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The Fundamental Issues
in the Controversy of the Policy Paradigms:
Policies, Theories, and Underpinnings

by

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The Fundamental Issues in the Controversy of the Policy Paradigms: Policies, Theories, and Underpinnings

by

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I. Introduction

Whether or not "paradigm" (1), as a word, is or is not an overstatement, in this essay I will identify the differences between and the sources of two policy programs. From the journalistic (popular) standpoint, policy differences stand out most vividly when programs are compared. But often the real differences lie at the underpinnings. What are these underpinnings? Are they at the theory level (where most economists generally believe such matters start), or do they appear, as I believe, long before particular theories are selected and examined?

Should one dispense with opening the examination at the theoretical level? Indeed, is the study of where to start (at the level of policy, at the level of theory, or even deeper) really the economist's problem? Had this better be left to methodologists and philosophers? I think not (2). I undertake a different course and suggest that we start not with the theories but with the consideration of two policy programs, which I will try to synthesize. Thereafter, I will use personal nouns to describe the theoretical tents housing these policies. Finally, I hope that we can agree on looking at the ground where the underpinnings are anchored.

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(1) What "paradigm" means depends upon the choice of dictionaries. Some think that a paradigm is a synonym for ideal type; others identify the word with a completely new set of ideas as, for example, modern chemistry, built on a theory of elements, replaced the earlier phlogiston explanation. I use the word in the former sense.

(2) There is a recurrent theme in many of the histories of our discipline that there is a distinction between the "economic science" (where real "truths" lie) and "economic policy" (which reflects the self interest of factions). In his early [Schumpeter, 1914] work on the history of economic analysis, Joseph Schumpeter [1954] considered only the former, as did Lionel Robbins in his 1932 monograph [Robbins, 1984]. However, both men modified their earlier positions: Schumpeter sometime in the 1940s [Schumpeter, 1954] and Robbins in 1980 [Robbins, 1984]. Nonetheless, the recantations have not influenced the profession, and the current approach still honors this distinction. The popular view is that "policies are theories in action". And according to Occam's law the wiser place to start is with the display of the theory (i.e., the model).

In so doing, I find myself in good methodological company. Hayek, for one, endorses this method (1).

I term my two basic policy groups the "Kiel-Schumpeter Policy Set" and the "Principal Keynesian Policy Set". The former I associate with the views of Herbert Giersch, although he has repeatedly suggested that he got them from his reading of the works of Joseph A. Schumpeter. The latter, as the concept is expressed, draws more than a little from Alan Coddington's metaphor, "the Hydraulic Keynesians" [Coddington, 1976, pp. 1263-1267].

II. The Kiel-Schumpeter Policy Set

A. General Comments

The Kiel group refers to its position as Schumpeterian [Giersch, 1981; 1985a; 1985b; 1986a; 1986b; 1987]. I am willing to label it thus, but the label refers to Professor Giersch's interpretation of Schumpeter (2). If

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(1) Hayek's point is that the alternative method, the one stressing Cartesian abstraction and pure reason, leads not only to the obvious failing, a divorce of thought from life, but also to faulty reasoning associated with incomplete premises [Hayek, 1948]. And Terence Hutchison made the same point when he noted that Ricardo studied economics and then sought election to Parliament not to read the latest truth from *Econometrica* to the House, but to shape policies [Hutchison, 1977]. Economic theory is surely more than rhetoric (an avenue to persuasion), but it is not coterminous with reason and truth.

(2) In 1986, in Augsburg, the Joseph A. Schumpeter Intellectual Society was incorporated. Regardless of whatever else it is, it is a collection of individuals who see in Schumpeter's many writings the bases of quite divergent thoughts. Professor Giersch's selection is not idiosyncratic; my point is that calling something Schumpeterian is becoming so popular that confusion is likely to result. Schumpeter, like Keynes before him, has come to symbolize different ways of framing economic problems. One frequent reference point is that Keynes sought to emphasize the immediacy of crisis - "In the long run we are all dead" - while Schumpeter, the proponent of Kondratieff long cycles, was often long-run oriented. But,

I am reluctant to use such an appellation, it is because the Kiel (really the Giersch) program does not need an adjective taken from history (1).

Yet, Giersch's view is that we are now in the Age of Schumpeter [Giersch, 1987], just as we had been in the Age of Keynes during the third quarter of this century. His reasoning, as I infer, is that his policy prescriptions, which surely reflect much of Schumpeterian thinking, acquire necessary cachet with the adjective. And his judgment on such things has generally been better than mine.

