8

Stagflation

In the interwar years the task had been to 'maintain real economic activity and employment at some predetermined full employment level' (SWF, 98). Keynes had regarded monetary and fiscal expansion as the way out of the under-employment trap. Meade, like his fellow Keynesians, had believed that a nation could and should spend itself into internal balance.

By the early 1950s Meade had become convinced that prices and not quantities were the more immediate cause for concern. In the new economic environment, what was required was not a reflation but a reduction in total demand. In an overheated economy what was needed was not the accelerator but the brakes.

By the late 1950s the emphasis was to change again (CP I 385, 398). Unemployment in Britain had ranged between 1 and 3 per cent in the 1950s. The rate of inflation lay between 0.6 and 4.9 per cent except in the outlier 1951–1952 when it exceeded 9 per cent. In 1984 the rate of unemployment was 12½ per cent and the rate of inflation 5 per cent. Unemployment had gone up. Inflation had not gone down. It was inflation *combined with* unemployment. It was stagflation. It was 'a nasty economic animal' (SWF, 1).

D. Reisman, *James Edward Meade*, Great Thinkers in Economics,
https://doi.org/10.1007/978-3-319-69281-4_8

Stagflation, Meade said in 1978, had emerged ‘relatively recently’ (CP I, 363). It had stood the old Keynesianism on its head. Stagflation was ‘the ultimate horror to anyone brought up in the Keynesian tradition’ (SWF, 4). Not only was it impossible to ensure sustained full employment but it was just as impossible to eliminate the upward displacement in the price associated with any given level of joblessness. As Weitzman says: ‘Stagflation is an especially difficult disease to cure because the macroeconomic treatment for one symptom of the malady aggravates the other’ (Weitzman 1984: 2).

All market economies, Meade declared, were experiencing the same upward drift. Britain, however, was in the worst shape of all (CP I, 402). Britain, Meade said in 1975, was ‘near the edge of the precipice’ (CP I, 365). The precipice lent urgency to the four volumes of his *Principles* between 1965 and 1976, to his two volumes on *Stagflation* in 1982 and 1984 and to his *Full Employment Regained?*, published in 1995, the year of his death. The question mark in the title was a part of the message. Once internal balance had come to mean both employment and prices, Meade was not certain that a satisfactory joint product would ever be delivered. It was an ‘ugly state of affairs’ (DM, 3).

8.1 Cost-Push

Demand-pull is no match for high interest rates and cuts in public spending. Stagflation is, however, the new reality that Keynes did not chart. Rising prices often signal that demand is excessive. Slack and waste might suggest that it is deficient. The old Keynesians could not explain the *too much* that coexisted cheek-by-jowl with the *too little*. Meade was the revisionist who brought the macroeconomics of the 1930s into line with the new reality of supply-side cost-push.

Already in 1957 he was saying that it had to be done: ‘The problem of control of inflation from the cost side as well as the demand side is perhaps the most important economic issue which now faces the governments of Europe’ (CP III, 225). In Britain, due to a ‘much stronger monopolistic union organisation’, the ‘atmosphere of extreme confrontation and conflict in industrial relations’ (CP I, 402) was especially serious.

Corporations charge administered prices. Cartels restrict supply to corner all that the traffic will bear. In Meade's time there was OPEC and there was the Sugar Agreement. Marshall and even Smith had written about imperfect competition. Non-competitive gouging was not new. Nor was legislation to challenge the restrictive practices.

Imperfect competition is Marx's monopoly capital. Yet it is also the belligerent and exploitative union movement which seizes a surplus to which it has no right. Meade was concerned about the growth of trade unions with concentrated power which were strong-arming their capitalists for an unearned reward. It is all in Marshall. Marshall was opposed to the 'class-selfishness' of aggressive and redistributionist union leaders who were seeking supernormal remuneration in their own narrow markets: 'I want these people beaten at all costs' (Marshall 1925: 400). Unions were countervailing power. They must not become a new locus of original power that redistributes income because winter feels cold without fuel.

Meade, like Marshall, could see no case for Big Labour. Like Big Business, it was holding the community to ransom. Both the bullying unions and the leaderly corporations were a departure from the equity and efficiency of the self-stabilising market benchmark. In the case of the unions there was something more. Not only were the imperfect competitors getting the microeconomics wrong, they were causing a macroeconomic failing. Union cost-push was at the root of a continuing rise in the general price index that was cox-and-box with an unacceptable level of unemployment. Already in 1946 Meade was expressing his concern about the new virus that was on the cusp of an epidemic: 'Trade Union policy is the crux of the whole matter' (letter from Meade to D.H. Robertson dated 7 April 1946, MP 3/6). He wanted those people beaten.

The ideal for Meade is supply and demand, flexible parameters and an omniscient auctioneer. The rate for the job should be whatever emerges from 'any bargain freely struck between employers and employees' (SWF, 158). The reality is not freedom but 'uncontrolled power', exercised in a 'lunatic way' (CP I, 365, 369). It is 'a monopoly which like any other monopoly will often promote its own sectional interest at the cost of the rest of the community' (PPM, 68). The reality is not the public but the private interest. Meade wanted those people beaten: 'It is essential that all forms of restrictive practice among wage-earners should disappear' (CP II, 293).

