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Monetarism for Beginners

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At the centre of the rows that have been taking place in the Tory cabinet in recent weeks has been the question of monetarism. This has been the approach underlying government economic policy since the Labour Government abandoned the mildest of its manifesto promises back in 1976 and especially since the Tory victory last year. Yet the increasingly parlous state of the British economy – revealed in the worst ever forecast for Britain by the intergovernmental agency, the OECD – has begun to put a big question mark over the monetarist approach in some ruling class circles. Callaghan and

Healey – ever wining to forget in opposition that which they themselves did in power – have leapt in to-blame all evils en ‘punk monetarism’. But deeper issues are involved. *Chris Harman* looks at some of them, and suggests the direction in which things might go.

What is Monetarism?

> The basic argument is very crude and very simple: the price of things is determined by the amount of money divided by the amount of goods. If the amount of money rises, then the price of all goods must rise accordingly. Prices are in fact going up in Britain today; therefore the responsibility must lie with successive governments for creating too much money.

The monetarist argument is by no means new: known as the ‘quantity theory of money’ it has existed for at least 200 years. It has always been subject to criticism from non-monetarist economists, of both the bourgeois and the Marxist kind.

The central point the critics make is that an increase in the amount of money may be a *result* of price rises occasioned by other factors, *not the cause*.

They point out that it is possible for prices to rise even if no increase in the amount of money takes place. This will occur if some firms have the muscle to push up their prices (because of a monopolistic position). A refusal to increase the supply of money will not stop that. It will merely force

weaker, non-monopolistic firms out of business, since they will not be able to increase their prices, but will still have to pay more for what they buy from monopolistic firms.

The result will be a recession, with a fall in the amount of goods produced. Unless the supply of money is actually cut, there can be a rise in the average price of goods – since there are fewer goods with the same amount of money. But cutting the supply of money to stop further price rises will only lead to more bankruptcies, a deeper recession, a still smaller supply of goods, and higher prices.

The economic crisis will be made worse, without necessarily there being any end to inflationary pressures.

This was one of the points Marx made about the monetarist measures of the Bank of England, writing in the 1850s (in the **New York Tribune**) and the 1860s (in **Capital**, vol.III).

It was a criticism repeated (without any acknowledgement to Marx) by Keynes writing in the 1930s.

The monetarist retort has always been that it has only been 'imperfections' in the market that has prevented a reduction in the supply of money having the required affect. If there was 'real' competition, it would not be possible for firms to keep up their prices. Above all, without 'trade union monopolies' any unemployment caused by the beginnings of a recession would cure itself by forcing down wages until firms could afford to take on more workers.

The argument lost favour in the 1930s, when the scale of the crisis threatened fascism on the one side, social revolution on the other. 'Keynesianism' came into vogue with the Second World War and massive government intervention in the economy. By the 1950s the orthodoxy preached by nearly all apologists for capitalism – whether on the Labour left or the Tory right – was that the only

reason there had been a great slump between the wars was that politicians had not understood what was wrong with the old theories.

Instead of cutting back the supply of money in a crisis, it was said, governments should have increased their spending. Any increase in the money supply would not matter, since it would go to providing a market for goods which would otherwise not have been produced. Workers who would otherwise have been unemployed would get wage packets and spend them on buying things – and that would mean more employment for other workers and more output. There would be more goods as well as more money, and so prices need not rise. Only if full employment already existed would an increase in the amount of money be unable to cause an increase in output and instead cause a rise in prices.

The Collapse of Keynesianism

> The orthodoxy collapsed in the 1970s. Suddenly both inflation and unemployment were increasing throughout the world, and Keynesian remedies could do nothing about it.

The American economist Milton Friedman had revived the quantity theory of money some years before. Now he came into his own.