Summarily put, the Kiel policy set draws on Schumpeter by arguing that:

- Ours is a dynamic world, which tends to be chronically short of capital. There is a constant need to keep interest and profit rates high enough to encourage household saving as well as entrepreneurial capital formation (Ricardian reductivism).
- Social efficiency and economic growth are increased if all economic forces (in the factor as well as in the product markets) are allowed, indeed encouraged, to transcend national boundaries. National legal policies should be designed to monitor and prevent the development of factor and product market price inflexibilities (post-World War II international economic interdependency reductivism).
- Economic progress is principally the product of individualistic entrepreneurs who have been liberated from certain time and technological constraints by the institutionalization of the industrial corporation (Schumpeterian entrepreneurialism).

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there was more to each than can be discerned by drawing the distinction between the long and short runs.

(1) Professor Tobin calls much of this program "The Conservative Counter-Revolution in Economics" [Tobin, 1981].

B. Surveying the Policy Choices

The Kiel-Schumpeter policy particulars are:

Welfare and individualism. There is no more basic point to this policy set than the assertion that welfare is individually, *not socially*, determined. Social welfare, thus, becomes a summation of individual positions, each linked to the other through market participation. Externalities are, consequently, serendipitous, not a principal welfare objective.

Growth. Even so, the Kiel program is a social policy set stressing widespread economic growth which is functionally defined as a society with continuously-rising individual (household) incomes (1). This growth is achieved because firms, unimpeded by restraining institutions, increase their output in so efficient a fashion as to offer workers more employment and higher real wages (a significantly large portion of which ought to be saved). Owners can partake of higher profits, while consumers benefit by getting better and cheaper (surely in real-price terms) goods.

Economic growth flourishes when entrepreneurs function in a climate which encourages output efficiency. Efficiency is "not *just* a sometime thing". Indeed, it requires a continuous free flow of factor resources; for, if the flow is constrained by barriers or augmented by the intervention of nonmarket considerations ("distortions"), trouble develops (2).

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(1) This position is explicitly different from that of Simon Kuznets [1933], who argued in his seminal article on National Income that it was neither production nor household income but *household consumption* which was the key to national welfare.

(2) Giersch has recounted orally how, in 1968, after President de Gaulle was impelled for political reasons in the interest of civic stability to raise minimum wages (Giersch calls it the "Wage Revolt"), the seeds were planted for the substitution throughout French industry for decreased employment growth and increased capital substitution for labor. In 1973, those who controlled the production of oil used a cartel to expand their earnings (the "Resource Holders Revolt") and, in so doing, set up the program which in the past two or three years has led to a marked reduction

Deus ex machina: the critical role of the open market (1). Since real economic expansion, perceived first in output terms and then in terms of increased incomes (not necessarily increased comsumption), is the goal, and this expansion stems from ever-cheaper (more efficiently-produced) goods and services, the questions are: What is the incentive? What is the engine? What is its fuel?

The incentive is the private individual's desire to improve (and be personally responsible for) his or her well-being. The result should be that individuals, irrespective of what factor role they play, will earn more, thus permitting them to consume a greater amount and also to save somewhat more.

Generally, the engine giving force and direction for all of these good things is the firm, particularly the firm in the private economy.

Upon reflection, the usual fuel is privately-incurred debt. In itself, creation of debt is not to be feared, since for every debt there must be an equivalent amount of credit. What is to be feared, however, is the situation where the amount of debt becomes unrelated to the capacity to liquidate it. Since one of the institutionally unique aspects of governmental-incurred debt and spending is the ways that government can use its tax powers to cover its spending errors, there is a Kiel presumption that private rather than public debt is more efficiently managed. We will return to this point shortly.

All of the above leads to a stress on accountable economic units (generally perceived as privately-owned and managed) engaging in free and competitive interactions. This characterizes the free market. The basic rule thus becomes reliance upon market determination of prices and

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in the demand for oil. In 1980, there was a "Capital Holders Revolt", which should lead to increased reliance upon labor, although not necessarily those workers who wish to "protect" their wage rates; instead, LDC workers working for lower wages are becoming the beneficiaries.

(1) Two particularly trenchant analyses of the British application of this point can be found in Buiter and Miller [1981; 1983].

quantities. The market experience (requiring continuous higgling), if not impeded by regulation, becomes open to all within the national and international boundaries. Free trade, to trace a popular phrase to its functional origins, is *laissez passer, laissez faire.*

Deregulation and privatization. The basic rule is reliance only upon market determination of prices and quantities. But, why the insistence upon "control" by the unregulated private economy? The answer is of two types. The fact that welfare is individually determined is one part of the answer. In addition, that historical political experience shows that only in the private economy is there an effective instrument for destroying inefficient combinations of resources; creditors forcing reorganization and/or bankruptcy. There is, it seems, no comparable social equivalent in the public sector for taking losses sufficiently seriously as to "grasp the nettle" to avoid takeovers and/or bankruptcy. Given the above reasoning, the policy of privatization clearly follows.