Unions perpetuate a confrontational mindset inherited from the dark, satanic sweatshops of the past. In the Dickensian nineteenth century the factory-owners had power and the shop-floor supplicants did not. In order to redress the balance the lumps of labour banded together to bargain collectively with the moneyed elite. Uppermost was pay but there was also a common stake in hours, unfair dismissals, individual grievances, health and safety at work. Historically and functionally, the felt need for mutual aid 'provides the basic economic justification for trade union organisation' (SWF, 48). The mobility of manpower is always limited by housing tenures, skill sets and non-rational sentiment. The alternative to the reserve army is to enter into cartels that will fight for their rights.

Unions preserve the economic balance of power. Yet there is something more. A social democrat and a cooperator, the morally minded Meade assigned to the market for labour a subjective meaning which differentiated it qualitatively from the mundane market for pins. People are a commodity. They are also a living, breathing commodity. The market for labour is the pulse even as it is the marginal product.

Meade saw the privileges and immunities granted to the mutual-aid associations in the two centuries since the Industrial Revolution as a reversion to the communal integration that Tönnies called *Gemeinschaft* (Tönnies 2001 [1887]: 52). Self-help groups were a rejection of dog-eat-dog. Meade welcomed the unions because they 'represent a movement from "contract" towards "status" or "property rights" in the field of employment law' (SWF, 66).

It is a surprising concession for a market liberal to make. Meade is contending that the employee has something approaching an implicit title to the workplace where he spends so much of his life. Implicit in the employment contract is the invisible promise of affectual fraternalism and intrinsic motivation. The union is the implicit guarantor of the implicit claim. It is a focus for the human need to belong.

It is all in Marshall. While some unions are not afraid to dominate and abuse, Alfred Marshall, declaring that 'I am wholly a trade-unionist of the old stamp', stated that most were inculcating in their members the high values of forbearance, consultation and honesty: 'T.U.s are a greater glory to England than her wealth' (Marshall 1925: 398, 400). Marshall saw the unions not so much as a seedbed for dissention but as a school for democrats. He believed that the unions educate their members in the rights and duties of citizenship. They were intermediate bodies which socialised the individual into the whole.

Meade followed Marshall. It is the schizophrenic mix of status and contract, affirmation and exchange. Unions, like other clubs, accustom their members to other-regarding conduct. Common conditions channel their passions. The unions, in pressing for disclosure and consultation as well as the naked quid pro quo, are acknowledging the ethical distinction between the pin-pedlar and the supplier of human essence. Man is a social animal. Workers are not pins.

Meade, like Marshall, was on the side of the unions. Collusion rights an existing wrong. Yet he also believed that the redistribution of power had gone too far. Universal suffrage, union-sponsored politics and left-of-centre legislation had shifted the balance from social egalitarians to militant toughs employing 'the methods of unarmed guerilla warfare' (SWF, 31) to force through pay rises in excess of improvements in productivity.

It is not one union but all unions that are pushing for pay at an 'artificially high level' (CP I, 333). The incidence of the quasi-tax they impose falls on prices when firms pass on the cost and on jobs which denies the out-of-work a decent foothold on the ladder. The result is preventable inflation in tandem with unnecessary unemployment. It is stagflation. It is a nasty economic animal.

8.2 Restoring the Balance

Meade in 1948 spelled out the choices. They were 'Stagnation, Starvation, Slavery and Seduction' (PPM, 72). Stagnation was wasteful under-employment because of inappropriate pricing. Starvation was the descent into the mass unemployment of the 1930s. Slavery was Stalin's command economy. Seduction was supply and demand. Of the four, only supply and demand would ensure an optimal package of consensus and prosperity, full employment and stable prices.

The free market knows the way. It grinds out an equilibrium in which workers 'offer their services at a low enough real price for employers to employ them' (FER, 7): 'If there were perfectly competitive conditions in the labour market, the critical unemployment percentage would be greatly lowered' (CE, 374). It is the same assertion that was repeatedly being made by the pre-Keynesian classicals when they accused the unemployed of holding out stubbornly for an unrealistic rate of pay: 'If wage-rates were perfectly plastic—this implies the possibility of negative rates—there would be no unemployment' (Pigou 1927: 183).

The free market is the answer: 'It is essential that the price mechanism should work in the labour market' (PPM, 69). Unions which veil more power than they counter are the problem. Unless wage-fixing, 'unquestionably anti-social', is taken away from the narrow-minded and the sectional, the public interest will not be secure: 'It will be impossible to maintain full employment without an inflationary upward movement of money wages, money costs, and money prices' (PPM, 69–70). It will be stagflation. Looking forward from 1948, Meade could already see the face of what was to come.

Meade's criticism is being directed not at the unions per se but at the 'excessive monopolistic positions' (SWF, 93) of the militant apex. An irresponsible leadership is making 'excessive' claims which, by pushing up prices and creating unemployment, are in effect unleashing Pigovian diswelfares that 'damage the economic interests of other parties' (SWF, 72). Innocent bystanders are bearing the cost. It is not fair.

The whole should be protected from the depredations of the parts. The Labour Party was not doing what it should to insulate the general interest from the warlords and the bandits. In 1979, after 17 years as a member and almost 50 years as a collaborator, Meade resigned in protest from the Fabian Society. He told its General Secretary that he had to withdraw because of its embarrassing allegiance to 'overpowerful independent labour monopolies' that respect neither law nor morality: 'I cannot support any body which averts its gaze from this awkward but fundamental reality' (letter from Meade to Dianne Hayter dated 7 December 1979, MP 9/67). A socialist State is not a corporate State. Labour should be standing up to the unions who, inconveniently, were also its main source of funds.

