Story of this paper

The origins of the *Cambridge Journal of Economics*

- Departure of *Economic Journal* from Cambridge
- Kaldor's dealings at the Royal Economic Society
- Divisions within Cambridge

LETTERS TO THE EDITOR

Reversing Keynes on budgetary policy

From Professor Robert Neild

Sir, May I answer three points raised by my friend Professor Little in his comment (February 6) on my letter about budgetary policy.

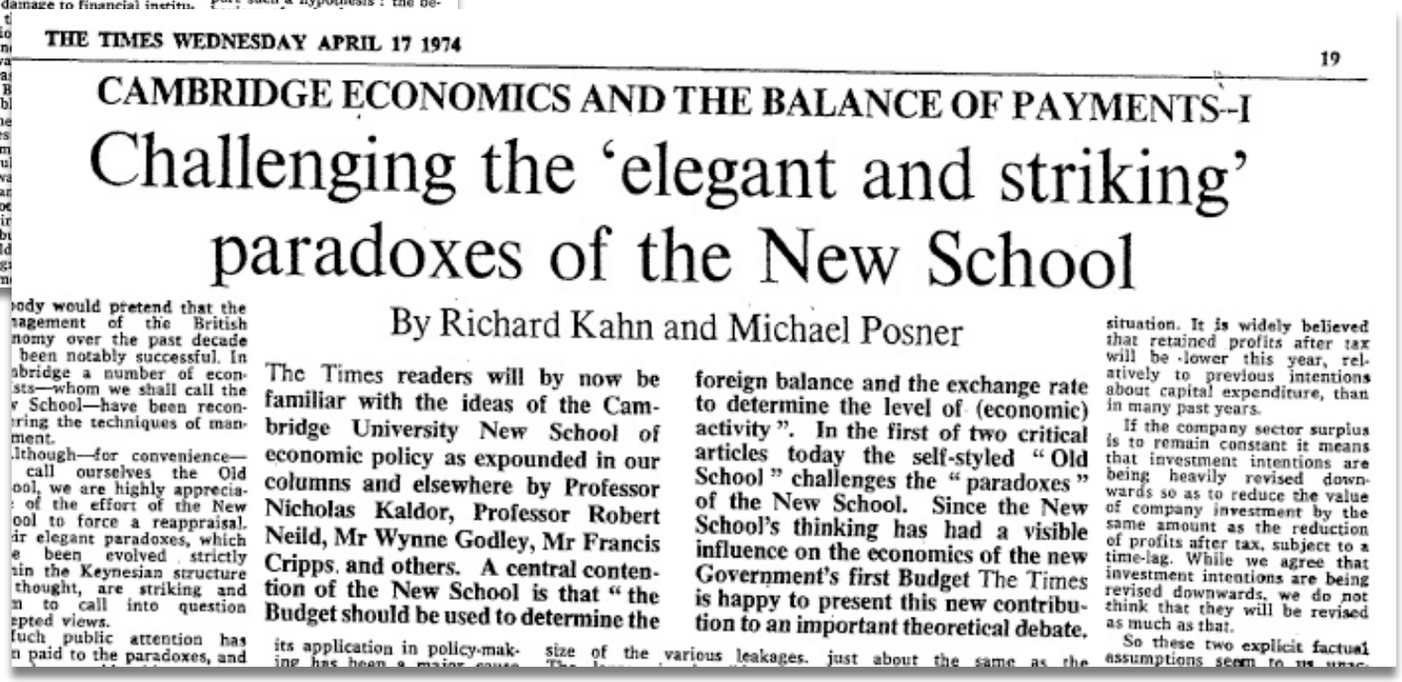
First, I did not repeat, as he supposes, the Keynesian orthodoxy that the Budget should be used to determine the level of employment and the exchange rate to regulate the foreign balance. I said the opposite: the Budget should be used to determine the foreign balance and the exchange rate to determine the level of activity.

This reversal is important. I, and a number of my colleagues at Cambridge believe that the orthodox view, to which many of us used to subscribe, is wrong and that its application in policy-making has been a major cause of Britain's post-war economic troubles.

Second, when I asserted briefly that monetary policy *is* deficit, such as we have had recently, would require as a monetary counterweight a rise in interest rates so draconian as to produce unacceptable contradictions in policy—inhibiting investment while consumption was encouraged by low tax—and such damage to financial institu-

demanded, whereas a change in demand for the same items brought about by fiscal policy tended to work the other way round, influencing quantities demanded rather than prices.

There is no evidence to support such a hypothesis: the be-



THE TIMES WEDNESDAY APRIL 17 1974 19

CAMBRIDGE ECONOMICS AND THE BALANCE OF PAYMENTS—I

Challenging the 'elegant and striking' paradoxes of the New School

By Richard Kahn and Michael Posner

The Times readers will by now be familiar with the ideas of the Cambridge University New School of economic policy as expounded in our columns and elsewhere by Professor Nicholas Kaldor, Professor Robert Neild, Mr Wynne Godley, Mr Francis Cripps, and others. A central contention of the New School is that "the Budget should be used to determine the foreign balance and the exchange rate to determine the level of (economic) activity". In the first of two critical articles today the self-styled "Old School" challenges the "paradoxes" of the New School. Since the New School's thinking has had a visible influence on the economics of the new Government's first Budget The Times is happy to present this new contribution to an important theoretical debate.

ody would pretend that the nagement of the British nomy over the past decade been notably successful. In bridge a number of econsts—whom we shall call the School—have been reconring the techniques of manment.

lthough—for convenience— call ourselves the Old ool, we are highly appreciaof the effort of the New ool to force a reappraisal. ir elegant paradoxes, which e been evolved strictly in the Keynesian structure thought, are striking and n to call into question epted views.

