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ECONOMICS IN THE CENTURY AHEAD

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To speak of the prospect for economics in the century ahead – in the next hundred years of this Journal – requires, along, no doubt, with a possibly excessive self-confidence, a fundamental decision. Are we concerned with a science or subject matter that is essentially static? Does economics explore and serve human motivations, aspirations and institutions that are ultimately constant? Does the subject change only as its unchanging context is more deeply explored and understood? Is there change only, or anyhow primarily, as the result of increasingly precise and technically more elegant examination and exposition?

Or, on the contrary, are we dealing with a subject matter that is in a constant state of transformation? Is the ultimate economic motivation subject to change? And, more particularly, are the economic institutions through which it is expressed and served also in process of change? If this last is the case, there is an inescapable need for continuing modification in content and conclusions and, needless to say, in the guidance that economists presume to offer both to individuals and to governing authority.

It will come as no great surprise that I see economics as in a continuing process of transformation. The other view, admittedly, has a powerful temptation; it assimilates economics to the hard sciences – physics, chemistry, biological sciences. Economists thus live in the universities in no less rigorous intellectual commitment than their fellow scholars. As a practical matter, it also ensures, or seems to ensure, that what is learned as a student or otherwise in early youth will remain relevant for a lifetime. And in scholarly writing and other interchange, since this allows of an infinity of technical refinement within an unchanging context and thus of a relatively objective gradation of professional achievement. For the successful, there is a rewarding sense of superiority as compared with those who have not similarly penetrated the complexities.

But, alas, if the basic subject matter is unstable, the result for those who think otherwise is a commitment to intellectual obsolescence. As regards either understanding or guiding the real economic world, it means increasing irrelevance. Economics that assumes transformation, change, can never be as tidy, secure and elegant as that which assumes and cultivates unchanging verity. It is, nonetheless, the economics to which I find myself committed. It is in this spirit that I contemplate the changes in our subject that are in prospect. The task is made somewhat easier because the circumstances forcing change are already evident. Lagging is the textbook and journal response.

The first of the controlling circumstances concerns the basic producing unit in the economic system. In the microeconomic orthodoxy this continues to be the profit-oriented, profit-maximising entrepreneurial firm which commands directly the capital that it employs. It may be a large limited company or corporation, but that makes no essential difference. It is the 'firm'. Competition is no longer, or anyhow not always, assumed; oligopoly or monopoly is fully admitted but with consequence only as regards price, social efficiency and income distribution.

In fact, as few will deny, the reality is the modern great corporate and management-controlled enterprise. In all mature capitalist countries these account for around two-thirds of nonagricultural production. In this enterprise the controlling management is presumed to maximise returns not on behalf of itself but, in a self-denying way, on behalf of stockholders, i.e. suppliers of capital. These, in the normal case, are both unknown to the managers and without any effective authority as regards the management of the firm.

That the great management-controlled enterprise with its distinctive motivation has not yet been assimilated to accepted microeconomics is, to say the least, bizarre. It is the accommodation by economists for which in the years to come one must most hope. Until then some of the most evident characteristics of the modern economy will continue to go unmentioned and unremarked in contemporary theory.

Thus power, its pursuit and its enjoyment, is a basic and admitted motivation in all corporate organisation. In his recently published memoir (*Father, Son & Co.*, New York: Bantam, 1990) Thomas J. Watson Jr., former head of IBM, says of his life in that notable enterprise, 'I learned a great deal about power, being subject to it, striving for it, inheriting it, wielding it and letting it go.' So much for a single-minded concentration on profit maximisation.

The power so sought and enjoyed is pursued and enjoyed for its own sake. It does not always, perhaps does not normally, serve simple profit maximisation. It may as well serve the scale and prestige of operations. Or the diverse revenues and enjoyments of management. Only as a minor concession to an inconvenient and eccentric voice does this enter into approved economic theory and instruction. Left out of that theory and teaching, in consequence, are some of the most pressing (and damaging) tendencies of modern economic behaviour – the empowered, entrenched and sometimes somnambulant management, corporate raiding, the leveraged buyout as protection, the massive and frequently deleterious substitution of debt for equity, profit maximisation effectively for company executives and their legal and financial allies and acolytes – all unrelated to economic performance and often notably in conflict therewith. None of this, to repeat, which is so evident in everyday observation, is present in accepted microeconomic theory. Can one avoid hoping that in the developing economics of the firm it will play a part and that its insusceptibility to refined theoretical and mathematical method will not bar its consideration? That reality is complex is not a sufficient excuse for failing to deal with the economic world as it is.