The well-recognized advantages under certain specified conditions of monopolies are admitted (1). But, the presumption is that these will be privately-owned monopolies, subject to some form of control, be it the threat of competitors trying to crack the market or even public review. Insofar as I am aware, the Kiel position on the nature, as well as the limits, of public control has yet to be spelled out.

The Kiel policy position generally favors deregulation of controls relating to price, entry, and market share (2). Regulations relating to full economic reporting and honest disclosure do not seem to be inconsistent with the general rule.

Competition nationally and internationally. Further questions relate to how efficiency is to be preserved. As already indicated, the simplified

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(1) Schumpeter was hardly condemnatory of monopolies.
(2) In this, the Kiel policy position is Smithian and not Schumpeterian, because Schumpeter had boundless faith in the disinterestedness of Consultant Administrators and was not concerned with "quis custodiet ipso custodes?", which was the question Smith thought could not be answered.

answer is through competition between firms - competition that is perceived initially as freedom of entry into a specified product or service market; but, it has other dimensions, as well. Principal among these is some sort of freedom for entrepreneurial balancing of factor price/output relationships at the margin. The literature on competition - is destructive (cutthroat) competition allowed? (as in Clark [1961]) - tends to get swallowed by definitions resulting from a general reading of the GATT rules, which are based on performance rather than market "structure". This area, involving market action, is one of continuous experiment; a Hayekian position which the Kiel group appears to accept (1).

How limitless competition really might become, I cannot say. Whether Kiel's liberal openness extends to truly worldwide openness (going beyond the European-North American-Japanese markets) to include all markets, I am not sure. It is clear that the Kiel program envisages competition between all geographical areas (2), but whether it would (in the face of some of the consequences), argue for the dismantling of

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(1) Hayek's interest, and what it involves [Perlman, 1986], in the market as a collective price and behavior-signalling institution is fully compatible with the Kiel-Schumpeter position, so long as the market's institutions do not enshrine "insider protection".

(2) The North-South division can be more than between sets of countries. For instance, Giersch sees Southern Germany, as with all of Southern Europe (in contrast to Northern Europe), underselling Northern Germany. Absent factor market rigidities, that situation ought to right itself - lower worker costs of production (reduced wages and social security costs as well as cheaper rents) ought to make Northern Germany more attractive than the South. But, in Giersch's view the rigidities are enshrined, with the result that employment opportunities continue to shrink in the North. He calls this "Institutional Unemployment", really a variant of "Classical Unemployment" which he contrasts with what Malthus called a glut where there is deficiency of purchasing power with resulting economic stagnation. This latter is in Giersch's lexicon "Keynesian Unemployment". Whether North German unit labor costs could ever be competitive with unit labor costs, let us say in Korea, is problematical. Giersch's formula would then argue for the North Germans' turning to some other products or services (if such there be and which Korea or some other comparable country would not immediately offer), at prices low enough to be competitive, but high enough to prelude political action adverse to the government in Bonn.

defense and such social service institutions (if tax revues would not allow them), I cannot say (1).

Price stability. The Kiel group has corollaries to its axiomatic theorem of economic growth. Price stability (or, at worst, a very low inflation rate with no commitment to deflation rate) is considered a significantly useful means, rather than a somewhat subordinated end. In addition, a policy of steadily-growing employment opportunities can be seen as a derivative objective, although such a policy is not required to contain a commitment to an income or wage-rate-maintenance program. Price stability is perceived as being strengthened by floating, rather than fixed, exchange rates; this policy, too, receives strong Kiel endorsement.

Uncertainty. Because the Kiel position does not require anyone except the individual to face the question of *ex ante* entrepreneurial miscalculation (its position is Knightian [Knight, 1921], that is, the capability to take risks successfully is the true rationale for profits), it does not have to "plan" for social rescue missions. Such rescue missions (i.e., military expeditions and governmental programs to help the crippled or elderly) will certainly occur, but they are seen as outside of the sphere of "normal economic performance". "Normal economic performance", as used in this sense, implies that some activities are socially, but are not necessarily economically normal - e.g., the police and court systems, public schooling, aid to the handicapped, and so on. The Kiel position thus preserves clearly and distinctly the analytical barrier between the economic aspects of industrialized society and its socio-political organization.

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(1) Again, I am taken with Hayek's view that reason *plus experience* is the basis for liberal policy. German experience with deregulation is by American standards limited (it is a country with effective retail price maintenance, obligatory closing of most retail establishments from Saturday noon through Sunday as well as on all holidays, and the like). I am almost sure that, after the fact, the Giersch formulation would temper principle with the consequences of experience. In any case, I presume that governmental regulation regarding the sale of addictive narcotics would be acceptable.