Much public attention has n paid to the paradoxes, and

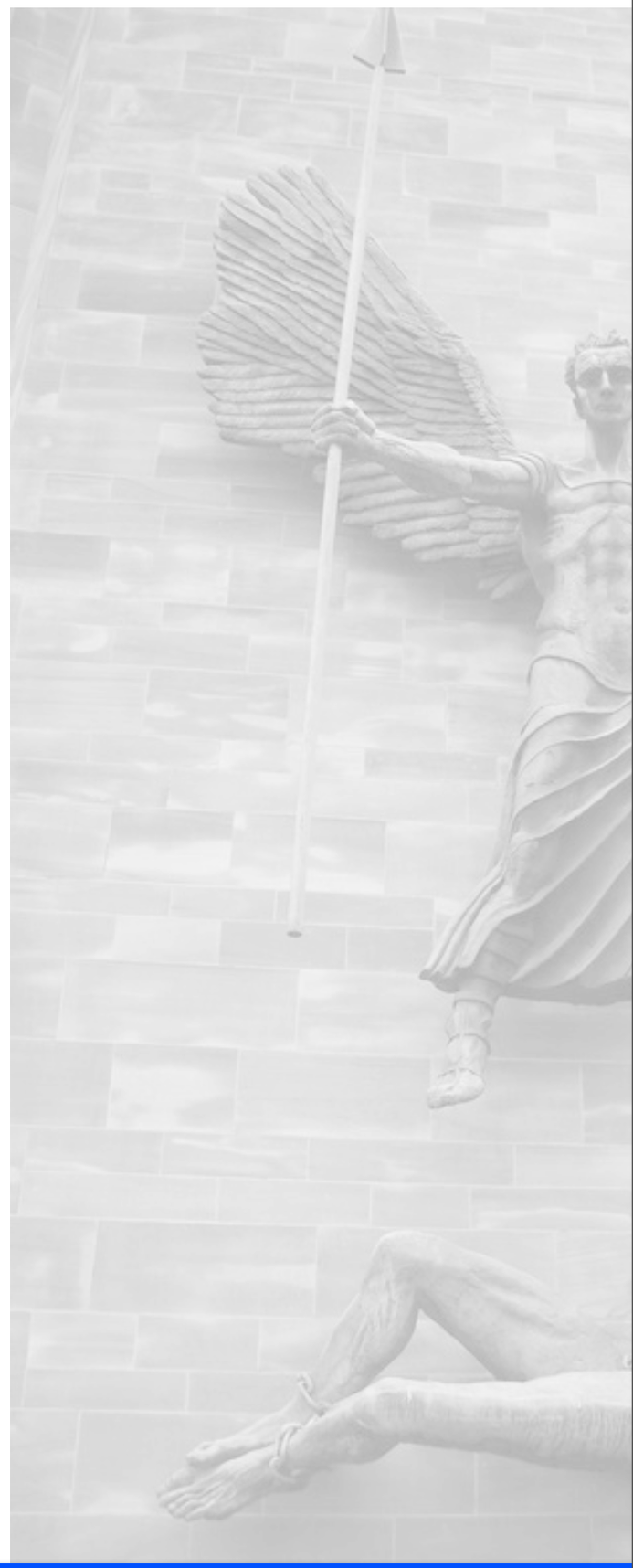
its application in policy-making has been a major cause

size of the various leakages. just about the same as the

situation. It is widely believed that retained profits after tax will be lower this year, relatively to previous intentions about capital expenditure, than in many past years.

If the company sector surplus is to remain constant it means that investment intentions are being heavily revised downwards so as to reduce the value of company investment by the same amount as the reduction of profits after tax, subject to a time-lag. While we agree that investment intentions are being revised downwards, we do not think that they will be revised as much as that.

So these two explicit factual assumptions seem to us



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Godley moves in mysterious ways:

