.

The Golden Age was truly golden. There was employment, economic activity, theatre, sport, music... Inequality declined. Even the public finances were to be stabilised. But in due course the achievement of full employment came to be disregarded by economists and policymakers and treated - much as it is regarded today - as a non-event. They progressively promoted instead an agenda based on "growth", and financial liberalisation.

From the early 1960s with full unemployment at 2 per cent, British policymakers echoed the OECD in setting an explicit target for real annual growth of four per cent.

These unrealistic targets combined with financial de-regulation inevitably led to the inflation of the 1960s and 70s. Inflation reflected policies that were far removed from those of Keynes - let alone of sanity.

Above all, with Finance freed from so-called "repression", low interest rates were replaced by high real rates – across the world.



Source: Geoff Tily: The long-term rate of interest: contrasting the Council of Economic Advisers and Keynes. Policy Research in Macroeconomics, 3 November, 2015.

Keynes is blamed for these policies. They are portrayed by economists as reflecting the failure of Keynes, an argument that was deployed to justify an intensification of forces towards financial liberalisation and globalisation.

From the point of view of Keynes's theory, the most significant and dangerous change was the restoration of dear money in 1980.

Since then advanced economies have endured 35 years of high unemployment and severe instability. This finally ended with the global financial crisis of 2007-08 after the greatest expansion of private debts probably in the history of the world – which could no longer be sustained.

As in the 1930s, these debts were the result of easy and dear money.

Unsustainable debts build up when lending is not managed by public authority and loans cannot be repaid. Unpayable debts are more likely under dear rather than cheap money.

The economics profession seeks only to impose the consequent failure of economic activity as the new norm – "secular stagnation". Interest rates are thought merely to *reflect in a passive way,* this dismal outlook, one expected to extend indefinitely into the future. Governments have been and are still required to retrench, to manage low investment, unemployment and political instability within severe constraints, and greatly reduced means.

Keynes is associated merely with those who argue against going too far.

Politicians have the imagination to do no more than to manufacture political capital from the imposition of the economists' retrenchment – fiscal consolidation.

Yet – of course – the retrenchment is resolving nothing. Debt is unresolved. And deflationary forces loom.

An emerging authoritarianism is rationalised as reflecting the ineptitude of western democracy in the wake of this terrible crisis. The immensity of the power of the finance sector is not contested to any material extent – by both progressive and reactionary forces in society.

5. Keynes today

The power of Keynes's ideas is of a scale that has no precedent.

The associated threat to vested interests is obvious.

To understand properly the *General Theory* is to recognise the genuine possibility of a profoundly better world – both for this generation, but also for our grandchildren. The fact that the General Theory is not recognised – or even taught here in Cambridge – tells us more about today's economists, than about Keynes's stature as one of Britain's great geniuses – on a par with Darwin.

For as Austin Robinson wrote in the Economic Journal back in 1972:

> "If in the process of reappraisal Keynes does not emerge as a truly great man, something, let me repeat, will have gone sadly wrong with the criteria of greatness".

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