Central banking. The Kiel group envisions an independent, but publicly accountable, monetary authority. This position suggests that there are limitations to total reliance upon the purely self-regulating aspects of the market, but that these limitations are met by the creation of a semi-private institution charged with establishing credit and monetary policies consistent with cost-reducing production (action taken on the supply rather than the demand side). Whether this central banking authority works best with rules or ad hocery is not fully specified. The authority has to maintain the conditions for economic growth (which implies commitment to rules), but, it also has to adjust these rules when it discovers that participants in the market are fully discounting them (1).

Role of equilibrium analysis. Since growth, rather than redistribution, is the hallmark of this view, I am prepared to argue that, for the Kiel group, the concept of equilibrium has almost its own Schumpeterian "word-of-art" meaning [Seidl, 1984a, pp. 145 ff.]. Judged from the neoclassical standpoint, any Kiel fascination with achieving and even maintaining equilibrium (as such) is given a very low priority. Equilibrium, as such, is a word used in many ways (2), and the Kiel use of it is worth noting.

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(1) My surmise is that the Kiel position reflects its recent historical-institutional experience with the Bundesbank, which, having the courage of its (correct) convictions, has taken a hard money position. This pattern of action is ascribed by the Kiel group to a statutory (constitutional?) prohibition of indexing. The Bundesbank's position, consistent with what the Kiel group advocates, gives the latter confidence in the current arrangements. Had the Bundesbank acted otherwise, I believe that the Kiel group would have sought further to limit legislatively (constitutionally) the discretionary powers of the bank.

(2) Newtonian equilibrium, where much of the discussion seems to have started, suggests a body at rest. A terrarium or a balanced aquarium, by way of contrast, suggests another kind of equilibrium, one that is not at rest, but one which equilibrates one kind of biological activity (e.g., consumption of inputs) with another (e.g., by-product outputs of waste used as the variable factor in the production of the aforementioned inputs). If these two activities are perfectly balanced, life within the system (the terrarium or the aquarium) goes on, but it need not proceed on the original scale. Additional inputs can be balanced by the production of an equivalent amount

From the standpoint of describing the underlying principles or paradigms of the Kiel approach, any commitment to identification with Walrasian general equilibrium seems on the balancing of countervailing (competitive) or complementary flows, rather than on the identification of long-term (natural) price relationships (1).

Supply side emphasis. The importance of maintaining both domestic and international competitiveness on the supply side, rather than through economic stimulation coming from expenditure on public goods and/or social welfare reform on the demand side, has become the crude ("quick and dirty") hallmark of the Kiel set of policy choices. The Kiel group does not seem to find the descriptor demeaning, although Giersch has clearly and repeatedly stated that the division between policy changes inspired on either side ultimately affects the other.

C. Summary

Succinctly, this approach is based on the classical macrotheory of total competition including Free Trade, but applies it to dynamic or growth economies rather than to what Schumpeter would have thought to be the

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of waste outputs. The balance that is being maintained is between what the inhabitants (vegetation or fish) require and produce, not a balance which suggests zero-population growth.
Natural price, a phrase popularized by Adam Smith, has suggested to many a unique equilibrium exchange rate. The word "natural", however, was used in any one of three ways by him. One meant "usual"; a second meant "God-given", but the third, the one economists seem most frequently to draw upon, meant "balanced between opposing forces". In the biological case, cited above, the plant or fish census within the confines of the terrarium or aquarium need, as we have noted, not be a constant. Thus, that kind of equilibrium does not describe a *situation at rest*, but a *situation continuously rebalancing*.

(1) Christian Seidl [1984b, pp. 198 f.] has raised an interesting point in his discussion of Schumpeter's overwhelming emotional attachment to Walrasian analysis (Seidl refers to Walras being Schumpeter's Procrustean bed). Does the Kiel position (as with Walras and Schumpeter) assume that price adjustments are inevitably more efficient than quantity adjustments?

original static situations. In a sense, this is what classical economists thought they were doing. But, the Kiel Schumpeterian theory goes beyond the classical achievement; it incorporates Wicksellian monetary analysis and the Knightian perception of uncertainty and profits (1).

III. The Principal Keynesian Set

A. The Background

Several years ago, there appeared Alan Coddington's particularly useful pedagogical survey of the various strands in the Keynesian tradition [Coddington, 1976] in which he identified three groups of thought. What defined each group was the way its members handled the inconsistencies in the *General Theory*. One group was essentially interested in the purity of the theory - these he called the Fundamentalists. Another, and the one relevant to this discussion, he called the Hydraulic Keynesians, metaphorically associating them with one of the early postwar models (literally a patentable gadget). The third, principally Robert Clower and Axel Leijonhufvud, claimed much of the article's attention because they were trying (in Coddington's assessment unsuccessfully) to integrate Keynes' own thinking with the postwar neoclassical efforts found in such places as Cambridge-on-the-Charles.