The craft of economic judgment in postwar Britain

Tiago Mata

Levy Institute, May 2011

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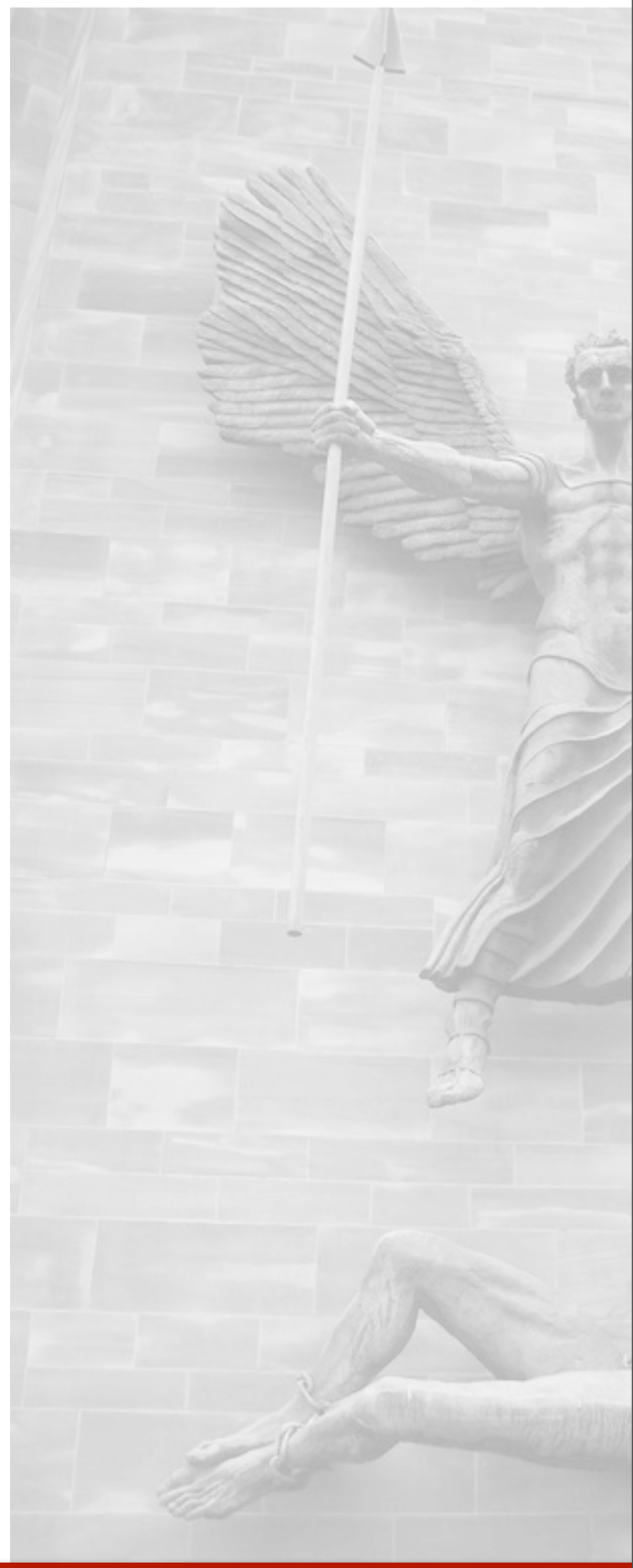
The issues

- **Godley's moves:** a review of the main moments in his career.

- **Godley's mysterious ways:** an insight into a tacit way to knowledge and economic judgment

- **Transformation in the late 1960s and 1970s of the modes of public and civic discussion of policy alternatives:** from the enclosed space of civil service to doctrinal journalism and competition among model builders



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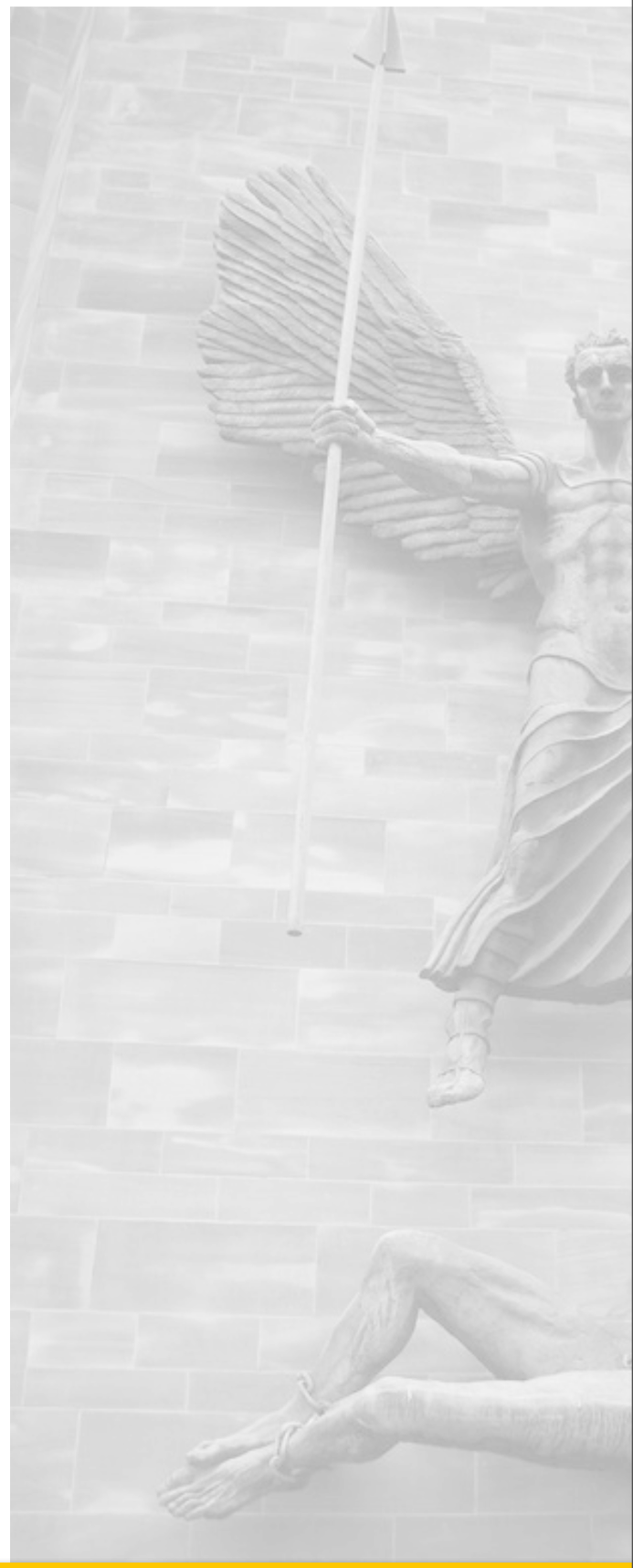
The Treasury and Cambridge

