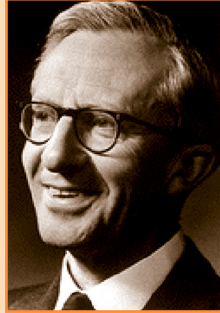


JAMES EDWARD MEADE

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James Edward Meade is ranked in textbooks of economics as one of the leading lights of neo-liberalism in England, promoting the idea of targeted and programmed interventions by the state into a market economy, as far as these contribute to its development.

In 1977 James E. Meade was granted the Nobel Prize for economics, together with the Swedish economist Bertil



Ohlin for their breakthrough work in developing the theory of international trade. As prof. Assar Lindbeck, a member of the Swedish Royal Academy of Sciences, stated this prize could have been granted to him also for his contribution in the field of national accounts, or for developing the theoretical foundations of Keynesian economic policy.

James Edward Meade was born on 23 June 1907 in England in the city of Bath, where he also grew up. Before going to Oriel College in Oxford, he studied primarily Latin and Greek. Here he continued in his classical education until 1928.

His interest in economics was awoken largely by the high rate of unemployment in Britain during the inter-war years. In 1930 he gained a grant for Hertford College with the possibility to continue study as a graduate student in economics, but instead, on the basis of an invitation by Dennis Robertson, a close family friend, decided to study at Trinity College Cambridge as his student. Here he became a close friend of Richard Kahn, as well as the wider circle of economists discussing Keynes's work the "Treatise on Money", providing the stimulus for its transformation into the "General Theory". From 1931 to 1937 he was a lecturer in economics at Hertford College. At that time the teaching of economics as a regular subject was still relatively new and Meade was one of a group of enthusiasts, including Hargreaves, Harrod, Phelps, Brown, Hitch, Hall, Fraser and Allen. Meade's task was to teach the whole subject of economic theory, but his interest was taken most by the economics of mass unemployment and international economic relations.

At the end of 1937 Meade became a member of the Economic Section of the League of Nations in Geneva and he worked as the main editor of the journal "World Economic Survey". He published two editions: the 17th and 18th. They were preceded by the publication of "The Course and Phases of the World Depression" by Bertil Ohlin in 1930. Preparation of the World Economic Survey relied on several specialised studies prepared by acclaimed members of the economics section, such as Rasminsky, Tirana, Nurkse and Hilgerdt.

Following the outbreak of war in April 1940, Meade left Geneva and returned to England. Up until 1947 he was a member of the economics section of the War Cabinet,

becoming its director in 1946. Under the leadership of Lionel Robbins and in close cooperation with Keynes the section became an influential institution solving everyday economic problems ranging from the rationing system through to the pricing policy of nationalised companies. Here Meade dealt in particular with the three main tasks:

- together with Richard Stone he prepared the first official estimates in the form of national accounts, for the incomes and expenditures of Britain,
- he participated in discussions and submitted proposals leading to a White Paper on Employment Policy in 1944, in which the British government accepted the maintenance of employment as an obligation of government policy,
- a third field comprised discussions, government proposals and conferences dealing with the issue of post-war international finance and economic arrangements in the form of the International Monetary Fund, International Bank for Reconstruction and Development and the General Agreement on Tariffs and Trade. It was this third task that most interested Meade.

In 1947 he became a professor of trade at the London School of Economics, where Lionel Robbins headed the economics department. During this period he worked with Professor A. W. H. Phillips, thanks to whom he came to understand the theory of dynamic systems. When he began to teach the subject "The World Economy" he decided to rewrite his own book from the pre-war period "An Introduction to Economic Analysis and Policy" and to concentrate on the topic of international economic policy. He elaborated this topic in a two-volume work "The Theory of International Economic Policy". The first volume, "The Balance of Payments", was published in 1951 and the second one, entitled "Trade and Welfare", was published in 1955.

The work on these books took Meade practically 10 years, during which time he was working at the London



School of Economics, nonetheless in his view they still did not cover the whole field of international economic policy. As he himself said, he had given little attention to the issue of the international aspects of economic growth or dynamic imbalance. Despite this, he was granted the Noble prize for economics for these works in 1977.