For us, the point to note was that the Hydraulic Keynesians were principally social-policy-oriented (rather than theory- or even "modern"

(1) I do not find this position overlapping the various types of rational expectations analyses that have been offered, since the latter do not deal with dynamic situations, and the Kiel group invariably keeps at least one eye on constantly changing technology. As I have mentioned, the Kiel group's perception of general equilibrium is Schumpeterian rather than Walrasian, and, in that sense, focuses on something different from the currently popular perception of general equilibrium analysis. I also did not find Hayek's distinction between cattalacatics and plutocratics helpful in explaining the Kiel position, since the group is interested both in the dynamic (relocational) properties of relative price changes and the creation of wealth.

theory-oriented), and they had found in the General Theory something of a blueprint for socioeconomic engineering, which more of less fitted what they had in mind (1).

Their interest in social engineering was hardly novel. Perhaps what was new was not so much the theory itself, but some concomitant events, which suggested (and many think clearly permitted) an effectiveness theretofore unknown. Specifically, what I have in mind was the development and adoption of wide-spread national income accounting conventions (2).

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(1) This craving for what was a demand-management national income growth policy had hardly started in Keynes' time. Malthus, Sismondi, and Rodbertus each wrote of gluts and the need to help the poor by giving them something to spend. More specifically, in 1931 a group of American economists meeting with Keynes at the University of Chicago published a manifesto calling for the government to give transfer payments to the poor in order to stimulate the economy.

(2) In terms of present usage, one does little violence to the truth if Simon Kuznets' article in the *Encyclopaedia of the Social Sciences* on National Income is identified as the seminal contribution [Kuznets, 1933]. At about the time that it was eventually published (it had been written earlier and was known in its prepublication form by many), Kuznets was asked to create official estimates of the US national income for the years 1932 and 1933. He assembled a small staff (including Robert Nathan) and, in an amazingly short time, not only were these estimates published, but the procedure was institutionalized in the Department of Commerce. Kuznets then turned to other tasks, including "cleaning up" one which Jacob Viner had undertaken but had not been able to finish. This latter became Kuznets' pathbreaking works on US capital formation [Kuznets, 1937].
When Churchill became Prime Minister in 1940, he drew Keynes into the War Cabinet's service. Immediately Keynes recommended that a British national income analysis unit be established, and James Meade and Richard Stone (quite junior at the time) were recruited. The two then worked out a set of social accounting conventions consistent with the Hydraulic Keynesian views, which were almost immediately accepted by the Washington Department of Commerce group [Carson, 1975]. (They were also written up in textbook form by John Hicks [1943].) The American group wrote a vast number of articles, analyzing wartime changes. These were immediately available (Gilbert used his previous connection as managing editor of the *Survey of Current Business* to secure fast (less than three months) publication). Thus it was that the Age of Keynes was "officially" launched.

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By the end of World War II, there was in America considerable political pressure for using national economic planning (1) to prevent what was popularly believed was going to occur, a resumption of the stagnation of the 1930s (2). In the autumn of 1945 and continuing well into 1946, there was Congressional debate on a Full Employment Act. Eventually passed in an emasculated form, the Act provided for an information-offering Council of Economic Advisors (to the President), whose task was to file an annual report on the state of the economy, but not to draw up recommendations. It clearly did not provide, much to the disappointment of such stalwarts as Leon Keyserling (its second chairman), any mandate for economic planning, something which its advocates had really set as their target.

Meanwhile, Kuznets' two efforts (the one involving national income, the other his analysis of American capital formation) became the bases for his work on the War Production Board in 1942 and 1943. His efforts there were astoundingly successful, although at the time he and Nathan were driven to resign, and the reputation of the Hydraulic Keynesian groups' ability to engineer successfully became overwhelming [Brigande, 1950].
So much so, that, immediately after the War, those who had taken over the National Income analysis program published a careful report on the subject [Gilbert et al., 1947]. It was reviewed, bitterly attacked [Kuznets, 1948], and defended by the authors [Gilbert et al., 1948]. Kuznets never retreated from his criticisms, and the national income teams never significantly modified their position, either. Compare Buiter [1983] for a recent assessment, one probably in line with much of Kuznet's thinking. The fifteen years of Kuznetsian effort reveal much about the institutionalization of data gathering, national income from national product analysis, and Keynesian theory [Perlman, 1987].

(1) In 1944, Keynes' old antagonist, Sir William Beveridge (then the Director of the London School of Economics), had published *Full Employment in a Free Society*, which offered a nonsocialist vision of postwar Britain. His colleague, Hayek [1944], responded with what was intended to be a "pie-in-the-sky"-shattering statement, *The Road to Serfdom*. In due course, a third member of the LSE faculty, Barbara Wootton [1946], countered Hayek with her *Freedom under Planning*. Others [Finer, 1946; Clark, 1948] got into the debate about the propriety and consequences of western-style democratic governments exercising social responsibility for intervening into the product and factor markets.