Meade knew that he would be called a 'union-basher' and even a 'Fascist Beast' (CP I, 369) if he continued to call upon the government to 'preserve the liberal nature of the economy' (CP II, 14). It was nonetheless his view that the concentrated power of labour even more than that of capital was standing in the way of justice and prosperity.

8.3 An Agenda for Reform

The first task is to revisit the existing regulations. The Government should abrogate the Trade Disputes Act of 1906 and its sister legislation in order to restore a level playing field. The unions had been given immunity from civil and criminal liability. Their funds could not be attached. Strikes could not be prosecuted as a breach of contract. Privileges, exemptions and 'exceptional legal powers' (SWF, 114) like these may have had a function at an earlier stage of British industrial relations. In the era of stagflation, Meade believed, it was no longer so.

Restoring a level playing field would 'increase the bargaining power with which employers can resist excessive wage claims' (CP I, 335). Business has lagged behind. Making the market more equal will rescue capital from the status of the residual claimant. No doubt 'certain interventions' to produce a 'modified free-trade position' (BOP, 326) would ensure that the employers' side did not prematurely capitulate. Free trade is always a threat to vested interest.

Meade also recommended that an extended Competition Commission should monitor imperfections in the market for labour and not just for output.

In the 1930s he was complaining that unions and professional bodies were restricting mobility and putting up pay (EAP, 96, 170). In the 1990s he was reflecting that the shortening of the working week, early retirement, artificial demarcations, redundancy packages that make new hires a potential time bomb and contrived discrimination that keeps out marginal minorities were 'the modern form of Luddite activity' (LEE, 40). They were artificially limiting the supply of labour and artificially inflating the wage.

There was also the pre-entry closed shop. Convinced that this was almost always an unneeded bottleneck, Meade invited the Competition Commission to conduct an unbiased review. It should do so with the impartial advice of outside experts who have in-depth knowledge of the trade or profession but do not themselves have a vested interest in the spurious credentialism of a self-regulating mystery: 'Even doctors and lawyers are human' (CP I, 334).

Welfare policy as well as constricted entry can increase the power of the unions. Even in the Great Depression, income maintenance 'on too generous a scale' (EAP, 78) had augmented the pool of unemployment. Benefits encourage the employable to extend their search. They make the workers choosier about a new opportunity. Reinforced by Keynesian demand management and financed by a deficit, the workers are being guaranteed a sellers' market. It is no more the market-clearing quantity than it is the market-clearing price. Public policy is making the very definition of full employment more nearly a range than a point.

Permissive welfare improves the bargaining position of the unions. Because involuntary unemployment is less likely to trigger absolute poverty, the unions will have fewer compunctions about protecting their members at the expense of the out-of-luck. Income-related benefits, Meade wrote in 1944, tend to soften the incentive for the negotiators to gravitate to the equilibrium wage: 'So long as the unemployed and other persons in want are cared for by the state, trade unions … are tempted to pay more attention to the interests of their own members who are in work than to the desirability of finding extra employment for their own unemployed members or for other outsiders' (CP I, 237). To clip the wings of the unions it would be necessary to cut the replacement ratio. If benefits to the unemployed approach the previous earned income, the unions will not need to shade their claims lest the crowded-out experience severe hardship on the dole.

The unions have 'little or no regard' (SWF, 89) for the verdict of supply and demand. Beveridge plus Keynes had seen to that. Meade's proposals for the liberalisation of statute law, competition policy and social welfare are all intended to prevent the Great Stagflation from having things all its own way. Demand management will have to acknowledge that there is no such thing as a bottomless pit. Full employment cannot mean full employment at any wage that the imperfect competitors pluck out of the air. It can only mean the right to a job at a realistic wage that leaves as much and as good for others.

Meade argues for realism in microeconomics, macroeconomics and social policy. There is, however, a further strand to his strategy. It is the self-policing morality of the citizen who knows his bounds. Unusual among economists, the individual to Meade is not just a free-floating monad but also an adequately socialised tribesman. The two are one. The social contract marches alongside the maximisation of utility when the union stagflationist sets off to prey.

Sometimes it is the good Dr. Jekyll and sometimes it is the bad Mr. Hyde. People are a mix. Conscience is an economic input. It fills a market void.

Some unions are large and national. The whole country is adversely affected when the railwaymen and the doctors go on strike. Some unions are small but situated at a crucial node. Air traffic controllers at the commanding heights have the latent power to disrupt. Large or small, the unions can impose unwanted stagflation on their nation as a whole. It is a disaster waiting to happen. Or is it? What is striking is not how often they play out devil-take-the-hindmost but how frequently they stay their hand. The unions do not necessarily do what they know they can.

Gangs and tribes, Meade says, are 'a difficult moral issue' (Meade 1981: 77). It is his contention that, large numbers or small numbers, unions in the real world are refraining from negative spillovers which would 'undermine an essential foundation for a decent society': 'This damage to the fabric of society may well be the most important aspect of the matter' (Meade 1981: 78). It is not just the Marxian profit-takers but the shoppers, the pension funds and the wider working class that suffer the loss when the weak-willed abstain from their social duty.

Meade never spells out why union negotiators should deviate from the textbook tenets of supply and demand. It may be the central value system in the sense of J.-J. Rousseau, E. Durkheim and R.H. Tawney. It may also be a politically orchestrated social compact according to which society pays non-specific compensation to all its members and receives in return the voluntary gift of moderation and abstention. Society redistributes the life chances and the endowments. In exchange for its pro-labour concessions the unions practice self-restraint and hold back.

