

EDITED BY

JON S. COHEN & G.C. HARCOURT

INTERNATIONAL MONETARY PROBLEMS AND SUPPLY-SIDE ECONOMICS

THE OTHER CONTRIBUTORS

SUSAN HOWSON

RONALD I. McKINNON

D.E. MOGGRIDGE

WALTER S. SALANT

TIBOR SCITOVSKY

MICHAEL M. WEINSTEIN

PAUL WELLS

International Monetary Problems and Supply-Side Economics

Essays in Honour of Lorie Tarshis

Edited by
Jon S. Cohen
*Professor of Economics,
University of Toronto*

and

G. C. Harcourt
*University Lecturer in Economics and Politics,
University of Cambridge, and Fellow and College Lecturer in
Economics, Jesus College, Cambridge*

M
MACMILLAN
PRESS

© Jon S. Cohen and G. C. Harcourt 1986

All rights reserved. No reproduction, copy or transmission of this publication may be made without written permission.

No paragraph of this publication may be reproduced, copied or transmitted save with written permission or in accordance with the provisions of the Copyright Act 1956 (as amended).

Any person who does any unauthorised act in relation to this publication may be liable to criminal prosecution and civil claims for damages.

First published 1986

Published by
THE MACMILLAN PRESS LTD
Houndmills, Basingstoke, Hampshire RG21 2XS
and London
Companies and representatives
throughout the world

Printed in Hong Kong

British Library Cataloguing in Publication Data
International monetary problems and supply-
side economics: essays in honour of Lorie
Tarshis.

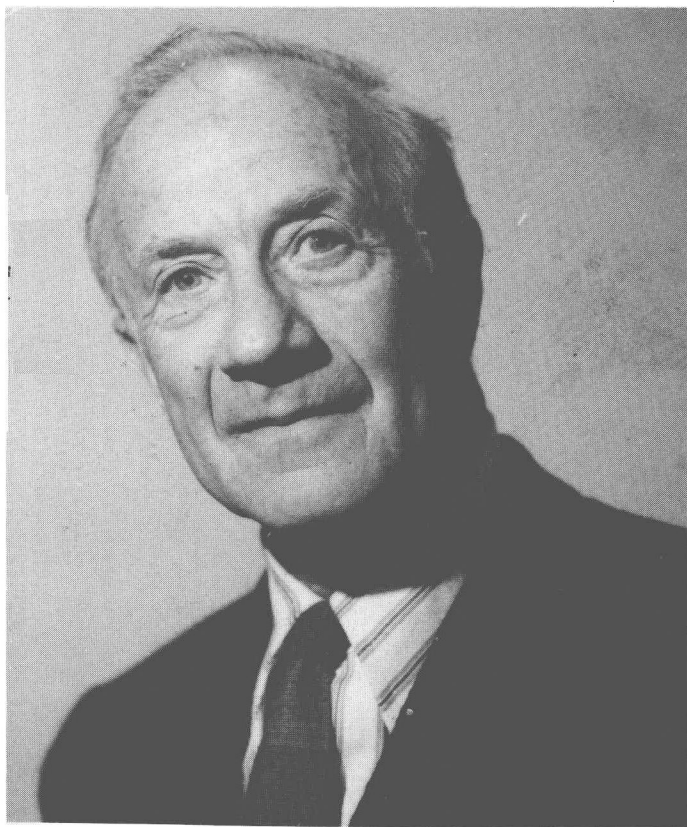
1. International finance 2. Supply-side
economics

I. Tarshis, Lorie II. Cohen, Jon S.

III. Harcourt, G. C.

332.4'5 HG3881

ISBN 0-333-36200-4



Lorie Tarshis

Notes on the Contributors

Jon S. Cohen is Professor of Economics at the University of Toronto. He is a specialist in modern European economic history and has published widely in this area and on contemporary problems in the Canadian economy.