(2) Few were the professional economists who predicted the postwar boom; so few, in fact, that the many who foretold of massive economic stagnation suffered little loss of prestige.

Nonetheless, by 1947 there was in place in the United States (and, of course, elsewhere) not only a belief that governments *could* "stabilize" employment rates, prices, and growth rates, but that governments *should* do so. If the Moses of this effort was Keynes, his priesthood was a willing group of economists, largely trained at the seminars (seminaries?) held in the two Cambridges.

What was the gospel (the good news)? Summarily put, it is the proposition that the *national economy* (1) (in part perceived as a complex set of money flows), while basically marketdriven, is, nonetheless, susceptible to successful manipulation by the federal government, *using (if thought desirable and, possibly, not necessary) the accumulation of public debt*. This intervention involves inter alia the saving, investment, and consumption processes. One obvious method of manipulation affecting all three is to stimulate demand for goods and services through transfer payment programs; either through previously-established "entitlements" or those created for the exigencies of a particular year ("emergency measures"). The *dominant* purpose for this political instrument insinuation into the generally market-dominated processes includes the protection of/provision for what now is termed "basic human needs" ("freedom from want"). Spelled out, this means the expansion of employment opportunity and of public sector services (more recently including environmental improvement). It also includes the expansion of the provision of economic security for the poor, those ren-

(1) While the Keynesian system was originally nationally autarkic (with plenty of room for foreign trade), the autarkic element seems to me to tie into the perception of just where social economic responsibility lay. Within the United States after 1933, the responsibility for socioeconomic welfare rested not only not on the local or state governments (where from a constitutional standpoint it had previously been), but also on the federal government. It does little violence to the common interpretation of post-World War II history to argue that much of the economic side of American foreign policy has served to shatter the purely autarkic view. Nonetheless, when "push comes to shove" (as in the current "protectionist" debate), the Hydraulic Keynesian hardcore point is that the American federal economic trade policy *must* face the "reality" that the federal government "owes" it to the American unemployed to put their interests first [Tobin, 1972].

dered dependent because of age and health, as well as those whose poverty is a result of regional economic senescence.

In addition, the Hydraulic Keynesian view is that economic equity is a high priority social objective. At times, this point has been stressed more than economic growth [Okun, 1970; 1975].

All of the above is subject to *ex ante* planning - with, of course, *ex post* "indicative" corrections.

B. Surveying the Policy Choices

On a more policy-active level, the Hydraulic Keynesian position has stressed compensatory fiscal policy; it clearly does *not* eschew the role of monetary policy, but subordinates it, believing it to be less effective than the governmental budget instrument. Examining policy particulars, we find:

Welfare and social responsibility. According to the Hydraulic Keynesian view, welfare is seen not only as the individual's own familial (or individual) responsibility, but also as a societal duty under certain circumstances (those beyond the family's or individual's normal capabilities). So described, social welfare is something different from a simple summation of household (family of individual) welfare; there is a synergistic factor. The provision of externalities can be an objective, not simply a by-product.

Economic equity and transfer payments. While growth is sometimes (as during the mid-1960s) advanced as a means to achieving equity (equality of income, adjusted for differences in age), it is rarely seen as an objective per se (1). If, historically, economic growth has been perceived as a means to equity, in recent years the emphasis has been on

(1) Second thoughts emerge, but not strong enough to unbend the argument [cf. Tobin, 1986].

nurturing equity, even at the expense of growth. There is a widespread belief, considered by some to be challengeable, that in recent years, the distribution of household income *even after transfer payments* has become more unequal. And, if there is also widespread acknowledgement that the American economy has "enjoyed" a lengthy expansion (i.e., economic growth), many believe that the loss of momentum in the historic drive for equality has been too great a price to have paid.

Deus ex Machina. Since social improvement is the obvious goal, and public policy debate is the usual means, political interaction runs the system. However, this interaction depends upon an assessment of what the market-driven economy will do. Thus, the incentive is socioeconomic redistribution. The engine is the federal budget, and the fuel is a combination of private and public debt. Public debt, once considered a "neutral" factor, has for years been seen as having an asymmetric quality ("one cannot push on a string" or "it has been proven to be far easier to borrow than it is to tax").

Forms of public intervention. In more specific terms, the Hydraulic Keynesian policy set accepts discretionary monetary policy; even that engineered by such instruments as the Federal Reserve Board's Open Market Committee, which is not subject to the election process. The important point is that this policy encourages wide-spread debate over what instruments should be used (as well as when and how) to achieve its socioeconomic objectives [cf. Thurow, 1985].

Autarkic internal competition and policies designed for an opening rather than an open economy. Insofar as I can understand the state of the current debate, few Hydraulic Keynesians believe that the already-opened Pandora's box of encouraged international economic interdependency should (much less *could*) be closed. Rather, there is increasingly expressed concern whether the United States, currently operating in a seemingly fully-open economy, can produce sufficient fiscal revenue to underwrite the costs of its *committed* social redistribution programs.