Friedman insisted that there was a 'natural level of unemployment'. Government spending based upon an increased money supply could not cut this for more than a short period of time, and in the long term could only lead to higher prices. Inflation would get continually worse, as people began to assume that the amount of money would

continually rise. Their ‘expectations of inflation’ would mean that the same ‘natural level of unemployment’ was accompanied by ever higher price levels.

To stop inflation, governments had to make the money supply grow more slowly than prices.

In the short term this would, as the Keynesians argued, mean that all goods could not be sold and that unemployment would rise above its ‘natural level. But over time firms and workers would be forced by harsh competitive pressures to end price and wage rises, and the ‘natural level of unemployment’ would be restored.

The intervening period of harshness was the price that had to be paid for ignoring market forces in the past and having too low a level of unemployment. The answer to it was not to back away from monetarism, but to reinforce it with government measures against ‘monopoly’ – in particular to-end ‘trade union monopolies’, to do away with things which impeded the free flow of the labour market (like reasonable levels of unemployment pay) and to curtail the government’s own ‘interference’ with the market via controls and subsidies.

The theory was seized upon by governments that had tried Keynesian methods and failed.

But the monetarist argument had obvious deficiencies. It could hardly explain a situation in which unemployment doubled but inflation was hardly affected. To fill the gap in the argument the monetarists had to introduce the peculiar notion that the ‘natural rate of unemployment’ was growing. They claimed it was attempts by governments to stop this ‘natural’ process by keeping unemployment ‘artificially’ down to the old level that had pushed up prices.

In practical terms the pursuit of monetarist policies has created problems from a capitalist point of view. Remember

the basic anti-monetarist objection (outlined earlier) that preventing a rise in the money supply will not hit the most powerful firms, who will raise their prices anyway, but the less powerful firms who cannot, and that as these are forced to the wall, the economy will contract without price rises necessarily stopping.

On the face of it, that has been the effect of the measures of the last few years. Inflation is as bad as ever. Restraints on the money supply have reduced the funds available for borrowing, forcing up interest rates. These would only fall if government spending was slashed much further, forcing the whole economy to produce less.

The proponents of monetarism are forced into the position of asking big business to grin and bear a tight squeeze on its markets, its cash reserves and its profits, until the medicine works – but that will take three years if you are to believe Biffen, ten years if you are to believe Howe.

Why Monetarism Fails

> If monetarism has any justification, it lies in the historical development of capitalism. In its youth the system could flourish precisely because it was thrown into periodic crises. These wiped out the inefficient, out-of-date firms and allowed their more vigorous competitors to flourish at their expense.

It was on this basis that capitalism expanded to embrace the whole world, as ho previous economic system had, in the 100 years between the Napoleonic wars and World War I. That was a time when periods of slump were followed by periods of boom, when unemployment did always seem to

fall again after it had risen, when prices went down after going up.

By destroying individual capitalist firms, the crisis made the system as a whole more efficient, it *rationalised* it.

Monetarism as a theory really argues that the same process of rationalisation has to be allowed free rein today. The elements of inefficiency, stagnation and [2 lines missing in scanned text]

However, monetarism forgets one crucial thing. Capitalism is made up of individual capitalist firms, some of which are very seriously hurt – indeed, destroyed – by the process of capitalist rationalisation. And the older capitalism gets, the more anything that hurts any one of. the major firms in any country hurts many of the others as well.

In the US today the 200 largest firms control 58.8 per cent of the market. In Britain the largest 100 companies control 42 per cent – twice as much as they did in 1950 and nearly three times as much as in 1910. This means that if any one large firm is forced to go bankrupt, many of the others suffer seriously.

Take the case of British Leyland. The company is too small and its level of investment is far too meagre for it to survive if measured by the standards of competition in world markets. Ford, General Motors, Peugeot PSA, Renault, Volkswagen, Chrysler US, Toyota, all produce more than twice as many cars as Leyland. Yet some of these are losing money, and they all expect to have difficulties surviving unless they are producing more than two million cars a year based on integrated production in half a dozen or more countries. If capitalist rationalisation of the world car industry is to take place, BL should simply close down.