- "Economic Section" from Meade to Hall to Cairncross
- 1965 Government Economic Service: 20 to 209 economists in government.
- "Department of Economic Affairs" vs "Economic Section" vs Buda and Peste
- Competition and partnership



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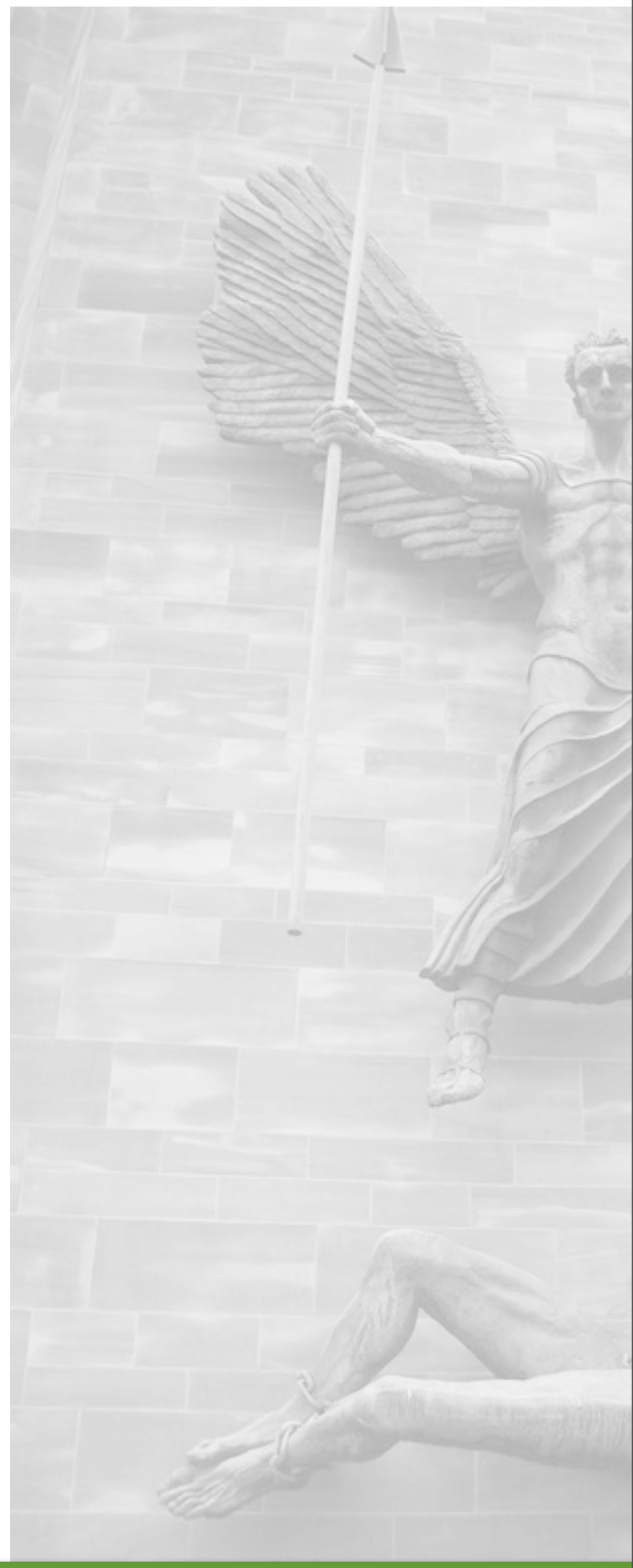
New Cambridge

- January 1974, Godley and Cripps, **policy proposition**: "changes in exports, import prices, etc, make a lot of difference to real income and output, but none at all to the balance of payments, however paradoxical."

- Public Expenditure Committee, late 1974, an **equation**, estimating the private sector's net acquisition of financial assets as a stable function of disposable income.