G. C. Harcourt is University Lecturer in Economics and Politics at the University of Cambridge and Fellow and College Lecturer in Economics at Jesus College, Cambridge. He taught for many years at the University of Adelaide. His books include *Some Cambridge Controversies in the Theory of Capital*; *The Social Science Imperialists: Selected Essays*; and *Keynes and his Contemporaries* (editor).

Susan Howson is Associate Professor of Economics at the University of Toronto. On leave from the university from 1979 to 1981, she worked as a research economist in the International Division of the Bank of England. Her publications include *Domestic Monetary Management in Britain 1919–1938* and, with Donald Winch, *The Economic Advisory Council 1930–1939*. She is currently researching British monetary policy, 1947–1951.

Ronald McKinnon is William Eberle Professor of Economics at Stanford University. His publications include *Money and Capital in Economic Development*; *Money in International Exchange: the Convertible Currency System*; and *An International Standard for Monetary Stabilization*.

D. E. Moggridge is Professor of Economics at the University of Toronto. His most recent work is the editing of *The collected writings of John Maynard Keynes* for the Royal Economic Society. He is currently editing the diaries of James Meade and Lionel Robbins.

Walter S. Salant is a Senior Fellow Emeritus in the Economic Studies Program of the Brookings Institution. Before joining the Brookings staff in 1954 he was an economist in several agencies of the US Government, including, during the Second World War, the Office of Price Administration and, as Economic Advisor, the Office of Economic Stabilization, the Price Decontrol Board, and in 1946 the newly

formed Council of Economic Advisors. He has taught at Harvard and Stanford Universities. Most of his research and writings have been devoted to international economics and macroeconomic theory.

Tibor Scitovsky is Eberle Professor of Economic Emeritus at Stanford University, Stanford, California, distinguished fellow, American Economic Association, member, American Academy of Arts and Sciences, corresponding fellow, The British Academy. His most recent book is *The Joyless Economy*.

Michael M. Weinstein chairs the Economics Department at Haverford College. His publications include *Recovery and Redistribution Under the NIRA*, a history of part of the New Deal. He serves as an economic analyst for public radio, as a columnist and editorial writer for Philadelphia newspapers, and as a consultant to the Pennsylvania Economy League and other non-profit research organisations and neighbourhood development agencies.

Paul Wells is Professor of Economics at the University of Illinois, Champaign-Urbana. He is a member of the board of editors of the *Journal of Post-Keynesian Economics* and has published one book and a number of articles in macroeconomic theory.

INTERNATIONAL MONETARY PROBLEMS AND SUPPLY-SIDE ECONOMICS

Also by Jon S. Cohen

FINANCE AND INDUSTRIALIZATION IN ITALY, 1894—1914

Also by G. C. Harcourt

ECONOMIC ACTIVITY (*with P. H. Karmel and R. H. Wallace*)
**SOME CAMBRIDGE CONTROVERSIES IN THE THEORY OF
CAPITAL**

**THE MICROECONOMIC FOUNDATIONS OF
MACROECONOMICS** (*editor*)

THE SOCIAL SCIENCE IMPERIALISTS: Selected Essays (*edited
by Prue Kerr*)

KEYNES AND HIS CONTEMPORARIES (*editor*)

**CONTROVERSIES IN POLITICAL ECONOMY: Selected Essays
of G. C. Harcourt** (*edited by O. F. Hamouda*)

Contents

<i>Notes on the Contributors</i>	vii
1 Introduction <i>Jon S. Cohen and G. C. Harcourt</i>	1
2 'Mr Churchill' and the <i>General Theory</i> <i>Paul Wells</i>	8
3 Foreign Exchange Dealers, the Domestic Money Market, and Stabilising Speculation <i>Ronald I. McKinnon</i>	28
4 Keynes and the International Monetary System, 1909–46 <i>D. E. Moggridge</i>	56
5 External Financial Markets, Capital Mobility and Monetary Independence <i>Susan Howson</i>	34
6 A Critical Look at Supply-side Theory and a Brief Look at Some of its International Aspects <i>Walter S. Salant</i>	108
7 Why the US Saving Rate is Low – A Conflict between the National Accountant's and the Individual Saver's Perceptions <i>Tibor Scitovsky</i>	125
8 Industrial Planning and Economic Policy-Making: Lessons from the 1930s <i>Michael M. Weinstein</i>	135
<i>Index</i>	159