But that would make major sections of British capitalism unhappy. Very large and very profitable firms depend for a

sizeable portion of their profits on components they make for Leyland. When politicians observe that as well as the 160,000 workers directly employed by Leyland, there are another half a million indirectly dependent on it, they are measuring as much the effect on *profits* of closing the company as the effect on jobs.

> 'The stock market still tends to think of GKN as a British company which is over-dependent on the British motor industry. In particular, each new crisis at BL can be expected to knock a few pennies off GKN's share price.' (**FT**, 29.2.80)

> Capitalism as a world system might benefit from the collapse of BL. But that does not mean that the individual capitalists who run most of British industry would.

Monetarism might provide a nice rallying cry for a country's capitalists when it comes to shifting the burden of taxation from themselves to their workers, to cutting welfare expenditure or to trimming their least profitable operations. But it is not something they are going to allow to destroy basic national industries like steel or motors or chemicals or even textiles. Yet for it to work as a remedy for the ills of the world system, such wholesale destruction is now necessary.

Even the most right wing employers can begin to worry that monetarism might wipe out not just the weak and the inefficient, but also the industrial core of British capitalism. When the Treasury forecast in October that 'motor vehicle production will fall by 21 per cent by 1983, mechanical engineering by 23 per cent and 'other materials' by nearly 25 per cent', the **Financial Times** could report:

> 'Leading people in the industry have been sufficiently disturbed to seek some explanation from the Treasury. Their feeling is that such a radical decline in these major industries must call for the introduction of new policies by the

government.'

Towards Import Controls?

> Against this background, it is hardly surprising that there is a groping in both political and business circles towards some non-monetarist approach which promises an easy answer to the crisis.

Among the older generation of Tory politicians – those who developed politically during the Macmillan era – that means falling back into *ad hoc* adoptions of Keynesian type measures: state aid to failing industries, blunting the severity of the public sector cuts, looking to collaboration with the trade union bureaucracy to pressure down workers' living standards.

But as an alternative Keynesianism by itself cannot be very convincing. It has already been tried and failed. That is why the growing fashion is to try to tart it up with something new: the call for import controls.

The pioneers intellectually of this approach have been the group of Cambridge academic economists, the Economic Policy Study Group. For several years the group has been arguing that the British economy's fundamental problem is the way in which imports flood in the moment there is any economic expansion. The result, over decades, has been a slower rate of growth than that of its main competitors, which in turn means lower investment, lower productivity, lower competitiveness, and an even greater tendency for imports to zoom if the economy is allowed to expand even a little.

The way out of the impasse argue the Cambridge group, is for government intervention to 'restructure' Britain's trade.

Otherwise, Britain's industrial decline will accelerate and 'in the 1980s when North Sea oil benefits level off ... unemployment would rise to 2½-3½ million and inflation would be in the 15 to 20 per cent range ...'

Because import controls were taken up very early on by the Labour left and other proponents of the 'alternative economic strategy', the Cambridge arguments are often seen as fundamentally left wing.

In fact, they are designed to have a much wider appeal than that. Like the Keynesianism of the 1930s they aim to draw together all those who dream of a way out of the present crisis which avoids the extremes of socialist revolution on the one side and bloody reaction on the other.

They claim that all classes will benefit if their policies are implemented. Their 1977 **Review** suggested that their policies would achieve by the mid-1980s 'full employment' (800,000 unemployed), average increases in real take home pay of a third, and a rise of nearly 80 per cent in 'income from property and self employment'. The 1979 **Review** promised 'benefits for productivity, profits, and the Public Sector Borrowing Requirement'.