Wage cuts in themselves are 'neither politically acceptable nor morally justifiable' (CP III, 283). Pigou himself observed that it would be 'out of harmony with the moral sense of the time' (Pigou 1927: 285) to cut low wages that have already touched their social nadir. What Meade would suggest is that consensus for the market-clearing wage can nonetheless be purchased by a package deal.

Progressive taxation levels down the differentials. Death duties level down the wealth. Tax exemptions for reinvestment turn profits into additional jobs. A national dividend gives every citizen a share in the We. It all contributes to an other-regarding consensus. Unions have power 'which they have not fully exploited in the past' (CP I, 328). Writing in 1971, Meade was insisting that the unions had not 'fully exploited' their power to do the best for their members. Exchange to be legitimate has also to be fair. Perceived organicism is the reason why good citizens do not drop litter, do not cheat their customers and do not go on strike.

8.4 Incomes Policy

Competition policy, full employment policy, State-led gift exchange and self-policing restraint might be enough to curb the excesses that were causing the stagflation. Where they are not, a government, post-Beveridge and post-Keynes, will have to choose 'between setting a lower target for the level of employment or imposing some form of compulsory wage regulation' (CP I, 256).

Neither option has an intrinsic appeal. Competition is conducive to efficiency and employment contributes to growth. Engineered stagnation that restricts the quantities or authoritarian edicts that stifle the price are, however, only palliatives that put off the search for a cure. Neither is a plus-sum solution to what is in effect an institutional malfunction.

Both are second-best. An incomes policy, 'neither pure Keynesianism nor pure monetarism' (Meade 1981: 84), has the advantage over macroeconomic slack that it does not antagonise the unions or retard economic advance. It does not displace labour. An element of 'social control' (CE, 374) is an acknowledgement that there are three sides to every bargain.

With the advantages come the reservations. There is the administrative overhead and the information deficiency. There is the felt loss of personal autonomy. Both efficiency and liberty are less. A nation should be careful what it wishes for. Meade said that an incomes policy was 'neither desirable nor practicable' (CP I, 329). He also said that wage-setting is 'a very bad instrument for efficiency purposes' (LEE, 10). He said it is 'a very bad instrument for distributional purposes' (LEE, 10). He said that it is in fact a very bad instrument all round.

Yet economics is the science of costs and benefits. Incomes policy is not perfect but still more imperfect is endemic stagflation. Traditional demand management is not enough: 'It requires a change in basic wage-setting institutions' (LEE, 4). Not only in a national emergency but where the 'nasty economic animal' is on the loose there is a need for 'suitable wage-fixing arrangements' (CP III, 225).

It is at this point that the dictionaries come out. The world is a grab-bag of wage-fixing arrangements. Some are 'of crucial importance' (CP I, 353) and some are of no importance at all. Some are 'suitable'. Some are 'unsuitable'. Meade at least gives a good idea of the kind of wage-fixing that he personally prefers.

8.4.1 The Board and the Norm

Incomes policy requires some 'central co-operative machinery' (CP I, 405), some parastatal body on the pattern of the Council on Prices, Productivity and Incomes in the United Kingdom in the 1950s. Its members, appointed rather than elected, would have had extensive experience in industrial relations. The Board would be tripartite. It would not be party-political. It would be independent of government save in the strict legal sense that 'ultimately the government would be responsible for the number chosen' (MP 9/75).

The main function of the Board would be to issue a statement at regular intervals in which it recommended a norm. The norm would be a guiding light. Reflecting the natural rate of pay, it would be 'the percentage increase in the general level of money wage-rates which would be compatible in the coming year with the preservation of full employment in a regime of stable selling prices' (CP I, 307). In 1995 Meade took 2½–3 per cent to be the level of unemployment that would be consistent with stable prices (FER, xvi). The twin targets put flesh on the definition of internal balance.

A dictatorial Board could supersede the free economic mechanism. Meade's Board, doing the opposite, does not lead the market so much as follow it. Meade said that an incomes policy ought to proceed with 'an absolute minimum of governmental intervention in labour markets' (CP I, 331). Administration is not a contradiction in terms but a reaffirmation of the ideal. A Board would only be successful in promoting full employment combined with stable prices if it 'accepted the supply-demand principle' (BOP, 172). It is the function of the Board to defend the true market-clearing wage against the private market-makers who do not live by the invisible hand.

The norm, because it looks forward to the 'coming year', is never likely to predict market conditions with absolute accuracy. The equilibrium price can only be determined ex post facto through the trial-and-error groping of the 'experimental method' (JE, 161). Since the market always moves on, the Board must always be prepared to revise its recommendation in line with its target outturn.

A norm is indicative but not imperative. As such it cannot have the force of law. It cannot be made mandatory without 'usurping powers which properly belong to the government' (CP I, 329). As for the government itself, it would rightly resist the poisoned chalice. Surveillance by an inquisitorial bureaucracy would be 'unbearable' (SWF, 106). Policing, local or national, would be difficult: 'The scale and complexity of monitoring even a single uniform norm would be immense' (SWF, 102). Norms would be evaded through bonuses, promotions and fringe benefits. The master's eye cannot be everywhere.

The guideline is meant to be loose. Employers and employees retain the right to deviate if both parties express a wish to do so. A local shortage, a new sector, the need for internal migration, a productivity clause, a reappraisal of differentials, special compensation for unsocial hours might all justify a settlement in excess of the norm. At the very least the pecuniary temptation will encourage workers to be mobile from declining to contracting industries. It will in that way reduce the pool of unemployment.