- *Economica* article 1976, a **model**, the policy and the equation are not deduced from the model assumptions. As:

$$\frac{DG}{Y} = 0.15g + 0.30r - 1.05\frac{B}{Y}$$



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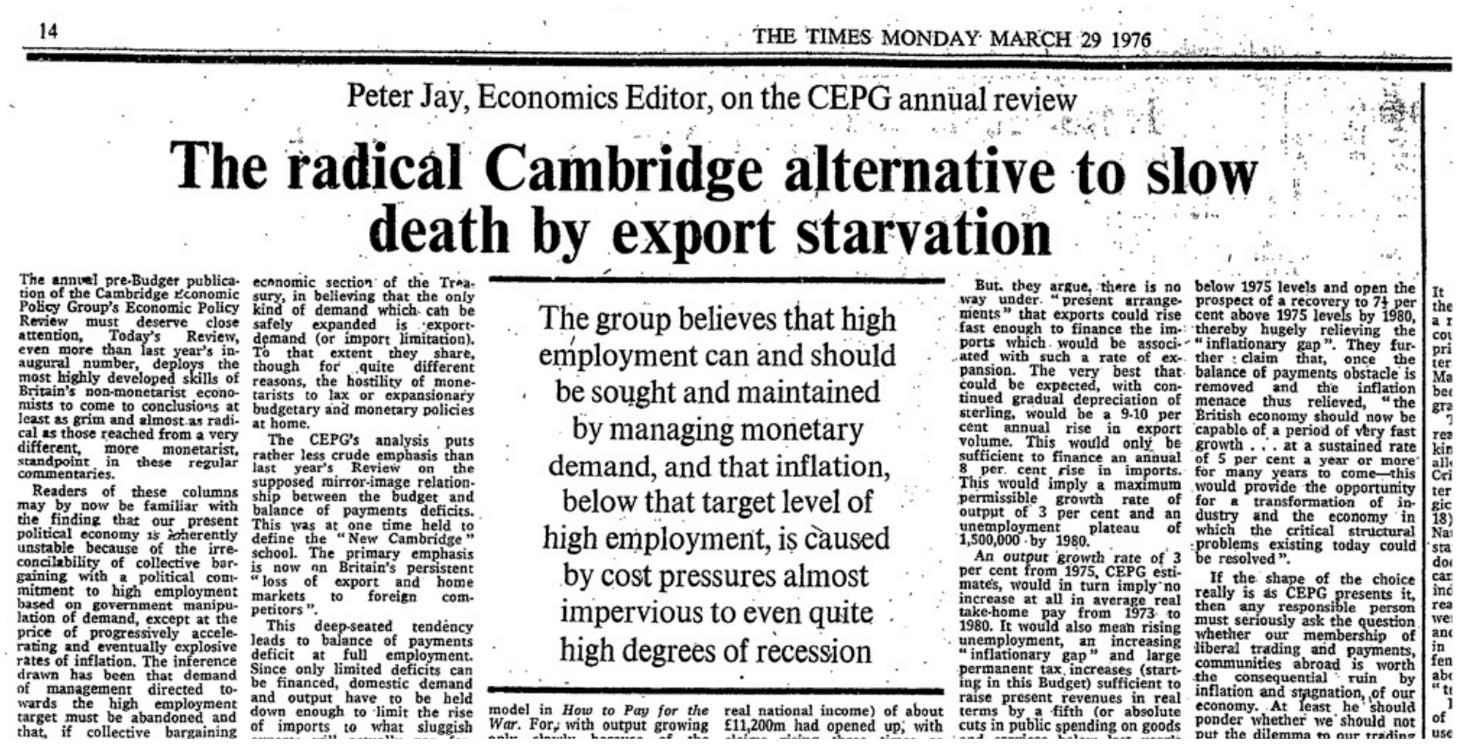
New Cambridge



14 THE TIMES MONDAY MARCH 29 1976

Peter Jay, Economics Editor, on the CEPG annual review

The radical Cambridge alternative to slow death by export starvation

The annual pre-Budget publication of the Cambridge Economic Policy Group's Economic Policy Review must deserve close attention. Today's Review, even more than last year's inaugural number, deploys the most highly developed skills of Britain's non-monetarist economists to come to conclusions at least as grim and almost as radical as those reached from a very different, more monetarist, standpoint in these regular commentaries.

Readers of these columns may by now be familiar with the finding that our present political economy is inherently unstable because of the irreconcilability of collective bargaining with a political commitment to high employment based on government manipulation of demand, except at the price of progressively accelerating and eventually explosive rates of inflation. The inference drawn has been that demand of management directed towards the high employment target must be abandoned and that, if collective bargaining

economic section of the Treasury, in believing that the only kind of demand which can be safely expanded is export-demand (or import limitation). To that extent they share, though for quite different reasons, the hostility of monetarists to lax or expansionary budgetary and monetary policies at home.

The CEPG's analysis puts rather less crude emphasis than last year's Review on the supposed mirror-image relationship between the budget and balance of payments deficits. This was at one time held to define the "New Cambridge" school. The primary emphasis is now on Britain's persistent "loss of export and home markets to foreign competitors".