Nor is this all. The great enterprises that embrace so large a part of modern economic life are subject to the basic tendencies and constraints of all great organisations – in less engaging language, to the basic tendencies of bureaucracy. These, in turn, can be stolidly in conflict with profit maximisation. Such firms regularly substitute established policy for profit-maximising change; they proliferate personnel, for it is by the number of subordinates that power and prestige are assessed; they measure intelligence according to what most conforms to the intelligence of those making the assessment. From this, then, comes the corporate sclerosis of older business enterprises, the antithesis of effective profit maximisation. In the older capitalist countries, these are matters for everyday observation and comment. On them turns much of the discussion of the effectiveness of national economies. One must hope that in years to come, at whatever inconvenience to formal theory, the view of the firm will be broadened to incorporate what is so evident and important in the experience of our time.

There could be some of my general mood who will disagree with my urging and my hope. They will say that were many, perhaps a majority, of economists not attracted to technically fascinating irrelevancies and thus rendered silent, too many voices would be heard on public policy. And the voices of those of us who do so speak would be lost in the din. My answer, proffered in what, I trust, is a characteristically generous way, is that this is a risk we should run.

I have referred to microeconomics. I would hope that in the century ahead the present sharp dichotomy as between microeconomics and macroeconomics would blur and disappear. Microeconomic interaction between prices and wages has been an urgent cause of inflation. This has been suppressed in practice either by restraint in negotiation or formal public action, i.e. a passive or deliberate incomes policy, or by a socially aggressive macroeconomic policy operating through unemployment and weakened trade union (and employer) power. It is implicit in much established theory that only macroeconomic action – monetary and fiscal restraint – accords with the basic principles of the market system. Only this is relevant macroeconomic policy. This limitation on thought I hope to see abandoned. The stark separation of microeconomics from macroeconomics in its bearing on public policy stands as one of the more damaging errors of modern economics.

The foregoing brings me to my next hope for the coming years, one of no excessive novelty: it is that the political context of economics will increasingly be recognised.

Anciently classical economics was seen as a stern limitation on state intrusion upon the market economy. If selectively, it still so serves. Less recognised is the way conventional theory acts as a political and social cover for the exercise of corporate influence and authority. If the business firm is safely subordinate to the market, the clear implication is that it is broadly powerless in the world at large. While I believe that we suffer far more from corporate lethargy and incompetence in the older capitalist countries than from the exercise of corporate power, it should not be the service of economics that it conceals the latter. The modern great corporation has a commanding role as regards prices paid and prices received, and its influence extends on to shaping the demand that it serves and on to the state. It should not be the service of economics that it casts a cloak over the exercise of political influence for economic ends. This has been strongly its service in the United States in past years and, if perhaps more subtly, also in Britain.

The economists associated with the administration of Mr Reagan were eloquent, even passionate, in their emphasis on free market principles, as, with perhaps marginally more sophistication, are those now of Mr Bush. This economic rhetoric has, in turn, been a cover for the greatest resort to international trade restrictions – tariffs and numerical quotas – since the 1930s. And for unparalleled subsidies to financial institutions, notably the now infamous savings and loan associations. Also for large subsidies to sometimes larcenous housing and real estate interests. Also for massive support to the defence establishment, with its powerful economic presence in Washington. And very specifically for tax action on behalf of the influentially affluent. I would hope that in the years ahead we would be more alert to, and more relentlessly critical of, the use of economic concepts as a cover, however transparent, for political purpose.

The more flagrant of economic service to politics in these last years has not, indeed, entirely escaped professional criticism. Justifying the American administration's desire to reduce taxes on its affluent supporters, one notable economic construct has held that the resulting release of incentive and investment would ensure against any reduction in aggregate revenue. The more general case for improved economic incentives has contended that the rich were not saving and investing because of undue taxation and too little revenue, and the poor, in contrast, needed less government support and the spur of their own poverty. These unduly convenient constructs have, to the credit of economists, been regarded with well-justified professional contempt. I would hope for a similar and even sharper reaction in the future.

Specifically, I would hope for less professional tolerance of the politically convenient proposition that a certain minimum level of unemployment, not necessarily low, is economically essential. Also in the United States, as perhaps in Britain, economics has been unduly, if not universally, accommodating to the political pressure for low taxation and high real interest rates as the basic policy against inflation. High interest rates operate against inflation by limiting that part of aggregate demand that comes from productive investment. And they accord income to the economically passive rentier class. To this policy, broadly denoted as monetarism, which is so favourable to the affluent and rentier interest, economics, as I have said, has been unduly accommodating. Appropriate taxation has a far more productive effect.

In modern life no clear line separates economics from political interest. The two live in inevitable juxtaposition. I do not wish to see economics indifferent to larger political and social concerns. Economics, as I have urged, should not be a soulless abstraction; it is in the service of the larger social good as the individual in question sees and defines it. But in the years ahead I hope that economic conclusions will be less subservient to political need and convenience. We must not in the future spare those who, whether innocently or deliberately, engineer or accept such accommodation.

