Review Essay

Money and Government: The Past and Future of Economics. *By Robert Skidelsky*. New Haven: Yale University Press, 2018. xix + 492 pp. Figures, appendixes, bibliography, notes, index. Cloth, $35.00. ISBN: 978-0-300-24032-0.

Reviewed by Hugh Rockoff

Robert Skidelsky, a historian whose fame for his monumental biography of John Maynard Keynes is well deserved, here provides us with a brilliant, well-informed history of macroeconomics stretching from the "British recoinage debates" of the 1690s to today. *Money and Government* was prompted by the 2008 financial crisis. It is an attempt, Skidelsky tells us, to answer the question that Queen Elizabeth II posed to a group of economists at the London School of Economics in October 2008: "Why did no one see it coming?" Not surprisingly, to skip to the bottom line, Skidelsky believes that macroeconomics reached its apogee with Keynes and that it has been more or less downhill from there. The 2008 financial crisis could have been predicted, and ameliorated after it occurred if not prevented, if macroeconomists had remained loyal to Keynes.

How close did macroeconomists come to getting macroeconomics right before Keynes? The mercantilists got a lot right because they believed in a powerful state with much taxation and government borrowing. The main goal of the mercantilists was a state that could win wars. But high taxes and massive government borrowing, according to Skidelsky, helped to make Britain rich. What about the macroeconomics of the classical school of Adam Smith, David Ricardo, and John Stuart Mill? One word will suffice: wrong. Or perhaps better three words: wrong, wrong, wrong.

Keynes set them straight, but after that it goes downhill. First there was the attempt by John R. Hicks, Paul Samuelson ("the most arrogant and clever of the American Keynesians," Skidelsky writes [p. 148]), and others to combine the older classical school with the Keynesian economics and create a "neo-classical synthesis." Samuelson thought that the classical model could be modified to produce Keynesian policy implications if an assumption of sticky wages was introduced. Skidelsky believes

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this was a step backward. The attempt to maintain Keynesian policies was a good thing, but the attempt to keep some of the old school in the mix was a mistake. Samuelson argued that the economy could be kept on an even keel through changes in taxes and government spending without the extreme "socialization of investment," to use Keynes's term, that Skidelsky believes is crucial.

After the neoclassical synthesis we come to the monetarist school of Milton Friedman and his allies. Skidelsky's conclusion about the monetarist school is the same as for the classical school: wrong, wrong, wrong. Friedman claimed that his views were supported by his studies of economic data, and that he had carried out these studies in the spirit of scientific enquiry. But, for Skidelsky, this was "disingenuous" (p. 175). That is, Friedman's empirical findings simply reflected his ideology. The monetarists made logical errors and produced misleading empirical studies because they were warriors for a malign ideology.

Some aspects of Friedman's monetarism have survived, for example, his belief in the efficacy of flexible exchange rates and the importance of lender-of-last-resort interventions by the Federal Reserve. But reliance on the stock of money as an indicator of monetary policy has largely disappeared. One exception is Tim Congdon, a prominent economist at Buckingham University, who still looks to monetary aggregates for insight into the direction of the economy. For this reason, Congdon is a particular *bête noire* of Skidelsky. Congdon even merits an appendix in which Skidelsky claims to refute him.

Macroeconomics has moved on since Friedman's time, but not in ways that please Skidelsky. Robert Lucas introduced rational expectations into macroeconomic model building; however, Skidelsky sees Lucas as a "logical extremist" whose brand of economics was a step further away from reality even than Friedman's (p. 194). The development of dynamic stochastic general equilibrium models, by Finn Kydland, John B. Long, Charles Plosser, and Edward C. Prescott, fares no better. For Skidelsky it is another step away from the real world as described and explained by Keynes. Some macroeconomists might identify themselves as New Keynesians because they calibrate dynamic stochastic general equilibrium models but adopt assumptions that allow them to reach Keynesian conclusions about the effectiveness of fiscal policy. Better, Skidelsky concludes, but still not as good as the real thing.

How does Skidelsky prove that Keynes got things right and that most macroeconomists since then, including many Nobel Prize winners, have gotten things wrong? He relies partly on finding flaws in the reasoning of economists whose policy prescriptions he does not like. But he knows that this will only take him so far. Most readers will want some empirical evidence. And so he turns, as economists must, to economic history.

His hero, Keynes, set a good example. Keynes argued that deficit spending on a sufficiently large scale would get the world out of the Great Depression. To convince his fellow economists, he attacked conventional economic thinking and developed a new theoretical framework for macroeconomics in *The General Theory of Employment, Interest, and Money* (1936). For evidence he turned to history. For one thing, deficit spending had created full employment during wars. Most economists in his day—indeed, most thoughtful citizens—having lived through World War I would have been convinced. Keynes had made this point earlier, and succinctly, in his famous "open letter" to President Roosevelt published in the *New York Times* in 1933: "But in a slump governmental Loan expenditure [deficit spending] is the only sure means of securing quickly a rising output at rising prices. That is why a war has always caused intense industrial activity."

For empirical evidence on the same scale, the answer that Skidelsky keeps returning to is what he and others have designated the "golden age": an unprecedented period of global prosperity that, according to Skidelsky, lasted from 1950 to 1975 (p. 141). What produced the golden age? For some countries that had suffered devastating levels of destruction during the war, Skidelsky acknowledges that growth was rapid in part because of the rebuilding that was necessary. For the United States and Britain, Skidelsky's explanation is simply the adoption of Keynesian fiscal policies.