This deep-seated tendency leads to balance of payments deficit at full employment. Since only limited deficits can be financed, domestic demand and output have to be held down enough to limit the rise of imports to what sluggish

> The group believes that high employment can and should be sought and maintained by managing monetary demand, and that inflation, below that target level of high employment, is caused by cost pressures almost impervious to even quite high degrees of recession

model in *How to Pay for the War*. For, with output growing

real national income) of about £11,200m had opened up, with

But, they argue, there is no way under "present arrangements" that exports could rise fast enough to finance the imports which would be associated with such a rate of expansion. The very best that could be expected, with continued gradual depreciation of sterling, would be a 9-10 per cent annual rise in export volume. This would only be sufficient to finance an annual 8 per cent rise in imports. This would imply a maximum permissible growth rate of output of 3 per cent and an unemployment plateau of 1,500,000 by 1980.

An output growth rate of 3 per cent from 1975, CEPG estimates, would in turn imply no increase at all in average real take-home pay from 1973 to 1980. It would also mean rising unemployment, an increasing "inflationary gap" and large permanent tax increases (starting in this Budget) sufficient to raise present revenues in real terms by a fifth (or absolute cuts in public spending on goods

terms by a fifth (or absolute

below 1975 levels and open the prospect of a recovery to 7½ per cent above 1975 levels by 1980, thereby hugely relieving the "inflationary gap". They further claim that, once the balance of payments obstacle is removed and the inflation menace thus relieved, "the British economy should now be capable of a period of very fast growth . . . at a sustained rate of 5 per cent a year or more for many years to come—this would provide the opportunity for a transformation of industry and the economy in which the critical structural problems existing today could be resolved".

If the shape of the choice really is as CEPG presents it, then any responsible person must seriously ask the question whether our membership of liberal trading and payments, communities abroad is worth the consequential ruin by inflation and stagnation, of our economy. At least he should ponder whether we should not put the dilemma to our trading

"I did find myself badly outflanked by the rise in influence of monetarism . . . It was not, as I now see it, that the monetarists won any argument in the sense that they made propositions which I was forced to concede, on reflection, were correct. They won it for a different reason which I now admit with some shame and frustration - namely because in my own thinking I was only just beginning to incorporate balance sheet concept systematically and therefore found myself unable, at the elementary level of accountancy, to give convincing answers to perfectly simple questions about where money 'was' in my model." (Godley 2000, p. 236)

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Defeat

Monetarism attacked by top economists

By David Blake
Economics Editor

Three hundred and sixty-four of Britain's leading academic economists have today published an outspoken attack on the Government's handling of the economy.

The group, which includes most of the men who have held the coveted post of Chief Economic Adviser to governments since the war, declares that present policies are eroding the industrial base, deepening the depression and threatening social and political stability.

The attack comes in the form of a statement which was circulated in Britain's universities just after the Budget. Copies have been sent to the Prime Minister and to the Chancellor of the Exchequer. Although uncompromising in tone, it has succeeded in attracting massive support from the community of academic economists.

Among the signatories are the president, nine vice-presidents and the director-general of the Royal Economic Society.

The statement says: "We, who are all present or retired members of the economic staffs of British universities, are convinced that:

There is no basis in economic theory or supporting evidence for the Government's belief that by deflating demand they will bring inflation permanently under control and thereby induce an automatic recovery in output and employment;

Present policies will deepen the depression, erode the industrial base of our economy and threaten its social and political stability;

There are alternative policies; and

The time has come to reject monetarist policies and consider urgently which alternative offers the best hope of sustained economic recovery."

Five men who have held the post of Chief Economic Adviser to the Government since the war have signed the statement. They are Professor James Meade, Lord Roberthall, Sir Alec Cairncross, Sir Bryan Hopkin and Sir Fred Atkinson.

Sir Donald MacDougall, at present at the Confederation of British Industry, and Sir Kenneth Berrill, who was until

Continued on page 15, col 4

University economists attack Tory policy

Continued from page 1

last year head of the Government "think tank", are the two former Chief Economic Advisers to the Government who have not signed the statement. But under Sir Donald's guidance, the CBI has been critical of Government policy.

The organizers say that the response from different universities throughout the country may have been influenced by the timing of the statement, which went out as term was ending. The biggest contingent, 54 in all, comes from Cambridge University, the original home of the statement. There are 47 signatories from the various colleges of London University, 13 from Oxford and 21 from Warwick.

The list includes 76 present or past professors. Thirty-six universities are represented.

The statement was organized by Professors Frank Hahn and Robert Nield at Cambridge.

The aim is to bury the controversy over whether the Government is right in its present policies and switch attention to what alternatives should be pursued instead. The organizers feel that the economics profession in Britain has never been convinced of the case for monetarism, but that this fact has never clearly been communicated to the country as a whole.

Monetarism's converts have been largely in the City, politics and in the Press, although there are some leading academic economists who do broadly subscribe to the monetarist viewpoint.

The statement aimed against monetarism comes from economists who could be loosely described as "Keynesian" in their views.

