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CORRESPONDENCE

From John Langmore and John Quiggin

TOM VALENTINE'S recent review article 'A Consumers' Guide to Recent Critiques of Economics' (*Agenda*, vol. 2, no. 2, 1995, pp.233-40) reviews three books, including our *Work for All: Full Employment in the Nineties* (Melbourne University Press, 1994). Our book is about economic policies for a return to full employment. It is not and does not pretend to be a critique of economics. However, in order to assist potential consumers, we wish to respond.

Valentine's second paragraph is worth quoting in full. He says:

> At the core of all three books is a critique of economics. In some cases (such as Langmore and Quiggin) the criticism is directed towards 'rational economics', but this term seems to denote no more than the application of mainstream economic theory to policy questions. The authors use the word 'rational' in a pejorative sense, apparently because it evokes the impressions of such horrors as expenditure cuts and reductions in employment. In the remainder of this review the adjective is dropped and the term 'economics' is employed alone. (p.233; quotation marks in original)

In reality, we never mention the term 'rational economics' in *Work for All*, and use the word 'rational' exclusively in a positive sense. Valentine appears to believe that, because we refer to other people's use (both favourable and pejorative) of the term 'economic rationalism', it is acceptable practice to fabricate quotes in order to represent us as not only as critics of 'rational economics', but as being frightened of the very word 'rational'. While unconventional in academic terms, this treatment of textual evidence is quite consistent with Valentine's attitude towards inconvenient empirical evidence.

For the record, this is what we say about economic rationalism:

> The term 'economic rationalism' first entered the Australian lexicon in the period of the Whitlam government and was used primarily in a positive sense. The connotation was that of policy formulation on the basis of rational analysis, as opposed to tradition, emotion and prejudice. With the exception of support for free trade, there was no presumption in favour of particular policy positions. Views were generally in the economic mainstream of the period. (p.42)

We make it quite clear that we support the rational application of mainstream economics to policy formulation. Precisely for this reason, and because many people still use the term 'economic rationalism' in the sense described above, we

reject it as an appropriate description of the body of economic and political thought we are criticising, preferring the term 'economic fundamentalism' to describe an irrational approach which invariably regards markets as operating perfectly satisfactorily, regardless of the empirical evidence, and rejects intervention in the interests of either efficiency or equity.

The problem here is more than semantic. Valentine's attempt to claim that 'economics' equals his brand of economics is a common rhetorical manoeuvre in this kind of debate. However, this manoeuvre is rarely as blatant as in Valentine's references to our work as 'non-economists' views about economic questions' (p.240) and to our alleged belief that 'if economics is wrong, their own views must be right' (p.235).

Equally common, but entirely self-contradictory, is Valentine's point that our 'criticisms [of the competitive model] are not new. They have been raised and discussed in economics textbooks and courses for as long as I can remember' (p.235). This is, of course, true, and we cite such eminent economists as Keynes, Baumol, Samuelson, Meade, Tobin and Vickrey as our sources for particular arguments. But if our criticisms of economic fundamentalism are based on standard economic arguments by mainstream economists, what becomes of Valentine's claim that our position represents a rejection of mainstream economics and indeed of economics *tout court*? Nothing more than the fact that Valentine has decided that he is right and that Keynes, Baumol, Tobin and Samuelson are wrong. According to the exigencies of his argument, Valentine shifts from defining economics as agreement with his own views to a definition that would allow Samuelson, Tobin and perhaps even Keynes into the mainstream.

A related rhetorical trick is at work when Valentine says 'Langmore and Quiggin *appear* to believe that [the falsity of the rational egoist model] means people do not react to economic incentives at all' (p.235; emphasis added), then goes on to point out various instances in which we recognise that incentives do matter. If the review were focused on our actual views rather than those imputed to us by Valentine, such contradictions would disappear.

Our principal crime appears to be the view that the elasticity of employment with respect to real wages is smaller than the −0.5 per cent estimated by studies such as that of Russell and Tease (1991), and is of minor relevance to policy. If this view is enough to define us out of the economics profession, what would Valentine say of Card and Krueger (1994), who find no significant impact of the minimum wage on American employment? Worse, what of the referees and editors of the *American Economic Review* who accepted the article for publication, or the members of the American Economic Association, who awarded Card the J. B. Clark Medal? The economics profession as defined by Valentine would be a small and select body.