However, as the economist must not accommodate to political convenience, so he or she must not be indifferent to the political context and its social and humane constraints.

As this is written, economic designs are being advanced in Eastern Europe and the Soviet Union for a return to a market economy. That a movement in this direction is necessary, even inevitable, is not in doubt. Both the incentive basis and management structure of comprehensive socialism have been shown to be gravely at fault. Also its planning and command structure does not serve the infinitely diverse and unstable wants of the modern consumer goods economy. Inflation, which is manifested in socialist countries in long lines at the shops, has been endemic as income has regularly been supplied in excess of the supply of goods. But economic proposals being advanced and in some cases, as in Poland, adopted have been gravely indifferent to social and political consequences. What has been called shock therapy is politically acceptable only to those not experiencing it; in consequence, much welcome liberalisation in politics and personal expression is being associated with painful economic deprivation and hardship. Economics, to repeat, must not be the servant of political ends. It must, however, accept pragmatic adjustment to larger political and social needs and constraints.

There is here an error that I trust will be avoided. That is the tendency to identify ideological rigour with wise economic policy. Lecturing in Eastern Europe in the autumn of 1989, I was asked in a reproachful way why I did not urge the economics of Professor Friedrich Hayek as the alternative to the economic system there so obviously failing. I replied that this was not a design which, in its rejection of regulatory, welfare and other ameliorating action by the state, we in the United States or elsewhere in the nonsocialist world would find tolerable.

There is an undoubted satisfaction in seeing economic life and policy as existing within stern parameters. So it was with those who once avowed firm socialist principles; so it is with those who now avow stringent capitalist or free enterprise principles. I would hope that in the future this would be recognised as simply an alluring escape from thought. The only humane course in economic policy is to assess individual economic action not in accordance with broad rules but in accordance with specific effects. This is mentally far more tedious. It is, however, because of such assessment and the resulting action that what is still frequently called capitalism has survived. And it should not be wholly a matter for professional regret that this places a far greater responsibility on those who call themselves economists. Not much intelligence is required for the application of the seemingly immutable rules; rhetoric and indignant condemnation of deviation can then replace thought. Far more is required of those who bring information and analysis to bear on the particular case.

Economics in the time immediately ahead will have a primary focus on the erstwhile socialist world. This is not to suggest that the economic problem is solved in the capitalist lands. Nowhere in the world are economists by way of becoming the predictable and commonplace figures that Keynes identified with dentistry. There is, however the possibility, indeed perhaps the probability, that the nonsocialist economic systems have developed a certain resilience that acts against their most feared, most decisive danger, namely the deep and politically and socially devastating depression. It is a matter of elementary personal caution that one avoid prediction. I accept the possibility of recession. Yet over the last forty-five years these economies have shown a remarkable overall stability, which includes an impressive ability to withstand bad economic guidance or, on occasion, no visible guidance at all.

In contrast, the Central European countries, the USSR and China must make their way from a system that all too evidently does not work to the pragmatic structure that serves Western Europe, the United States and the Pacific lands. This is a perilous passage, one no country has yet had the experience of navigating. We do not know of the problems and the pain. So it is here that the attention of economists and economic discussion in the next years will be focussed. That this great transition will be the centre of economic attention well into the next century is, perhaps, the one forecast that can now be made with safety.

I conclude with the hope that economics in the future will not be confined in its concern to the relatively affluent countries. Beyond the developed world, that of erstwhile socialism and modern welfare capitalism, lies the large world of still relentless poverty. From living in past years in that world, I am far from happy about the long arm of economics as it is extended thereto. Far too often it sought to transfer both the doctrine and the physical investment relevant only to more developed countries. There was debate over free enterprise or socialism where neither was relevant. Airports, dams and industrial plants were seen as both the symbols and the substance of development. Stable, predictable government operating within the limits of sharply circumscribed administrative capacity and a strong emphasis on public education were the far greater, far more relevant needs. This would once have been assumed. In our time, I remind as often before, no literate population is poor, no illiterate population is other than poor. Perhaps poverty and illiteracy have larger causes; nonetheless, this unshakable association should remain always in mind.

I come to a word in summary. In the nonsocialist world economics must, above all, come abreast of the modern institutional structure, not be in the service of politics but be responsive to larger social needs and be subject to overriding public and social constraints. The erstwhile socialist world, which will be a major focus of attention, must find the uncharted and possibly perilous path not to classical capitalism but to the pragmatic compromise that, in fact, is the model it sees. And in the Third World, as it is called, there must be a new attention to the requirements for development – education and stable government – that were once considered essential and that remain so in a time when other, later action, notably the transfer of industrial plant and technology, are too alluring. Let it be called, if we insist, investment in human capital. Let us stay with the simple fact that development and stable government both require well-cultivated human intelligence.

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