In 1957 Meade moved to Cambridge, where he worked as the head at the Department of Political Economics and remained there until 1967, when he took a place as an independent research worker. During this time he

wrote several scientific studies: "The Stationary Economy", "The Growing Economy", "The Controlled Economy", "The Just Economy". In these studies he worked from the thesis that rational economic policy must take account of all aspects of economic life, something he considered a very demanding task.

From 1974, when he retired, he chaired a commission composed of first class economic theoreticians and foremost experts in tax law, accounting and administration.

James E. Meade died in 1995.

Meade and his contribution to the development of economic theory

One of Meade's most important contributions was in the field of elaborating the theory of the balance of payments, where he identified under which circumstances a country can concurrently achieve an equilibrium both internal as well as balance in its international payments. He pointed out the conflict between the aims of ensuring full employment and bringing the balance of payments to equilibrium. He proposed resolving this conflict through an appropriate combination of various economic policy instruments leading to the concurrent attainment of both goals. He made breakthroughs primarily in his analysis of the impacts of the interest rate and monetary policy on the balance of payments, as well as his analysis of the importance of exchange-rate system for the effective operation of stabilisation policy. He also clarified problems that occur when countries resolve their internal and external equilibrium without regard to the situation in neighbouring countries. On the basis of this he highlighted the importance and need for coordination of stabilisation policy between countries.

Of great importance was also his analysis of the consequences of various types of economic-political measures and institutional arrangements for international trade and the international division of work. Meade may be considered as the founder of the modern theory of employment in open economies. His analysis also pointed out the need to ensure a corresponding level of aggregate demand for goods and services in such economies, as well as the level of domestic costs and prices at which full employment is achieved and the balance of payments brought into balance.

Meade's contribution to developing the modern theory of economic policy in the conditions of an open economy

Meade's most important work, "The Balance of Payments" (1951) and "Trade and Welfare" (1955), bears the mark of Keynes's theory, based more on models of

a static equilibrium in the economic system than on dynamic, or disequilibrium, models. As he stated in his lecture on the occasion of receiving the Nobel Prize for economics, he understood the macro-economic system as a tightly interconnected complex of internal and external equilibrium, where the attainment of internal equilibrium concurrently creates the conditions for external equilibrium.

By internal equilibrium he meant concurrent full employment and price stability, where he did not view these two variables as two separate things. He worked from the assumption that if within an economy the level of effective demand ensuring full employment is maintained, the nominal price level is also adequately stable. An important precondition for this understanding of internal equilibrium is that nominal wages are either constant or changing only slowly. As however Meade himself later stated, this seemingly rational presumption was valid only in the 1930s. He gradually though came to the conclusion that it is necessary to perform an analysis of employment in the conditions of an open economy and thus he saw equilibrium of the macro-economic system as lying in a reconciliation of three goals: bringing the balance of payments to equilibrium, full employment and price stability.

An problematic element in these considerations was the danger that trade unions and other institutions setting wages do not allow the attainment of full employment without nominal cost-price inflation. Meade's view was that it is possible to define the natural rate of employment as that level (in the case of the existence of the relevant institutions influencing the mechanism for determining wages) at which real wages would grow at the same rate as labour productivity growth. If we take this natural level of employment to be full employment, then we can say that Meade succeeded in defining the condition for internal equilibrium for that situation in an economy when both full-time employment and price stability are achieved concurrently.

This raises the question of what is the role of those institutions who, through their activity, influence the level of full employment thus defined. Meade tends to incline towards the view that institutional factors deter-



mining wages can be the cause of very real difficulties and therefore put forward the view that it is necessary to reform the institutional arrangement of wage determination. Therefore in its extreme form the definition of full employment can be taken to be that level of employment when the relationship between demand and supply in the labour market, in conditions of perfect competition (no monopsonic employers, no monopolistic trade unions, no social benefits, no mandatory payments upon redundancy or additional payments to wages, etc.) does not lead to efforts to force real wage growth to be faster than labour productivity growth.