1 Introduction

Jon S. Cohen and G. C. Harcourt

All those who are associated with this volume are friends and many have been pupils and/or colleagues of Lorie Tarshis, in whose honour the volume was conceived. The subjects of the essays relate to issues with which Lorie himself has been concerned during his working life – which still continues vigorously. He is currently Chair of the Economics Department of Glendon College of York University in Toronto.

Lorie Tarshis is an original and eminent Keynesian economist. He was introduced to the works of Keynes, principally the *Treatise*, as an undergraduate at the University of Toronto by Wynne Plumptre and Vincent Bladen. In the early 1930s, as an affiliated student reading for the Economics Tripos at Cambridge, he went to Keynes's lectures on what was to become the *General Theory*. Lorie has always worked on issues which were close to Keynes's heart too – theories of employment and inflation, (Lorie was to add new micro-foundations and a theory of distribution), international monetary matters and the appropriate policies with which to deal with macroeconomic problems in democratic capitalist economies. Thus Lorie's PhD dissertation, Tarshis 1939, was in essence a macro theory of distribution which incorporated the theories of imperfect competition and the short period analysis of Joan Robinson and Richard Kahn, together with empirical support from US experience. He wrote the first Keynesian textbook for North America (Tarshis, 1947) and his most recent book, *World Economy in Crisis: Unemployment, Inflation and International Debt* (Tarshis, 1984), brings together all these themes in an up-to-date analysis of some of our most pressing problems, together with a set of down-to-earth, sensible policy proposals with which to tackle them. (For an account of Lorie's career see Harcourt (1982, Essay 23). In the appendix to this introduction we list his education, appointments, war service, and selected publications.)

The essays in this volume cluster around Lorie Tarshis's principal concerns. Some relate to historical episodes but all search for relevance to modern pressing problems, in the spirit of Lorie's mentor, Keynes, and of Lorie himself. Thus, Paul Wells returns to a small Keynes masterpiece, *The Economic Consequences of Mr Churchill* (1925), a work which illustrates well the ability of Keynes to make up theory on

the spot as new economic problems arose. Wells wonders why Keynes felt that he had such a struggle to escape from old ideas when he so excelled at inventing new ones! Moreover, Keynes's account of how to cope with an over-valued exchange rate, and especially of how to avoid its impact on employment, has an all too modern ring about it.

So, too, does Ronald McKinnon's essay on foreign exchange dealers, the domestic money market and stabilising speculation. McKinnon points out that the foreign exchange market cannot be treated as if it were a market for any ordinary flexibly priced commodity such as wheat or copper. The value of a country's foreign exchange is jointly determined in national and foreign money markets. Dealers in these markets may be classified into merchants who deal in goods and services (which often have fix price characteristics), and professional speculators – mainly the foreign exchange departments of large commercial banks – who are interested in the balance in their portfolios between domestic and foreign monies. McKinnon argues that a market made up of merchants alone would be unstable and that, even if there are speculators, very special conditions have to be met before transitory fluctuations of a financial nature can be removed to allow the exchange rate to exhibit the underlying trends in trade and productive capital movements – a sobering conclusion which has been borne out by the events of recent years.

Susan Howson and Donald Moggridge contribute two essays on aspects of the international monetary system. Drawing on his unrivalled – and remarkable – knowledge of Keynes's works, Moggridge examines Keynes's views on the international monetary system, its workings and its reforms, and its relation to domestic policies, from the earliest times to his last article, 'The Balance of Payments of the United States', which was published after his death. Moggridge uses a classification which was adopted by Williamson (1977), in order to put a structure on Keynes's huge output on these issues. Not surprisingly, Moggridge is able to document the development and change of Keynes's views, but also their continuity – especially in the attempts to devise 'a scientific management of the central controls ... of our economic life' (Keynes, CW vol. 6, p. 302). Perhaps most of all, an aim which is of vital relevance today, was 'the effort to combine an international system with the maximum of monetary independence.'

