

Comments on *Getting Back on Track: Macroeconomic Management after a Financial Crisis* – Panel 3, INET Annual Conference, Bretton Woods, NH, April 8-11, 2011.

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New Economic Thinking? It is urgently needed and we have heard four papers this morning, from Richard Koo, Duncan Foley, Mario Seccareccia and Alan Taylor, and commentary by Carmen Reinhart and Paul Jenkins, which provide excellent examples of it. However, I would also say that we need to be aware of “old economic thinking” and not continuously be “re-inventing the wheel” and repeating the mistakes of the past. This, in itself, would be something quite new. Therefore, I cannot resist putting up two quotes from Keynes - both from the year of the original Bretton Woods conference (1944).

Keynes to Hayek about the *Road to Serfdom* (1944).

... we all have ... reason to be grateful to you for saying so well what needs ... to be said ... Morally and philosophically I find myself in agreement with virtually the whole of it [However] ... You admit that it is a question of knowing where to draw the line. You agree that the line has to be drawn somewhere, and that the logical extreme is not possible. But you give us no guidance as to where to draw it ... I should therefore conclude your theme rather differently. I should say that what we want is not “no planning”, or even less planning ... we almost certainly want more. But the planning should take place in a community, in which, as many people as possible, both leaders and followers share your own moral position ... we need therefore ... not a change in our economic programmes, which would only lead in practice to disillusion with ... your philosophy , but even ... an enlargement of them. I accuse you of perhaps confusing ... the moral and material issues ... acts can be done safely in a community which thinks and feels rightly which would be the way to hell if they were executed by those who think and feel wrongly.

(quotes and emphasis added)

Hayek’s book was an attack on socialism and collectivism and an argument that these would lead to totalitarian government. But if, today, one visits websites on the political Right (big R) side of

the blogosphere, we find that Keynes is demonized and Hayek is idolized. But that cannot be right (in the sense of “correct”) can it? Keynes agrees with Hayek philosophically and morally.

But, Keynes is too mild when he says that a Hayekian programme would merely lead to “disillusion”. Hayek presented a theory, not of capitalism, but of a barter exchange economy essentially without money or credit. This is what is usually meant by the term “market” in the academic context, but it is a system which not only has never existed, but could not possibly exist.

“Planning” is a vague term that was much “in vogue” in the 1940s. It really has no clear meaning and was frequently used simply as a catch-all for any type of government involvement in the economy. Given that it is Keynes who is writing, however, we can be fairly certain that what he is asking for “more of” is what our speakers today have discussed under the broad heading of “macroeconomic management”, on either the monetary or fiscal side, and including thinking about the overall financial framework.

In that context, Keynes’s response to Hayek is not really a “good” answer – so to speak - but, it is the only possible answer. Everything hinges on whether our “communities” both national and international and both “leaders and followers” do indeed “think and feel rightly”.

Keynes Defending the Original Bretton Woods Treaty in the British House of Lords (1944).

We are determined that, in future, the external value of sterling shall conform to its internal value as set by our domestic policies and not the other way around. Secondly, we intend to retain control of our domestic rate of interest, so that we can keep it as low as suits our own purposes ... Thirdly, whilst we intend to prevent inflation at home ... we will not accept deflation at the dictate of influences from outside ... have those responsible for the “monetary proposals” been sufficiently careful to preserve these principles from the

possibility of interference? I hope your Lordships will trust me not to have turned my back on all I have fought for ... It is above all as providing an international framework for the new ideas ... associated with the policy of full employment that these proposals are not least to be welcomed ...

(quotes and emphasis added)

All “I have fought for” is obviously again the potential for conscious macroeconomic policy management, and “monetary proposals” means the original Bretton Woods system of “fixed but adjustable” exchange rates.

What is important here is the highlighted part of the quote. We can see that Keynes did have doubts. “Trust me” is not the best possible policy advice regardless of where it comes from.

So, the question is, whether Keynes had, in fact, protected the domestic economic interests of Great Britain in the negotiations? Perhaps we can answer that simply by contrasting the subsequent financial fortunes of Britain - which is the country where I was born - with those of Canada, where I have spent most of my adult life, and all of my career as “professional economist” .

I really need only refer to the three major exchange rate crises in Britain in 1949, 1967 and 1992 (the last one in the context of the short-lived “European Monetary System” rather than Bretton Woods). I was present for only one of those crises, and did not know much about it at the time, but have since read much about all three, as well the similar episode in 1931 (before the Bretton Woods system, in the days of the “restored” gold standard).

Meanwhile, Canada was only briefly part of the Bretton Woods system, for a few years in the 1960s, and the exchange rate has been floating now for the past 41 years since 1970. This has not always been popular either with the business community or the general public. When the Canadian dollar was 62c US, that was “too low” - when it was \$1.10 US, that was “too high”.

My wife and I are both very well aware of the impacts these fluctuations have on ordinary Canadians, as during this period we have made fairly frequent trips to the USA for family reasons. My attitude has always been to “take the rough with the smooth”.

The point is, however, that these exchange rate fluctuations are precisely what allowed the Canadian monetary and fiscal authorities to pursue their own course, and the national economic interest as they saw it. This does not mean to say that I have agreed with all, or even most, of the policies pursued by either the Bank of Canada or the Government of Canada, over that period. I have always been opposed to the inflation targeting policy, for example, and would be still more so for a price-level targeting policy. My own view is that that the central bank should attempt to stabilize real interest rates at “low but still positive levels”. That is my mantra. Similarly, I was opposed to the high taxes coupled with spending cuts (in the pursuit of “balanced budgets”) in the 1990s and early twenty-first century - and would take the same position today in terms of what is needed to recover from crisis and recession. Our panelists have already explained why this might be a reasonable attitude, and there is no need to repeat their arguments. However, the point is that there has been nothing to stop the Canadian authorities from pursuing these or any other policies. “On their own heads be it”, as the saying goes.

The British pound itself has also been floating since 1992, and Britain did not actually join the disastrous Euro-Zone. (I say it is disastrous because it places formerly independent countries in the same precarious fiscal position as provinces in a federal state). However, at least as seen from afar, not having joined the Euro-Zone does not seem to have prevented the British policy-makers from pretending that they have done so. Why? Why do they do that? The main answer is probably bad economic theory.

Each of our panelists, it seems to me, have all asked similar highly pertinent questions, either in the case of other individual national economies, or on the global scale.