The two sides of industry can agree legitimately to break with the official norm. Their harmonious concord is not without its downside for their nation as a whole. Labour and capital might, when demand is buoyant, collude to pass the higher wage on to the consumer. Employers in good times have no incentive to resist the numbers that the unions pluck out of the air. The result is that the norm becomes the minimum and that the economy continues to experience the negative externality of cost-push. It is a reminder of Meade's view that incomes policy must be backed up by a responsible macroeconomic policy that imposes a cap on total demand.

8.4.2 Arbitration and Enforcement

Employers and employees, if they agree, are free to trade above the norm. In a minority of cases they will not agree. Their dispute will then be passed upward for the 'not-quite-compulsory arbitration' (SWF, 109) of an impartial adjudicator. A permanent body rather than an ad ho*c* tribunal, the arbitrators will be able to draw upon experience and precedent to reach an unbiased decision. It is a 'civilised way of replacing costly conflicts by the rule of reason' (SWF, 114).

In the United Kingdom the model has been the Advisory, Conciliation and Arbitration Service. Either side can ask for a referral to be made. Importantly, the government can do so as well. Such a referral by elected representatives is a reaffirmation that the people of the country are always the third party to every bipartite dispute. The social interest will be protected. Employment will be fuller. Inflation will be less.

The norms promulgated by the Board are no more than recommendations. The decisions reached by the arbitrators are more formal. They do have the force of law.

Penalties are incurred if the verdict is flouted. A strike or lock-out can be taken to mean voluntary termination. The right to redundancy pay can be forfeited if the walk-out is for more than the norm. Strikers can be sued by third parties who believe that their interests have been infringed. Union funds can be debited if a strike made official violates the recommendation of the arbitrators. For the employer, non-observance could be made a criminal offence. Meade presumably does not expect that anyone will go to jail (IR, 59–60).

Strike pay received from a union's war chest should be taxed. Strikers should not be entitled to unemployment benefits. Supplementary benefits claimed by the families of strikers should subsequently be clawed back as a loan. Even the social dividend is not ring-fenced. Precisely because citizenship rights are wedded to consensual duties, the national dividend should be refused to strikers who want their nation to subsidise their breach of the social contract: 'To subsidise all strikes on this scale would be an irresponsible encouragement of cost inflation' (CP II, 344).

Taxes on high claims together with subsidies to low ones would align the wage bargain with other spillovers and externalities: 'Financial inducements rather than direct controls should be used' (PPM, 77). There is much that can be done. Social consensus, 'wide acceptance' (SWF, 114), is, however, the precondition. The norms of the Board, the awards of the arbitrator, will only take root if they enjoy the backing of public opinion. Opinion-formers have an important role to play.

8.4.3 Criteria and Standards

The title of Meade's book on *Wage-Fixing* is misleading. In 1982 as in 1948, 1951, 1957, 1977 and the other landmark dates in his discussion of stagflation, Meade advised planners who were expecting the blueprint for 'a detailed, authoritarian, centralised method of wage-fixing' (SWF, 88) that they had totally misinterpreted his intentions. Unions and employers had long been involved in wage-fixing. It was the purpose of *Wage-Fixing* not to impose an additional superstructure of criteria and standards but to return wage-fixing to the tried-and-tested high court of supply and demand.

Advocates of an incomes policy often propose that it should go beyond the control of stagflation alone. Meade was a strict constructionist who believed that a policy tool should never be overloaded with more objectives than it can attain. His discussion of criteria and standards is in the circumstances largely negative. The supplementary targets so often endorsed by social reformers have no place at all in his theory of *incomes* policy. *Incomes* policy is not the whole of the good society.

The first of the supplementary criteria is comparability. Social conservatives often say that the norms should protect horizontal equity and preserve time-out-of-mind distance. Meade's answer is that conventional relativities, far from being self-legitimating in themselves, are in truth a social bad that holds back the pace of advance. Customary differentials are out of touch. It would be better for the pecking order to be determined by the market. The ratios are bound to change.

Besides that, there is more to remuneration than money alone. Prestige, security, job satisfaction, an occupational pension, a quiet life, an exciting life, longer holidays, a tied cottage all influence the rate for the job. The discrete job-seeker alone can estimate the weights, subjective and unique, or judge how they must be adjusted in response to creative destruction. The individual knows and the Board does not. Clearly, there is only a limited amount that 'an expert, impartial assessment' (SWF, 88) can accomplish. The worker who votes with his feet does more.

A second criterion is often taken to be the cost of living. Contracts are negotiated in the light of an expected rate of inflation. Surprises redistribute the balance of advantage. Real wages are cut without consent. It is an argument for money wages to rise in line with prices so as to protect the agreed-upon standard of living.

Meade accepts that it is inequitable for real purchasing power to be reduced without consultation. This, however, is a reason why inflation should be kept low rather than a case for a hands-on incomes policy that corrects the deviation. Index-linking and inflation-proofing 'lead to great instability in the economy' (SWF, 34). Wages and prices come to leapfrog one another. A higher claim in one round is answered by a compensating claim in the next. Inflation escalates when it ought to be damped. Meade concludes that not the Board but the market is the better judge of real and money values.