Valentine says that we launch

> a vicious attack on a straw man: the suggestion that real wages should be reduced by 30 per cent. So far as I know no economist has advocated this policy. Any substantial reduction in wages would be disruptive. (p.239)

The reference to disruption is a red herring since we discuss only the long-term consequences of such a wage cut. Also, Valentine does not mention our observation (on the following page) that, while some commentators have endorsed the idea of a 30 per cent wage cut, the majority of economic fundamentalists have declined to nominate any target wage cut.

The minority that has accepted the case for specific large wage cuts includes John Stone, who, in his article titled 'Cut wages for more jobs' in *The Australian Financial Review* of 3 June 1993, quoted Gregory's estimate that 'to restore full employment, real wages would need to fall by about a third' and asked why Gregory and others had not 'expressed outrage that our nationally disastrous unemployment figures are allowed to persist'.[1] It includes John Howard and John Hewson, whose *Jobsback* package included cuts of more than 30 per cent in minimum youth wages. It also includes Valentine (1993), who presents a simulation claiming to show that unemployment would have been eliminated if annual real wage growth since 1964 had been cut by 0.7 per cent. The implied real wage reduction by 1995 is over 20 per cent.

Valentine criticises us for claiming that dividend imputation is 'regressive' (p.239), but does not deny that our claim is true. His subsequent argument has nothing to do with tax incidence, but is simply a reiteration of the standard efficiency case for imputation. The question of whether any efficiency benefits justify the adverse income distributional effects is not even addressed. This is simply confirmation of our claim that economic fundamentalists are unconcerned with equity, at least as the term is used in mainstream economics.

On financial deregulation, Valentine claims that it is as inappropriate to examine movements in bank margins as a guide to the benefits of deregulation as it would be to examine the profitability of BHP on the basis of margins between input and output prices, since such a comparison 'ignores all other costs' (p.239). We, along with other mainstream economists who have debated the issue, would suggest that the critical issue is precisely that of movements in costs, and that profitability is a side issue. The whole basis of deregulation was that competition would lead to efficiency gains and therefore to cost reductions. However, if profitability is the issue, it is disingenuous to quote the 1991 Report of the Martin Committee as evidence of declining profits. Surely Valentine is aware that in the period since 1991, a number of banks have reported record profits.

In summary, Valentine's main argument is based on invented quotes and on a wilful or reckless misrepresentation of our position. His attempt to claim sole ownership of the term 'economics' for himself and his clique is arrogance that is not backed up by performance. His specific criticisms of our work are sloppy and inaccurate. Consumers who want to decide for themselves, and to see what has called forth this kind of attack, should read our book.

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[1] To be fair, Stone suggested that this was an overestimate of the necessary cut. But his support for large wage cuts to restore full employment is unequivocal.

References

Card, D. & A. Krueger (1994), 'Minimum Wages and Employment: A Case Study of the Fast Food Industry in New Jersey and Pennsylvania', *American Economic Review* 84(4): 772-93.

Russell, B. & W. Tease (1991), 'Employment, Output and Real Wages', *Economic Record* 67(2): 34-45.

Valentine, T. (1993), 'The Sources of Unemployment: A Simple Econometric Analysis', *Economic Papers* 12(4): 1-20.

Tom Valentine responds:

WHERE is one to start? The letter from John Langmore and John Quiggin suffers from the same weaknesses as their book. It is highly emotional and relies heavily on debating tricks and invective when, as frequently happens, logical argument fails the authors. What light is thrown on policy differences by their reference to a 'clique'? Does the publication of a paper in the *American Economic Review* or the award of a prestigious medal to one of its authors indicate that its model is correct or relevant? In fact, the article by Card and Krueger has been subjected to considerable criticism, and the issue remains unresolved.

An example of the debating tricks used by Langmore and Quiggin is the allegation that I have decided that I am right and that Keynes, Baumol, Tobin and Samuelson are wrong. Where did I make this claim? What I did was to point out that the criticisms given in the three books I reviewed were 'not new' (p.235). In fact, I regard most of the criticisms as valid, but not as justifying a rejection of free-enterprise economics.