Perception of the Phillips Curve. The "tradeoff" between inflation and unemployment has turned out to be an "addictive" relationship, meaning that the more one becomes accustomed to trying to reduce unemployment, the more inflation one has to accept. Nonetheless, the Keynesian Hydraulic set of policy choices lives with the Phillips Curve concept, albeit with less and less confidence in it, principally because much of the unemployment is structural. But structural unemployment, too, has undergone some changes in meaning. One is the increased effects of rapid technological change, another is the consequences of the breakdown of such "institutions" as the black family. Given these, why does this set retain any confidence in the Phillips Curve? I infer that the answer lies in the belief that the dynamic elements in the industrialization development process increasingly make unemployment a function of *structural* change more than simple wage rigidities, but that absent these factors, the tradeoff between unemployment and inflation remains stable [Gordon, 1983, pp. 290 f.]. *It is this belief, as much or more than any other, which serves as the architectural corner stone of current Hydraulic Keynesianism.*

Uncertainty. The problem of uncertainty is one of the unresolved aspects of the disagreement about "what Keynes really meant". His 1937 article in the Quarterly Journal of Economics [Keynes, 1937] seems to be in marked conflict with the policy position one can derive from the last chapter of *The General Theory*. My preference, indeed the reason why I find Coddington's article so useful, is to accept the QJE view as the "theory" and to accept the other as the basis for "policy". Hydraulic Keynesians, in practice, use iterative planning rather than the confident fully *ex ante* type originally proposed (as in the 1945-1946 Full Employment Act debates).

Central banking. Any Hydraulic Keynesian policy set must have a pragmatic test (1). In a better world, the central bank ought to be under

(1) I use the term "pragmatic" as meaning something more than opportunism. Pragmatism is the philosophic view that *in addition to passing other tests* (such as coherence or moral decency), a theory must "work".

the control of the political authorities. As things currently stand, the Board of Governors of the Federal Reserve System is technically independent when it comes to policy decisions. In practice, however, the Board often (but not often enough) keeps a weather eye on what the Executive and Legislative branches seem to want. Apparently this factor occasionally suffices and most Hydraulic Keynesians, rhetoric aside, do not really cavil (1).

Role of equilibrium analysis. If there is anything to Hydraulic Keynesian policy, it is the view that one has to do better than to leave matters to the equilibrating forces of the market (2). In spite of a desire to integrate Keynes and Walras, Hydraulic Keynesians do not base their policy set on even the most dynamic interpretation of equilibrium analysis.

Demand management emphasis. While "demand management" is often used (particularly by their critics) to describe the essence of the Hydraulic Keynesian policy set, I think that it is a secondary characteristic (3), albeit useful when it comes to contrasting their views with "supply siders". What Hydraulic Keynesians stress is the moot point that government can *and should* successfully intervene in virtually all areas of socioeconomic concern. That intervention often takes the form mostly of augmenting aggregate demand, but it need not be restricted to this. In his American Economic Association Presidential address, for example, Lawrence R. Klein (whom most identify as a particularly prominent

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(1) I found Professor Tobin's assessment of the late Harry Johnson's eulogy of monetarism particularly appropriate [Tobin, 1981].

(2) One of the common rhetoric misjudgments of our time is the reliance upon Keynes' dictum, "In the long run we are all dead". The full quotation (with its italics) is much better: "*In the long run* we are all dead. Economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again" [Keynes, 1971, p. 65].

(3) The *Economist* (6-12 June 1987, p. 30, "Who Cares?") put the matter thus: "The old view that unemployment simply reflects a lack of demand and can therefore be cured by throwing more money at the economy has practically vanished".

Keynesian) stressed explicitly that the "*demand* aspects are possibly overstated" (1).

IV. Conclusions: Antecedent to the Paradigms

My conclusions are based on the belief that the Kiel-Schumpeter position contains much that differs from that classical reductivist theory, which served as Keynes's target. For one thing, it is clearly anti-autarkic in the sense that no-one prior to 1970 dreamed possible (2). In another, its understanding of monetary theory is *perforce* post-Keynesian, giving it a chance both to have considered the Keynesian twists and the subsequent history (3). Finally, Keynes wrote his *General Theory* as a tract attacking one kind of social indifference, one based both on political blindness and professional incompetence. Not everyone shared his assessment of that situation, but few, if any, really hold today that the problems of Britain in the 1930s are congruent with any country's present problems.

But the Kiel position does have some clearly reductivist elements. These include a conviction that the self-regulation of the market process is

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(1) Klein's comments were largely directed to the importance of modeling the supply side, and he specifically sought to draw attention to Leontief's input-output method as a starting point [Klein, 1978, pp. 1 ff.].