- The 364 economists letter
- Social Science Research Council cuts funding in 1982
- Weak impact and dim reviews of *Macroeconomics* in 1983

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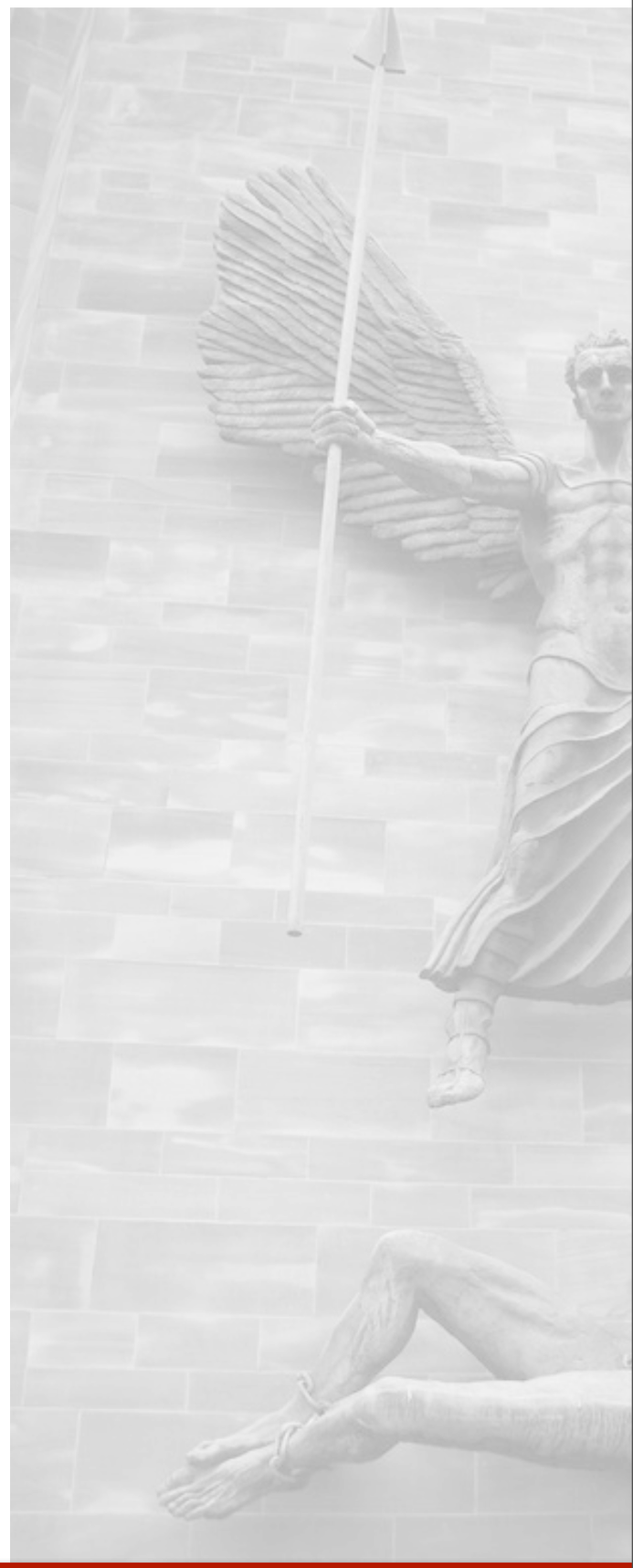
Wise man

- Return to the Treasury, Panel of Independent Forecasters.

  "the forecasts I publish are not the result of a model working independently of my mind" (Godley in Evans 1997, p. 410)

  "[T]ables of numbers are the enemies of good forecasting; [forecasts] should be judged by whether or not they give a good idea of what the whole situation is going to be like, what character it will have." and "A forecast ought to convey the whole character of the forthcoming period; it shouldn't be thought of as being an entirely quantitative thing" (Godley in Evans 1997, p. 411, 416).



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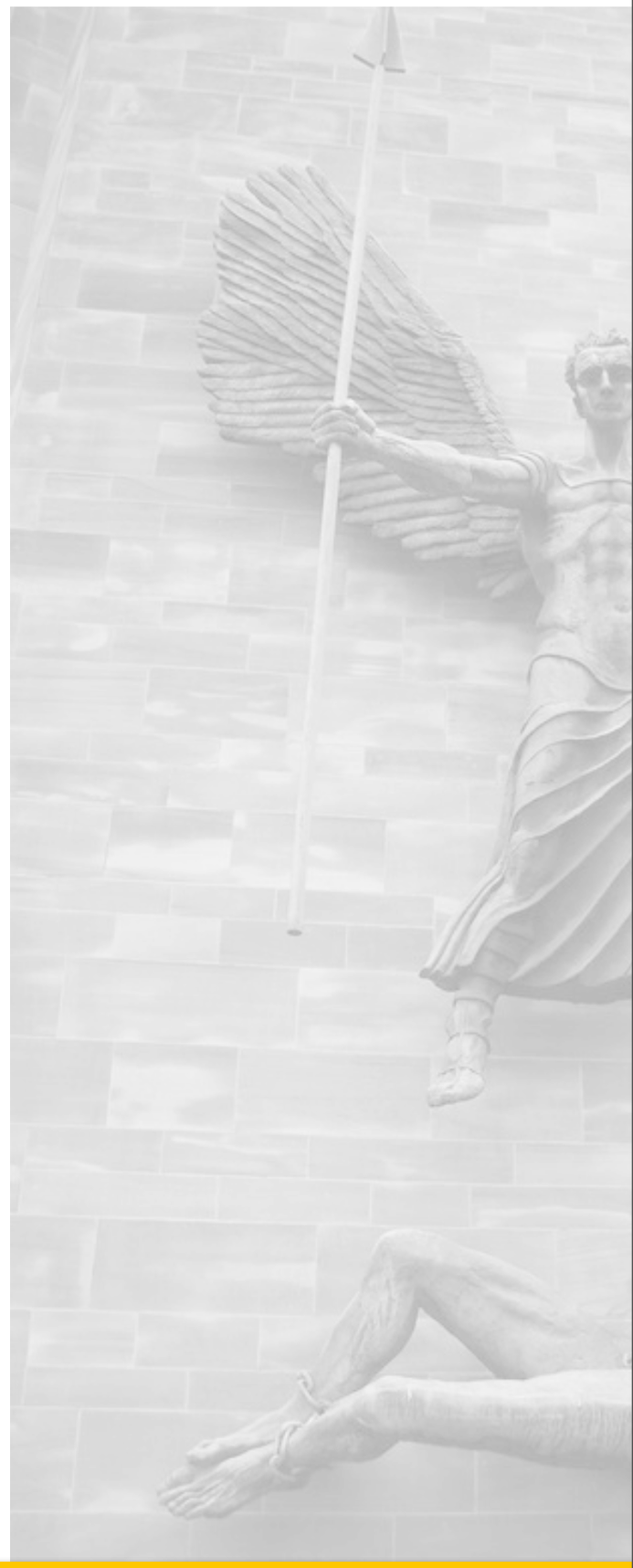
Judgment