Langmore and Quiggin frequently use the term 'economic rationalism' (see Chapter 4 of *Work for All*). 'Rational economics' is a widely used alternative to it. It is true that Langmore and Quiggin prefer the term 'economic fundamentalism', but this is because of its pejorative flavour. It has no other virtue. Nor, as Langmore and Quiggin suggest on page 40 of their book, is it commonly used. Langmore and Quiggin wish to depict those who favour the outcomes of free markets over those produced by government regulation as desiccated calculating machines, basing their recommendations on economic models drawn from first-year textbooks, interested only in efficiency and ignoring all non-economic aspects of human life. This is a straw man. The people that Langmore and Quiggin cite in their letter as favouring real wage cuts do so because they are concerned about the economic and the non-economic costs of unemployment. This is certainly made clear in the article of mine that they cite (Valentine, 1993).

In *Work for All*, the construction of the fundamentalist straw man quickly descends into name-calling:

> An unremarked feature of the work of economic fundamentalists is their pedantry. They deregulated only for the powerful but increased petty regulation of the weak. (p.47)

Did they really mean to use the word 'pedantry'? It is not appropriate, but it does add to the picture they are attempting to paint. An example they give of this 'pedantic' regulation of the weak, unaccountably missed by other commentators, is the imposition of taxes on financial transactions. In fact, most people who regard themselves as economic rationalists view these taxes as highly undesirable.

Langmore and Quiggin criticise me for saying that 'Langmore and Quiggin appear to believe that [the falsity of the rationalist egoist model] means people do not react to economic incentives at all' and then noting that they recognise the effect of economic incentives in certain situations. My actual criticism was that Langmore and Quiggin accept this assumption when it is convenient but reject it as having a relevant role in economic theory. Any reader who doubts this should look at page 101 of *Work for All*.

Langmore and Quiggin object to my use of the word 'appear' in the quotation discussed in the previous paragraph. Unfortunately, the word is necessary in reporting many of the statements in their book because they have a tendency to imply conclusions rather than stating them directly. Another example is found on page 49 of *Work for All*: 'The rise in unemployment was blamed on the real wage "explosion" under the Whitlam government.' Langmore and Quiggin appear to doubt this conclusion, but there is no direct statement of their reservations.

It is apparent that Langmore and Quiggin have been unable to cite an economist who has actually suggested a 30 per cent wage cut as distinct from favouring a modest wage cut or (what amounts to the same thing in the current environment) wage flexibility. It is not clear why disruption is a 'red herring', but it is clear that we are dealing with another straw man. The most important question is why these views (and other analysis relating unemployment to wage growth) are not discussed in the book. In *Work for All* Langmore and Quiggin attribute 'a totalitarian impulse' (p.43) to those who support economic rationalism in that they are supposed to ignore evidence that contradicts their views. This description seems more accurately to fit the approach Langmore and Quiggin adopt in their book.

In my own article (Valentine, 1993), I stressed that the need for wage reductions disappears if economic growth is sufficiently strong. In addition, wage flexibility is likely to promote economic growth, a possibility which Langmore and Quiggin ignore and which invalidates the analysis of the effects of wage cuts given on page 51 of *Work for All*. The analysis is questionable in other respects too.

Langmore and Quiggin criticise me for concentrating on the efficiency aspects of the imputation system of corporate taxation. I raised this question because Langmore and Quiggin ignored this aspect. In any case it is not clear that it is equitable to tax one form of income twice. This whole question requires a more thorough analysis than that provided by Langmore and Quiggin. It is also interesting

that they look for a measure of the balance of the equity/efficiency outcomes of this tax, because this approach is not applied to any of the policies they support.

Langmore and Quiggin's comments on financial deregulation are hard to follow. They now appear to accept that interest-rate margins are not the basic test of the success of financial deregulation, although they cited them as such in their book (p.72). According to Moore (1995), banks have reduced their ratio of operating costs to operating income. To this extent, deregulation has been successful, though Moore believes that further cost reductions are possible.

The major weakness of *Work for All* is that its authors present no economic model to replace the ones they reject. As a result there are no economic arguments underpinning their proposals, and no serious attempt is made to predict the effects of their proposals. That is why I do not regard *Work for All* as an 'economics' book.

References

Moore, D. (1995), 'Has the "Competition" Goal of Deregulation been Fully Recognised?', *Australian Banking Law Bulletin* 10(7): 57-66.

Valentine, T. (1993), 'The Sources of Unemployment: A Simple Econometric Analysis', *Economic Papers* 12(4): 1-20.