Susan Howson addresses an even more topical and pressing problem (one which has given Lorie Tarshis many sleepless nights (see Harcourt, 1982, p. 374)): the rise of external financial markets (the euro-currency markets) and whether the increased international mobility of

short-term capital – what we used in Australia to call ‘hot’ money – ‘makes it impossible for small open economies to pursue independent monetary policies’. The emergence of floating exchange-rate regimes, especially of free as opposed to dirty or managed floats, has served both to complicate matters and to make them more pressing. While Howson’s essay is relatively optimistic in tone, she does not underestimate the tasks facing central bankers (the essay itself was originally drafted when Howson was working at the Bank of England) and she does suggest that the control of monetary aggregates (as opposed to interest rates) may be neither possible nor desirable in a regime of managed floating exchange rates. Dennis Robertson, if not Keynes, would certainly have applauded.

Walter Salant, who has known Lorie since the 1930s, writes on two interrelated topics which are of great interest and urgency to Lorie: the claims of supply side economics to increase employment and reduce inflation, together with a consideration of the international aspects of the analysis and its claims. Salant is in the Keynesian mould (when Keynes criticised the argument of an opponent, especially its premises) when he writes: ‘I . . . think it is illuminating to make explicit every link in the chain of reasoning connecting . . . premises and . . . policy conclusions and then to examine all of those links.’ By introducing the vital dimensions of orders of magnitude and lengths of time of supply side effects, which aspects are conspicuous by their absence in the arguments of their proponents, Salant restores a welcome sense of perspective and relevance to an influential but basically rather silly discussion of recent years.

When the young Tarshis went to Keynes’s lectures in the early 1930s, he noted that much of them were taken up with definitions, the search for precise and rigorous units of measurement and the like, the necessary preliminary tasks by which Keynes sorted out his own mind and provided himself with the apparatus of his new theory. The emphasis which Keynes put on the definitions of saving and investment, and on the distinction between the gross and the net versions of these categories, is well known. Both Keynes and Lorie would therefore welcome the essay by Tibor Scitovsky who, in the context of the concern in recent years about the decline in the personal saving ratio in the United States (and other countries), returns again to the meaning of gross and net personal saving, in order to see whether we have a statistical illusion due to a particular definition or whether we are observing a real phenomenon. Scitovsky argues for the first interpretation, adding that while his is ‘a somewhat technical paper about

national income accounting, . . . the subject is of interest to Lorie – indeed, the danger is that he too will stumble or has already stumbled on the same argument.’

Michael Weinstein contributes a vigorously argued case that job impact statements should always accompany industrial policy legislation so that the diffused costs amongst the relatively powerless may be set against the benefits for the few and the powerful. As well as setting out the theoretical arguments for this institutional reform, Weinstein draws on his previous research into the costs and benefits of the National Industrial Recovery Act of the 1930s, ‘the most ambitious exercise in industrial planning ever attempted in the United States,’ in order to provide compelling historical and empirical support for his arguments. He shows that while certain groups of lower paid workers did benefit overall from the NIRA’s provisions it was still the politically powerful, both firms and labour groups, who benefited most while ‘low-paid entrants to the labour force, . . . small unorganised firms . . . [and] consumers lost.’ Moreover, he argues, it remains the politically weak who are the ‘invisible losers’ today from legislation because job impact statements are not required before legislation is debated and implemented.