- Knowledge of data: collection, interpretation, design.
- The comprehensive, interpretative view on the economy.
- One handed school of advising.
- Importance of forecasting: "unless a government is merely capricious, its policy is essentially based on a forecast, otherwise it can have no grounds for doing one set of things rather than another."



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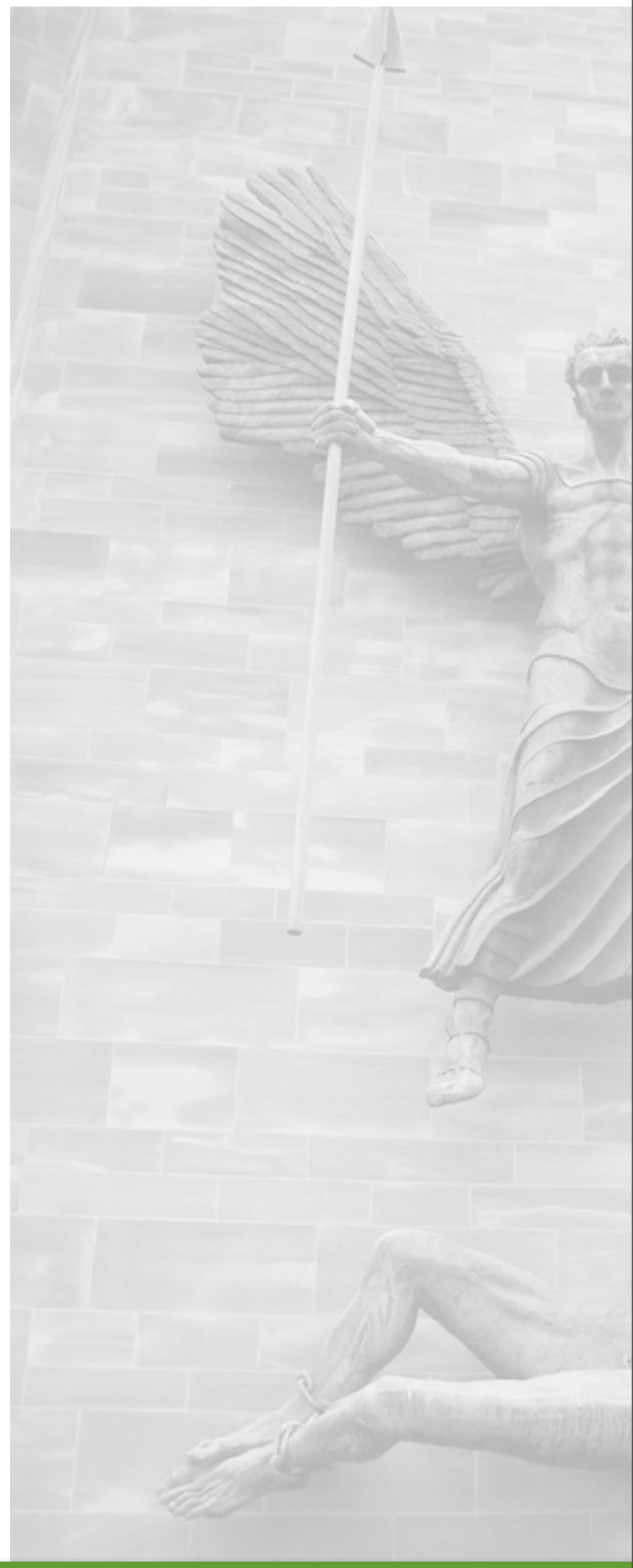
Academic economists build models.

Government economists build visions.



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