If we work from the thesis that to each macro-economic political targets (external equilibrium, full employment and price stability) there should correspond a relevant economic policy instrument, then Meade categorises these instruments as follows:

- instruments directly influencing the level of the demand for money (monetary and budgetary policy),
- instruments directly affecting the determination of nominal wages (wage bargaining),
- instruments directly affecting the foreign exchange sphere (determination of exchange rates, foreign exchange control measures and trade policy instruments influencing the total value of the import and export).

It is important to find a way of simultaneously putting in place all available economic policy instruments leading to the most favourable concurrent influencing of all aims. In such an approach no economic policy instrument is directed narrowly upon only the one specific target, but rather it is important to achieve a joint effect of the synergic action of all instruments on all goals. Meade however realised the demands this task leads to and also saw the political connections in which individual economic policy instruments are used, and therefore recommended that each institution exercising a specific economic policy instrument should have clearly delimited responsibility for the success, or otherwise, in achieving its clearly defined goal.

There are six different combinations as to how match the three aims with three instruments oriented on these aims. Meade considered the most important three of these to be:

- demand regulation instruments, tax and monetary policies, that would be used for influencing money expenditures so as to prevent too high inflation, or deflation of total financial incomes;
- institutions determining wages would be shaped so as to limit upward movements in nominal wages in those sectors where there is no shortage of workers and, conversely, to allow such movements upwards in those sectors to which it is necessary to attract, or retain workers so as to maintain full employment in the economy;

- foreign exchange policy should be used for maintaining an equilibrium in the balance of payments by demand regulation instruments leading to a limitation of monetary inflation and through instruments influencing wages leading to the attainment of a realistic level of employment and output.

From the aspect of the responsibility of institutions executing economic policy measures, Meade considered it most appropriate that the central bank, whose role it is to create the quantity of money in circulation, and the Ministry of Finance, which allows money to enter the economy, be responsible for preventing inflation and deflation. Those institutions in whose competence lies the determining of wage rates in various sectors of the economy should be responsible for the impacts of their decisions on the forming level of employment. The effectiveness of such a separation of responsibilities lies in the assumption that the flexibility of demand for labour is sufficiently high as regards the real wage. In Meade's view an effective combination of full employment with the exclusion of inflation necessarily requires that the main criterion for determining the level of wages is the relationship between demand and supply in the labour market, without an undue insistence on achieving and maintaining the specific real wage income. This must, in his view, be the result of domestic labour productivity, international trade, tax and other measures leading to the influencing of the division of income between the net (post-tax) wage and other net (post-tax) incomes.

As regards external equilibrium Meade works from the fact that there should exist a certain separation of powers between national governments and international institutions. National governments should be responsible for national monetary, fiscal and wage policy, ensuring full employment and price stability. External equilibrium should be maintained through foreign exchange policy under the supervision of international institutions, for example in the form of adjustments to exchange rates between national currencies, naturally in combination with free trade and payments.

Special regulatory mechanisms under the supervision of the respective international institutions are necessary in particular when there is a deformation of international transactions and limitation of the free movement of goods and capital, for example in consequence of sudden changes in international capital movements, or if marked differences exist between national tax regimes, etc.

The post-war arrangement of the international monetary system and the creation of institutions such as the International Monetary Fund, the International Bank for Reconstruction and Development, the General Agreement on Tariffs and Trade led to a remarkable expansi-



on in international trade. This system nevertheless had one weak point – inflexible exchange rates, though this was later successfully removed through a transition to flexible exchange rates. Despite this, in Meade's view there is still one haunting spectre in international affairs - that of the import of products competing with domestic sectors in which there already exists significant unemployment. As Meade stated, this occurs because many national governments of industrially developed countries have been unsuccessful in searching for an appropriate national institutional procedures for linking employment with price stability. In the case of full employment and price stability within a country the balancing out of the balance of payments could automatically be left to the flexible exchange rate mechanism. Meade considered a change in the approach of advanced countries towards wage policy principles as one of the most important factors upon which the healthy development of the whole world depends.

The reform of institutions involved in regulating the formation of wages, in his view, requires the retention of market regulation of wage rates on the basis of agreements between businesses and unions, and would concurrently create the institutional basis for the social regulation of wage rates again for achieving the highest possible employment with the help of independent salary commissions or arbitration panels. These commissions should, according to Meade, resolve disputes and determine wages or their increments so that the government forecast rate of wage growth be respected.