One of us (G.C.H.) concluded a 1982 portrait of Lorie Tarshis (Harcourt, 1982, p. 375), as follows:

Through students and colleagues, the essential soundness of Keynes’ message and approach has been imparted in the United States and Canada, quietly and unobtrusively but with conviction and persuasion, not least by Lorie Tarshis. He reserves his ire, his anger and scorn, which can be withering, for the stupid and the insensitive and the inhumane, who, failing to see the soundness of the approach, unwittingly push capitalism toward the abyss from which Keynes tried to rescue it well over forty years ago. I suppose the acid test for Lorie is whether you think that, in this world of ours, causality runs from employment to the real wage, or vice versa. If you think the former, you share his ‘vision’ and may enjoy the privilege of his friendship and concerned companionship.

We hope that Lorie will see in these essays a tribute to what he has quietly, unobtrusively but with conviction and persuasion, tried to impart.

REFERENCES

- HARCOURT, G. C. (1982) *The Social Science Imperialists: Selected Essays*. Edited by Prue Kerr (London: Routledge & Kegan Paul).
- KEYNES, J. M. (1971, 1972), *The Collected Writings of John Maynard Keynes*, vols 6, 9, ed. D. E. Moggridge and E. Johnson (London: Macmillan).
- TARSHIS, L. (1939) 'The Determinants of Labour Income', unpublished PhD dissertation (Cambridge: Cambridge University Library).
- TARSHIS, L. (1947), *The Elements of Economics. An Introduction to the Theory of Price and Employment* (Boston: Houghton Mifflin).
- TARSHIS, L. (1984), *World Economy in Crisis. Unemployment, Inflation and International Debt* (Canadian Institute for Economic Policy, Toronto: James Lorimer).
- WILLIAMSON, J. (1977), *The Failure of World Monetary Reform, 1971-74* (Sunbury-on-Thames: Nelson).

APPENDIX

Lorie Tarshis

- Born:** 22 March, 1911; Toronto, Ontario, Canada.
- Education:** University of Toronto
B. Comm. 1932
Trinity College, University of Cambridge
BA 1934
MA 1938
PhD 1939
- Academic posts:** Tufts College
Instructor, 1936-39
Assistant Professor, 1942-46
Carnegie Fellow, National Bureau of Economic Research, 1939-40
Stanford University
Assistant Professor, Associate Professor, and Full Professor, 1946-71
University of Toronto, Scarborough College, 1971-78.
Professor of Economics and Chairman, Division of Social Sciences, 1971-75
York University
Lecturer and member, Graduate Faculty, 1980-84.
Glendon College, Lecturer, 1982-84
Chair, 1984-
- War service:** War Production Board, 1942-43
Operations Analyst, US Air Force, 1943-45
Ninth Bomber Command, Libya, 1943
Twelfth Bomber Command, Tunisia, 1943
Fifteenth Air Force, Italy, 1944-45