A third criterion that is sometimes advanced is a rise in productivity. Higher output should be rewarded with higher pay. No market economist would disagree with that. Even so, Meade rejects the argument for a written-down rule. There is no need. The appropriate proportioning is automatically performed by the free market itself. Calibration is best done at the level of the firm where finely focused local knowledge is most likely to be concentrated. It is less well done by a national body that does not know what the conditions are like on the ground.

Productivity itself can be a false friend. Ethically speaking, it can be 'grossly unfair' (SWF, 40). Not all occupations allow for an increase in output. In teaching or medicine the quality of the service may be negatively and not positively correlated with the throughput.

Besides that, the difference between physical and revenue productivity makes it difficult to arrive at a single-valued recommendation. It is difficult for a Board to tell a worker whose hours have gone up that, because of the inelasticity of demand, his pay, tracking the price of the product, must go down. It is easier for the market to get the message across.

A fourth criterion is sometimes said to be deprivation. The low-paid are poor. Disproportionate hardship warrants disproportionate redress. An incomes policy is assigned the supra-economic obligation to practice selective discrimination in favour of the excluded and the left-behind.

Meade was a life-long redistributionist with 'a strong egalitarian philosophy' (CP I, 336). In spite of that, he did not see it as the function of incomes policy to raise up the poor. That is the function of the welfare State, fiscal socialism and economic growth. Social policy should provide benefits in cash and kind. It should retrain the redundant and facilitate geographical mobility. What it should not do is to intervene directly in the wage bargain. Earned income should be determined by supply and demand. Only after economics has had its say should a compassionate community become involved in the reconfiguring of the final destinations.

An incomes policy should be detached and even-handed. An across-the-board norm is an explicit commitment to equality before the law. Even Meade, however, had to make an exception for the poorest of the poor. For excluded and the needy, there was no choice but to set a floor: 'It is the right and duty of the state to intervene by the operation of compulsory Wage Councils' (SWF, 42).

A minimum wage is acceptable so long as it is selective. It cannot be made universal. A policy to combat stagflation will not succeed if it takes on additional targets. They are better addressed in other ways by a rational community that does not want market failure to lie where it falls.

8.5 Demand in the Age of Cost

In the 1930s there was mass unemployment. Keynesians called for a macroeconomic policy to stimulate the aggregate demand. In the 1950s the more urgent problem was the rise in prices. Keynesians recommended a rise in interest rates and taxes, a contraction in the money supply and public spending, in order to damp down the excess that was the causing the inflation. Policies in the boom are the mirror image of policies in the slump. The demand managers in the Treasury and the Bank will know what to do.

Monetarists from Bodin and Ricardo to Fisher and Friedman had argued that, in an exchange economy, the quantity of money was the action variable: '*Inflation is always and everywhere a monetary phenomenon* in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output' (Friedman 1970: 24). It was the great attraction of the gold standard and the balanced budget that the means of payment would proportion themselves automatically to the needs of trade. The monetarists differed from the Keynesians on the need for finely tuned discretion and the specific role of fiscal policy. They were in agreement that excessive demand where it was the cause of rising prices had to be pared down to size.

Meade as an old Keynesian had been drawn since the 1930s to the idea of a balance wheel spun by the beneficent and the omniscient. By the 1950s he was increasingly convinced that the nature of the game had changed: 'One of the most fundamental problems which we have still to solve is the marriage between trade unions, full employment, and the prevention of inflation in a free society' (CP III, 170). Cost-push was spoiling everything. The management of demand had become the management of people. Beer and sandwiches in Whitehall had become the new deal-breaker that was acknowledging the active role of cost.

Internal balance means full employment with stable prices. The new reality had become under-full employment with rising prices. The new game was not stagnation or inflation alone but rather two-headed stagflation. It was a nasty economic conundrum. It was the worst of both worlds.

There were two objectives: stable prices and full employment. There were two instruments: incomes policy and demand management. Demand management was itself a bundled instrument consisting of monetary policy, fiscal policy and the exchange rate. Meade warns against a knee-jerk adoption of the textbook Mundell box that was discussed in Chap. 5. The proper solution was not rigid assignment a priori but instead a 'combination of policies that will just produce the best attainable combination of the objectives': 'It is inefficient to devote the use of one instrument exclusively to the achievement of one objective' (DM, 13).

Meade is calling for a combination of instruments. Incomes policy and demand management, each focused on what it does best, must complement and support one another as if they were two pillars of a single arch. Stagflation is a nasty economic animal. The only answer is an appropriate mix. Meade believed in 'assignment by comparative advantage' and in the flexible rubric of 'use whatever works' (Martin Weale, personal communication). One way or another, the job must get done.

Meade anticipated that there will always be 'price inflation at a constant moderate rate' (LEE, 4). Low inflation does not mean no inflation. If the demand for labour is falling in one sector but rising in another, then it is a standard Keynesian prediction that the rises are likely to be less sticky than the falls. The fact that they are opposite but unequal biases the average pay settlement up. There is also the impact of invidious catch-up. Productivity varies but no grade or area wants to fall behind. Higher wages feed through into higher prices. The inference is clear. A market economy is likely to be experiencing some inflation.

Just as a healthy economy will always have some inflation, so it will always have some unemployment. There will always be the skills mismatch that is the concomitant of continuous change, the occupational and geographical imbalance that prevents the quantity of labour from responding to a bottleneck. In 1936 Meade called the normal minimum of frictional and structural unemployment, insensitive to total demand, the 'standard' rate (EAP, 77). In the 1970s he was calling it, in common with Friedman and the monetarists, the 'natural' rate. Anything more would be a violation of the social contract. Anything less would produce an intolerable rate of inflation.