Meade's contribution to the theory of inflation

Meade in his works at the turn of the 70's and 80's developed a new understanding of inflation, terming these "New Keynesianism". The most important of them was the work "Stagflation" (1982, 1983), which he wrote together with D. Vines and J. Maciejowski.

The starting point for Meade's New Keynesianism is his understanding of stagflation in the 1970's. In his view its direct cause was a reduction in the rate of profit brought about by growth in wage costs and imported material costs. The two most important factors contributing to the emergence of this situation were: 1. the generally extended use of traditional Keynesian policies using an increase in total money expenditures via budgetary, monetary and credit policy for any level necessary to achieve full employment; 2. the existing monopoly structure of market economies of that time, this referring mainly to the role of unions especially from the aspect of their pressure to increase wages. Meade emphasised that under these conditions it was

no longer possible to employ the traditional recommendations of Keynesian economic policy, since they were not able to face down inflation.

These new conditions, together with the development of international trade, significantly influence relationships between supply and demand in wage determination. In Meade's view, if international trade develops adversely for a given industrial country, for example due to a rise in a world oil prices, or imported raw materials, this has the same results as if labour productivity and other factors of production were to decline in the country. The pressure for a growth in nominal wages in the interest of maintaining the real purchasing power of wage incomes causes an increase in wage costs to domestic producers, without a growth in the sales price of their production. The result is a fall in the profit margin. Therefore domestic producers will reduce demand for labour until the profit margin recovers through a corresponding growth in the sales prices of domestic products. This increase in prices will however lead to a growth in the cost of living, which will bring about renewed pressure for growth in nominal wages and at the same time fall in the profit margin.

In connection with this Meade draws attention to the fact that maintaining real wages – in consequence of an adverse influence of international trade – is not compatible with full employment. The spiral nature of repeating pressure for a fall in profit margins, consequent pressure for a growth in domestic sales prices, growth in nominal wages, further pressure on profit margins and so on – is manifested in stagflation, where the level of employment is below that of full employment and is connected with inflation of nominal prices. He emphasises here that the effective combination of full employment with the exclusion of inflation necessarily requires that the main criterion for determining the level of wages be relationships between supply and demand in the labour market, without an adverse insistence on attaining a specific real wage income. This must be the synthetic result of domestic productivity, international trade, tax and other measures taken by the state towards influencing the distribution of income between usable wages and other incomes.

Meade's concept of New Keynesianism differs from orthodox Keynesianism in the fact that it combines traditional budgetary, monetary and credit policy instruments with policies aimed at regulating foreign exchange rates in the interest of achieving a permanent moderate growth in aggregate money expenditures outlaid on home-produced goods and services. In accordance with this the money income should also grow, by means of ensuring stable growth of the money supply.



Meade here however comes up against two issues, in which he – as he himself says – differs from the monetarists: in a modern economy what should be considered as money, because as he says, the volumes of money substitutes in the economy can quickly rise and fall. At the same time as the speed of money circulation can change substantially. Therefore he proposes that responsibility for monetary regulation should lie with an institution not directly dependent upon the government, but which would through its statute be bound to achieving a stable, though moderately growing money income. This monetary institution (the central bank) would be charged with the duty of independently and autonomously choosing a monetary policy for maintaining overall money incomes on their assigned course.

The stable rate of growth in aggregated money

expenditures outlaid on home-produced goods and services should be stimulated either by fiscal policy instruments (taxes), or credit policy (interest rates).

In Meade's view wage determination also has a considerable influence in all sectors of the labour market. This however requires the reform of institutions involved in regulating wage formation, which in turn requires the retention of the decentralised market regulation of wage rates on the basis of agreements between businesses and unions. Concurrently it would create the institutional conditions for the social regulation of wage rates, aimed at achieving the highest possible employment, with the help of independent salary commissions and arbitration. These commissions should, according to Meade, resolve disputes and determine wages, or their increments, so that the government forecast rate of wage growth is respected.