(2) Karl Pribram [1983] argues that the dominant post-World War II idea sets were the Keynesian autarkic welfare (responsible) state and the American commitment to international economic interdependency.

(3) Schumpeter's failure to complete his massive work on monetary economics, really a greater target than the 1954 *History of Economic Analysis*, is another reason for questioning the inclusion of Schumpeter's name in the Kiel-Schumpeter policy set. While Schumpeter expressed admiration for Fisher's and others' versions of monetarism, I am not willing to concede that Schumpeter was a monetarist. Nor, am I sure that Giersch is, if by monetarist one means total acceptance of the completeness (no less and no more) of the quantity theory of money.

better than public intervention into factor and product/service markets. If there are structural changes occurring, they are better handled according to the reductivist formula (repricing) than they are by subsidies, barriers, and so forth. The reductivist tradition embraces Free Trade, clearly also a major Kiel commitment.

By way of contrast, the Hydraulic Keynesian position clearly puts greater, but not all, faith in rational political discussion than it does in the automaticity of the free market's correction process. In retrospect, I have found Abba Lerner's *The Economics of Control: Principles of Welfare Economics* [1946] the best statement of both the alpha and the omega of Hydraulic Keynesianism. It incorporates almost all of the reductivist tradition, excepting only those areas where the assumptions of perfect competition (both on the supply *and demand*) sides are irrelevant or violated, and where equality is chosen socially as preferential to efficiency.

The bulk of this essay is an effort to synthesize the underlying theories. The table below offers a synoptic comparison of the policies. What remains is to identify the underpinnings. The underpinnings seem to me to be:

- Individuals choose their theory and policy sets within the context of their current and historical institutional experience. Claims to, as well as hopes about, the relative importance of equity or efficiency (growth (1)) are made on the basis of recent (marginal) experience.
- But, the interpretation of recent marginal experience is idiosyncratic. The idiosyncratic element rests on two foundations. One is the personal assessments of uncertainty, itself reflecting each individual's sense of (endowment with) optimism or pessimism regarding the trend of future events. The other is whether the individual believes that planned intervention can successfully thwart the undesirable events.

(1) Efficiency may lead to economic growth. John Stuart Mill, in his observations on the Stationary State, suggested an alternative, greater leisure for attention to finer transcendental matters.

A Synoptic View of Policy Differences

Item	The Kiel-Schumpeter set	The Hydraulic-Keynesian set
Principal goal	maximum individually-determined individual welfare	social welfare, socially determined as in "the greatest good for the greatest number"
Principal means	economic growth	combination of market and politics to optimize combinations of equity, efficiency, and liberty
Principal instrument	trade in the unfettered world factor and product/services markets	trade plus taxation plus equity-producing transfer payments
Deregulation and privatization	presumption favoring both because externalities are not planned	case-by-case considerations, because preservation of public sector and externalities are vital social responsibilities
Completeness of Free Trade policy	no limitations	desirable, but must be weighed against whole spectrum of national goals and policy considerations
Price stability	possibly an end, and certainly a major means	desirable, but less important than full employment
Full employment	desirable, but derivative from success of growth policy	a principal social responsibility and economic goal
Coping with uncertainty	the entrepreneurs' problem	ultimately a social responsibility
Central banking policies	dynamic rules	dynamic rules monitored by indicative modification
Emphasis	supply side, in the classical and Schumpeterian traditions	demand side policy *also* necessary as in the Malthusian and Keynesian traditions

- While it is true that some marginal experiences (Britain in the inter-war decades) tend to exacerbate the tendencies to pessimism, these are only tendencies, and there are inevitably some who successfully resist that tide. Conversely, when economic stagnation has generally been absent from the American scene since World War II, there are those who have successfully resisted what they have repeatedly thought were others' Pollyana-ish or Panglossian moods.

As against these foregoing points, there are the factors brought out in the syntheses:

- Is welfare individually or socially defined?
- Is growth or equity the greater immediate need?
- Is the market mechanism sufficient *for economic purposes*, or is public discussion of investment, saving and pricing policies a necessary concomitance?
- As a rule, is positive economic intervention (comparable to the traffic light) freedom-expanding, or is it corrupting and freedom-diminishing?
- Is national social responsibility (as in the modern welfare state) desirable, and, if so, can it be achieved under conditions of total economic openness (as when promises made to workers during eras of prosperity can no longer really be honored, tax revenues having fallen due to the shrinking of national economies engaged in unlimited foreign trade)?
- Are unemployment and price instability directly related, or are there only some forms of unemployment (nonstructural) and some forms of price instability (exempting the shock-hysteresis effect) so related?

The paradigms, doubtless, will be subject to greater refinements, improvements and better specification. But, it seems to me that the conflict is not between varying degrees of refinement, but between the kinds of considerations which I have termed "the underpinnings".

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