There will always be some inflation and some unemployment. The crucial task facing the policy-maker is to steer a middle course between the moderate and the intolerable. Jobs must be protected, but not at the cost of overfull employment and an unacceptable rise in prices. Policy-makers must both define and defend their optimum state. It is easier said than done.

Writing in 1948 when the rate of unemployment was 1.5 per cent, Meade, who had lived through the hungry 1930s, was nonetheless suggesting that more men and women should be put out of work: 'Some 4 per cent unemployment may well be the technical minimum to allow for the necessary turnover of jobs in a dynamic society' (PPM, 70). Even 4 per cent might be too low if the unions were knowingly exploiting the tight labour market to spiral upwards the nominal values. The government would then be facing a 'tragic dilemma between choosing unemployment or inflation' (PPM, 71). Unemployment might have to hit 10 per cent (BOP, 106) before wages and prices could be confined to the limits that the policy-makers had set.

Nationalisation is not the answer. Even the coalminers and the railwaymen go on strike. What is needed is an incomes policy in lock-step with the management of total demand. Even then, the arsenal of instruments might not be up to the task. Unknowledge is all around: 'The future can never be foreseen precisely' (IR, 39).

Households and firms act on the basis of 'satisficing rules of thumb and customary institutional procedures' (MAP, 11). Calculations pyramided on Herbert Simon-like heuristics rapidly go out of date. Leads and lags make it impossible to calibrate the dose. The unexpected might happen and happen again. An unpublished note from 1987 suggests that it probably will: 'The economy is altogether too complicated, the uncertainty about outside political and other events too great, and many forms of economic behaviour too institutionalised for the response to policy changes to be formed solely on a rational analysis of the causal relationship between present policy and future events' (MP 7/6). Bubbles, crises, lunatics, elections, OPEC, it is very difficult to hit the bull's eye or even the bull.

Ordinary people do not do what they are modelled to do. Rational expectations are 'very implausible' (IR, 39). Meade did not share the complacency of monetarist contemporaries like John Muth who concluded that random deviations will average out and the structural triumph over the transitory. Muth believed that *ex post* outturns correspond closely to ex ante conjectures: 'Expectations, since they are informed predictions of future events, are essentially the same as the predictions of the relevant economic theory' (Muth 1961: 316). So long as the decision-makers employ robust theories to compute relevant results, so long as ordinary people grasp precisely what it means when the macroeconomic handle is being turned, then expectations will be rational and policies will have teeth.

Muth was confident. Meade was not: 'It is not possible to accept the view that expectations are wholly and accurately determined by a rational understanding of the effect of present events on future developments' (MP 7/6). It is not possible to believe that 'all economic agents make efficient use of all information available to them' (MAP, 11). Expectations are not rational but at best adaptive. Meade, Weale recalls, was 'ambivalent' about the rational versus the adaptive so long as the variable selected was 'model-consistent' and policy-compliant (personal communication). The immediate and main inference is that government policy will seldom be 'wholly and accurately' on target.

Human error makes bad things worse. In-period discretion can shunt a well-meant correction on to an unwelcome track. What is needed instead of wise leadership is a rules-based approach that eliminates expectations about disturbing shocks in the management of demand. Exchange rate targeting is no more than a means of achieving the desired target for nominal GDP. It is not a maximand in its own right but only one of many tools that can be employed in the service of the rule. Nominal income is the rule. It is the only rule.

Meade, together with associates like David Vines and Martin Weale, was among the first in stop-go Britain to posit that policy becomes more stable when private actors *believe* it to be stable. The same logic underlies the macroeconomics of John Taylor (1993), Barro and Gordon (1983) and Kydland and Prescott (1977). Just before Meade, Kydland and Prescott had said that discretion may be appropriate for control where current outcomes depend on current and past policies but that the expectation of future intervention will itself have a feedback on the prediction: 'Changes in policy induce changes in structure, which in turn necessitate reestimation and future changes in policy, and so on' (Kydland and Prescott 1977: 474).

The process is iterative and time-inconsistent. The series may not converge. An attempt to overregulate the economy may steer it on to a reef: 'Active stabilization may very well be dangerous and it is best that it not be attempted' (Kydland and Prescott 1977: 487). *Not be attempted*: Meade's *Demand Management* appeared in 1983, his *Macroeconomic Policy* in 1989. They were some distance away from his youthful belief in countercyclical policy, fine-tuned from the top.

Friedman had recommended a constitutional amendment to set in stone an annual increase in the money supply (Friedman 1962: 54). Meade, like Friedman, was in favour of pre-commitment but believed nonetheless that it should be the outcomes and not the instruments that had to be bound: 'The controllers should watch total wage earnings rather than the stock of money' (Meade 1981: 85). The government should 'take the plunge'. It should announce its 'break-even point'. After that it should pull only those levers that it believes will lead it to its predetermined result.

Early on he had been attracted by inflation-targeting. The policymakers, he was saying, should 'maintain the highest possible level of demand for goods and services compatible with the prevention of a precisely defined price index from rising above a precisely defined ceiling' (CP I, 318). By the late 1970s he had decided that macroeconomic policy should be built around the targeting of nominal income and not the price level. Policy-makers would know enough to choose the growth path that would lead to the natural output. Prices would respond appropriately once nominal expenditure was controlled. There was no need to target prices on their own.