Such arguments have already begun to win over other economists of a decidedly establishment hue, like Wilfred Beckerman and Andrew Schonfield. It cannot be long before right wing Labour politicians begin to move in the same direction. Right wing union leaders like Frank Chapple already call for them. And a few months ago right wing Labour MP Giles Radice let slip that he thought he and his co-thinkers would have to refurbish their image 'by stealing Benn's clothes on import controls'.

However, the most important development in recent months has been the way in which influential, if not yet decisive, sections of big business have begun to move in the same direction.

The leaders of the CBI were unable, at their annual conference, to prevent the passing, narrowly, of a resolution implying import controls. Since then the pressure has grown, as section after section of big business has felt imports hit its sales and profits.

The giant chemical firms like ICI and Unilever have been asking for action at the EEC level to reduce imports of substances like styrene from the US. The textile firms want restrictions to be similarly applied. The footwear manufacturers are demanding prompt government action against imports. And even Michael Edwardes of Leyland has made 'efforts to persuade the government-to take action against "unfair competition in world markets".' (**FT**, 26.2.80).

The government has not been able to avoid heeding these voices, despite its public commitment to 'non-intervention' and 'free trade'. The trade secretary, John Nott, recently told the NEDC, of 'the range of import restrictions already in place for steel, textiles, footwear, and consumer electronics which the government has been stacking up since May'. (**Economist**, 9.2.80)

It is hardly surprising that some commentators reckon the first U-turn the government will make will be back to the protectionism that characterised the Tory Party for the first third of this century.

The Contradictions in the Import Control Strategy

For all their growing popularity, on both the left and the right, import controls are no more capable of

leading British capitalism out of the present crisis than are monetarism and Keynesianism.

Modern capitalism has an inherently contradictory relationship with national boundaries. On the one hand, the great firms have most of their production facilities within single states and rely upon the forces of those states to protect their interests against either workers or other capitalists. On the other hand, the same firms increasingly look towards world markets and a world organisation of production. Moves towards import controls by any state can bolster up the national economic base of its great firms; but they can also threaten to disrupt those firms' moves to an international organisation of production and sales.

Hence the proponents of import controls are by no means united on what sort of controls should be imposed and who they should be directed against. The Cambridge group want 'general controls'. The 'Alternative Economic Strategy' usually talks of 'selective' controls. Benn has said in a recent TV interview he wants only to protect new, 'fledgling' industries, not 'inefficient', 'ageing' ones. Trade union advocates of import controls are usually more worried about the destruction precisely of the older industries and the devastation of the lives of the workers in them. The Cambridge group propose controls imposed by both the US and Britain against Japan and Europe. Much of big business wants controls imposed jointly with Europe against America and the Third World.

Above all, there is the problem of what the impact of import controls will be on the international economy. The Cambridge group claim that import controls by Britain will not provoke the sort of retaliatory action from other countries that broke the world into rival trading blocks between the wars and made the economic crisis still deeper. Instead, they argue that the whole world suffers from a

‘structural imbalance’, that means a Japanese and German surplus on trade and an American and British deficit. The whole world would benefit if Britain and America restricted imports and therefore there would be no retaliation from Europe or Japan.

Such arguments are fantastically naive, at a time when there are continual wrangles between the Americans on the one side, and the Japanese and the Europeans on the other, as the Americans try to keep out European and Japanese steel, while the Europeans try to keep out American textiles and chemicals. Already there are warnings of the dangers of a trade war over steel or textiles. The notion that the Europeans and the Japanese would simply sit back, contentedly, while the US (or Britain) imposed rigorous general import controls is nothing more than a rejigged version of the fallacy that the world economy is a harmonious structure.

Far from import controls leading to a peaceful way out of crisis for the whole world, they could only serve to intensify the problems of certain British firms to the advantage of others, while deepening the contradictions within the world market and the scope of the world economic crisis.

There is one, limited way, however, in which the ideology of import controls could help British capitalism: if it served to tie workers to the system while its problems were solved at their expense – if, in other words, it was to provide the basis for a new social contract even less costly to British capitalism than the last one.