This wonderful Keynesian world, however, was not to last. Inflation began to rise in the second half of the 1960s. In the United States the takeoff of inflation was partly due, Skidelsky reminds us, to the failure of President Johnson for political reasons to listen to his Keynesian advisers who warned him that taxes had to be raised to prevent inflation. Western industrial economies then entered a period of high unemployment *and* high inflation that required a new name: "stagflation." Monetarists claimed that this stagflation was due to excessively expansionary monetary policies. Skidelsky suggests it might have been due to oil prices. Finally, in the 1980s the inflation was brought under control. A period ensued that has come to be called the "Great Moderation," to contrast it with the Great Depression. Wasn't the Great Moderation the vindication of the adoption of monetarist policies by central banks—indeed, a vindication of Milton Friedman? No, Skidelsky tells us, probably not. It was probably due to falling oil prices and the arrival of a flood of low-cost goods from China.

Granted that Skidelsky has written a highly persuasive polemic, could someone who favored a different point of view—perhaps an enthusiast for Friedman's monetarism or even for the current standard synthesis in macroeconomics—write an equally persuasive volume? I think so.

It would not be easy. They would be competing with a well-informed Keynesian who wields a brilliant pen. But it isn't hard to see how they would go about it. Skidelsky, for example, can see no better explanation for rapid growth in the United States and Britain after World War II than Keynesian fiscal policies.

At least for the United States, it is not hard to come up with a different story.

Let me mention a couple of candidates. First, on the demand side there was a backlog of demand for housing and consumer durables because of the depression and the diversion of resources to war production in World War II. During the war many people accumulated assets that could be liquidated after the war to make these purchases. Similarly, on the supply side there was a backlog of innovations that had been made in the 1930s and during World War II—research went on apace during the 1930s (Alexander Field, *A Great Leap Forward: 1930s Depression and U.S. Economic Growth* [2011])—but that could not be fully commercialized until after the war. Second, in addition, there is what I think would be Friedman's explanation. It would go like this: The rate of growth of real output per capita from 1950 to 1975 was not unprecedented. In fact, it was typical of economic expansions in the United States. The rate of growth of real per capita, for example, was similar, indeed a bit higher, in the ten years before the panics of 1907 and 1930 to what it was during the "golden age." But earlier expansions had been aborted by banking panics. The introduction of deposit insurance, and the policy of the Federal Deposit Insurance Company of finding merger partners for troubled banks essentially creating 100 percent deposit insurance, ended the banking panics and allowed the postwar expansion to go on longer than had been typical. Eventually, to push Friedman's argument forward, the beneficent effects of deposit insurance were undermined by the growth of shadow banks that created what were in effect uninsured deposits.

What all this means to me is that Skidelsky has written a brilliant and powerful polemic, but someone who admires another school could write an equally convincing history of macroeconomics that concludes it was their preferred school that got things right.

Who is the intended audience for *Money and Government*? Not, I think, economists, although one can see the book on the reading list for a course on the history of economic thought. It would not be on many lists, of course, because, at least in the United States, sadly, the history of economic thought is no longer widely taught. The book could also serve on the reading list for a course in undergraduate or graduate macroeconomics, to provide some historical context. But I think it is written mainly for the layperson, perhaps a journalist or politician, who is already an enthusiast of fiscal policy. Such an individual might ask themselves whether they have to listen to an economist from Harvard or Chicago or the Hoover Institution who is defending a tax increase or a cut in government spending. The book's answer is no; listening just to Skidelsky and other Keynesians is the right thing to do.

We economists have made great strides in measuring the economy's ups and downs. We now have measures of employment, prices, and aggregate output that are superior to those available to earlier generations of economists. But we do not have macroeconomic models that allow us to predict when those ups and downs will start and end. I believe we are a bit like the seismologists, or at least what my casual reading of newspaper reports about seismology suggests. We economists can measure the impact of financial earthquakes. We know where the fault lines are. We know, for example, that a financial earthquake is more likely in the United States than in Canada because we have had many financial panics and Canada has had none. But as a science we simply have not reached the point where we can predict the next financial earthquake. Unlike the seismologists, however, it is hard for us to admit what we do not know. We can, or believe we can, influence the outcome of policy debates and influence the world around us by making pronouncements. Inevitably, we fall back on our instincts and our ideological commitments.

Toward the end of the book Skidelsky presents his policy agenda. Government budgets would be divided between a balanced current account and a capital account. The latter could run deficits to finance public works. There would be a buffer stock of public works that could be undertaken in a recession; an American might use President Obama's term, "shovel ready" projects. There would also be an investment bank to undertake provision of public goods such as climate-friendly energy projects. And, if needed, a state holding company to hold the ownership rights to nationalized corporations. All of this seems rather unlikely, at least in the United States. It is hard to imagine Congress turning over so much of its power to spend money to bureaucrats. But then again, political earthquakes are as hard to predict as financial earthquakes.

Hugh Rockoff is distinguished professor of economics at Rutgers University, the State University of New Jersey, and a research associate of the National Bureau of Economic Research. His research focuses on the monetary and banking history of the United States and on wartime economic controls. He is also the coauthor, with Gary Walton, of a textbook: History of the American Economy. *Currently he is working, slowly, on a history of the failures of financial institutions that have triggered financial panics.*