Nor was there any need to target output. Real rather than money income had been the primary concern of the old Keynesians. It was not the primary concern of the post-war consensus. The under-employment of the 1930s belonged to the past. As for the present, the 'primary objective of financial policy' (FER, 18) had become the rise in prices. The way to contain the rise in price is to target the money GDP. It is 'the center-piece of our proposals' (MAP, 3).

Meade left no doubt about his targets when, in 1978, he made it 'a sacred rule' of monetary and fiscal policy 'not directly to maintain full employment, but to maintain a steady rate of growth of, say, 5 per cent per annum in the total money demand for goods and services and so in the total money national income' (CP I, 370). The 'steady, but moderate, predetermined rate of growth of the total of money income' (IR, 32) is the key. If total output is growing at 2 per cent and total expenditure on domestically produced goods and services is growing at 5 per cent, then the price index would be rising by 3 per cent (SWF, 7). Inflation would not fall to zero. It would, however, be kept within the safe zone that the policy-makers had marked out.

Meade states that macroeconomic policy should be 'so conducted as to cause a given rate of increase in the total money demand for the services of labour' (SWF, 99). He also says that it should be 'so devised as to maintain the total level of money demand for the products of labour on a steady growth path' (SWF, 8). Meade uses the terms 'the services of labour' (the input) and 'the products of labour' (the outcome) as if they were synonyms. He seems to be implying that to track one is to track the other. Money demand in both cases is the relevant tool.

History had not gone away. The memory of the dole-queues and the Depression had caused policy-makers to put full employment first. At the same time, aware that rising prices too are a social bad, the policy-makers had been reluctant 'to adopt Keynesian expansionary policies because of their fear of inflation' (SWF, 154). It had been *damned-if-you-do* combined with *damned-if-you-don't*. It had become an unstable compound.

Aggressive unions had been taking advantage of the policy-makers' divided loyalties to strike unjustifiable deals for 'lucky insiders' (SWF, 154). Unlucky outsiders had been condemned to involuntary unemployment. Expansion or contraction, employment or inflation, policy-makers did not know which way to turn. Meade's new Keynesianism provided the answer that solved their equation.

Demand would be matched to supply. The multiperiod rule would be the macroeconomic constitution from which neither the central bank (ideally independent of party politics) nor the Treasury (inevitably a part of the Westminster vortex) would be permitted to depart. Taxation and public spending had been an intrinsic part of the old Keynesian toolkit. Not least was this so because in the liquidity trap there were few other shots in the locker. Meade in the 1980s could see a role for fiscal policy, and especially if its scope could be extended to the national and not just the public-sector balance. Increasingly, however, he was relying upon the rate of interest to keep the pre-determined growth in demand on its pre-assigned track. It is what David Vines has called ‘intelligent interventionism’ (personal communication). It is not perfect automaticity but nor is it uninterrupted tampering.

The rule would be pre-announced. Being fixed, it could not be varied by weak leaders in response to an impending election or a strike. There would no longer be the possibility that the authorities would ex post come to the rescue. Adjustment of the target in-period would in principle be avoided: ‘The more one allows for increasing the money GDP targets to mop up unemployment, the smaller the role which can be played by the stabilisation of the money GDP in establishing a reformed system of wage-setting which pays great attention to the effect of *money* wage rates on *real* employment’ (letter from Meade to J. Williamson dated 5 February 1987, MP 9/96). In-period adjustment would be more likely if it were inflation rather than nominal income that was being targeted. An invariant rule protects jobs. Discretionary meddling protects stagflation.

Because of the rule, unions and employers would understand that they had to bargain for openings and remuneration within the confines of the revised playing field. The result would be ‘no more than a moderate and steady upward pressure of money wages and prices’ (SWF, 154). It would be non-accelerating inflation. It would be a ‘NAIRU’ where joblessness would be ‘sufficiently high to cause the claims for real improvement to be reduced to the rate of productivity increase’ (DM, 20).

Incomes policy works hand-in-glove with Meade’s demand management: ‘The level of wages could be set to generate some predetermined inflation rate, with macroeconomic policies then set to achieve what is believed to be the natural rate of output conditional on that inflation path’ (Bean 2009: F443–4). One tool complements the other. The Board would be promulgating a norm that would guide the unions and the employers to the new market-clearing wage.

The unions would become aware that claims in excess of the norm would reduce the volume of employment (CP I, 305). Lucky insiders would stay their hand lest unlucky outsiders pay the price: 'Experience suggests that pressure from the outsiders (the unemployed) does exert some restraining influence' (FER, 36).

Meade contends that insiders would behave like gentlemen. He believes that they would not bargain irresponsibly for pie-in-the-sky lest innocent bystanders pay the cost. Theories of strategic interaction, the prisoner's dilemma and the free rider problem suggest that he may have been underestimating the role of calculative selfishness. Meade approached the labour market *bellum* as much from sociology as from economics. What he seems to be saying is that moral and not just pay norms have a contribution to make to the war on stagflation.

Most of all, however, it is incomes policy in alliance with demand management on which the policy-makers must depend. Each has its own complementary specialism. A norm by itself is not enough: 'Merely to limit rises in wage rates, prices and profit margins is to play with the symptoms' (PPM, vi). Suppressed inflation is bound to be translated into evasion or formal rationing. Incomes policy if it is to succeed must be reinforced by an uncompromising macroeconomics that keeps demand within the tramlines of supply. Real variables will drift into their natural slots. Inflation will be moderate. Stagflation will come to an end.

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