Selected publications

- 'A Note on the Elasticity of Substitution', *Review of Economic Studies*, vol. 1, nos 1-3, 1933-34, pp. 144-47.
- 'Real Wages in the United States and Great Britain', *Canadian Journal of Economics and Political Science*, vol. 4, no. 3 (Aug 1938), pp. 362-76.
- An Economic Program for American Democracy* by Seven Harvard and Tufts Economists (Harvard: Vanguard Press, 1938).
- 'Changes in Money Wages and Employment', *American Economic Review, Papers and Proceedings*, vol. 28, no. 1 (March 1938), pp. 157-59.
- 'Changes in Money and Real Wages', *Economic Journal*, vol. 49, no. 193 (March 1939), pp. 150-54.
- The Elements of Economics: An Introduction to the Theory of Price and Employment* (Boston: Houghton Mifflin, 1947).
- 'An Exposition of Keynesian Economics', *American Economic Review*, vol. 38, no. 1 (May 1948), pp. 261-91.
- T. Scitovsky, E. S. Shaw and L. Tarshis, *Mobilizing Resources for War, The Economic Alternatives* (New York: McGraw-Hill, 1951).
- Introduction to International Trade and Finance* (New York: Wiley; London: Chapman & Hall, 1955).
- 'Price Ratios and International Trade; An Empirical and Analytical Survey' in M. Abramovitz et al. (eds) *The Allocation of Economic Resources, Essays in Honour of Bernard Francis Haley* (Stanford: Stanford University Press, 1959), pp. 237-44.
- 'The Optimum Size of a Country from the Standpoint of Economic Stability' in E. A. G. Robinson (ed.), *Economic Consequences of the Size of Nations* (London: Macmillan for International Economic Association, 1960), pp. 190-200.
- 'The Elasticity of the Marginal Efficiency Function', *American Economic Review*, vol. 51, no. 5 (December 1961), pp. 958-85.
- 'Retained Earnings and Investment' in K. Kurihara (ed.), *Post-Keynesian Economics* (London: Allen & Unwin, 1962), pp. 365-88.
- The US Balance of Payments in 1968*, W. S. Salant, E. Depres, L. Tarshis (eds) (Washington: Brookings Institution, 1963).
- 'Optimal Budgeting Practices' (prepared for Stanford University, adopted in Considerable Part), 1965.
- Modern Economics; An Introduction* (Boston: Houghton Mifflin, 1967).
- 'International Mobility and Movement of Capital', F. Machlup, W. S. Salant, L. Tarshis (eds), *NBER*, no. 24, New York, 1972.
- 'The Dollar Standard' in P. A. David, M. W. Reder (eds), *Nations and Households in Economic Growth* (New York: McGraw-Hill, 1974).
- 'The Aggregate Supply Function in Keynes's *General Theory*', in Michael J. Boskin, *Economics and Human Welfare, Essays in Honour of Tibor Scitovsky* (New York: Academic Press, 1979).
- 'The Macroeconomic Effects of OPEC's Price Hikes', Ontario Economic Council, Proceedings of a Conference on Energy Policies, 1979.
- 'Post-Keynesian Economics: A Promise that Bounced?', *American Economic Review, Papers and Proceedings*, Vol. 70, no. 2 (May 1980), pp. 10-15.

'A Macroeconomic Analysis of Stagflation', Ontario Economic Council's Conference on Stagflation: Focus on Supply, 1981.

World Economy in Crisis: Unemployment, Inflation and International Debt (Canadian Institute for Economic Policy, Toronto: James Lorimer, 1984).

2 ‘Mr Churchill’ and the *General Theory*¹

Paul Wells

INTRODUCTION

In a handsomely written paper which opens with an attractive sketch of Keynes as a teacher and closes with a succinct preview of his meticulous study of Keynes's aggregate supply function, Lorie Tarshis (1978, pp. 48–63) questions the practice of using hindsight to read too much significance into the words of earlier writers. Despite this sound advice from my teacher and friend, I propose to jump straight into Keynes's celebrated essay ‘The Economic Consequences of Mr Churchill’ and bring to light a number of rather important theoretical innovations which he first developed in this essay and subsequently refined and wove into the core of his *General Theory*.

Keynes's *Essays in Persuasion*, ‘the croakings of a Cassandra who could never influence the course of events in time’ (CW vol. 9, p. xvii)² are perfect models of literary art and inventive economics. The surprisingly modern and prescient nature of these pre-*General Theory* essays, most of which were written in the 1920's, can easily be seen in his ‘Social Consequences of Changes in the Value of Money’, ‘Can Lloyd George do It?’ (jointly written with Hubert Henderson) and ‘The Consequences to the Banks of the Collapse of Money Values’, to name a few. But it is his ‘Mr Churchill’ which best illustrates Keynes's inventive mind at work in concert with his marvellously assured grasp of the real world, of institutions and human behaviour. To read ‘Mr Churchill’ today is to be delighted by his cool (at times hot) dissection of ‘one of the most contentious acts of economic policy in English history’ (Pollard, 1970, p. vii); it is to be surprised by the profound and lasting value of the several analytical contributions this one brief work made at that rather early date.

In the preface to his *General Theory*, Keynes wrote that ‘The composition of this book has been for the author a long struggle of escape ... a struggle of escape from habitual modes of thought and expression’ (CW vol. 7, p. xxiii). The *Essays in Persuasion*, however,