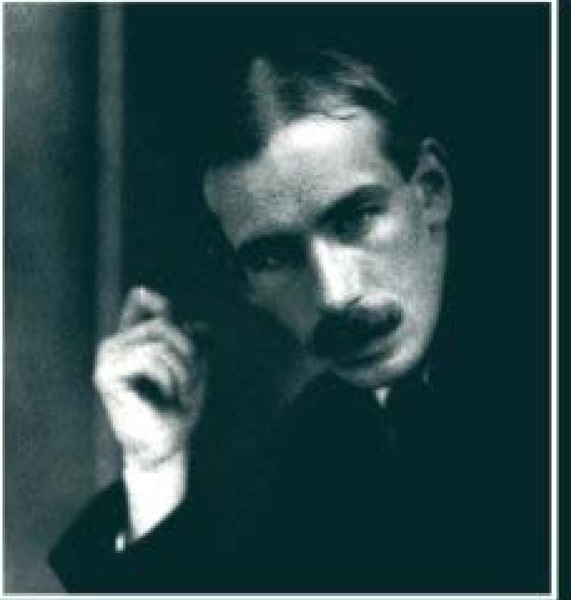
The Political Power of Economic Ideas

Keynesianism across Nations



Edited by Peter A. Hall

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PREFACE

THIS VOLUME IS the product of a working group on the diffusion of economic knowledge established by the States and Social Structures Committee of the Social Science Research Council (SSRC). Recent work on the role of the state in politics has drawn increasing attention to the importance of ideas in the policy process. Accordingly, this group was asked to investigate the ways in which economic ideas are diffused across nations and acquire influence over policy. The natural case for such a study was that of Keynesian ideas, which originated in the interwar years but became a definitive component of economic policy making in the era after World War II.

As befits the interdisciplinary nature of the problem, the chapters of this book reflect the collaborative efforts of scholars from a variety of nations and several disciplines: economics, history, political science, and sociology. Two collective meetings were held during the three years in which these essays were refined to discuss common issues and to go over drafts of each chapter. At several junctures in this process, new contributions were solicited to deal with important issues that emerged in these discussions.

We are grateful to those who made this project possible, the members of the States and Social Structures Committee and especially to Theda Skocpol and Albert O. Hirschman, who took a particular interest in this project. In addition, a number of other people not represented in this book made important contributions to our discussions. These include: Ira Katznelson, Stephen Krasner, Dietrich Rueschemeyer, and Kerry Schott. Finally, three staff associates at the SSRC helped immeasurably with this project. Martha Gephart organized the initial stages of collaboration; Yasmine Ergas organized our second conference; and Nikiforos Diamandouros saw the volume into press.

Peter A. Hall
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INTRODUCTION

Peter A. Hall

In a memorable phrase, John Maynard Keynes once observed that "the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood."[1] This book takes that assertion seriously: its object is to trace the impact of Keynesian ideas across nations in order to understand why an economic theory influences policy in some places and periods, yet not in others. We begin by considering the response to the economic depression of the 1930s, which inspired many of Keynes' own theories, and then turn to the reception given Keynesian ideas in the three decades after World War II when many nations erected the systems of macroeconomic management they still largely use today.

The focus of this volume is explicitly comparative.[2] Several of the chapters consider more than one country, and all have benefited from a number of comparative discussions. Together, they provide a detailed account of the reception given Keynes' ideas by the major industrial nations of the world and they review the processes whereby those ideas became an important component of policy. That is the first purpose of this volume. Limitations of space prevent us from

[1] John Maynard Keynes, *The General Theory of Employment, Interest and Money* (London: Macmillan, 1936), p. 383.

[2] Although there are a number of studies that trace the progress of Keynesian doctrine in one or two nations, the cross-national focus of this project is unprecedented. The only other collection which considers Keynes' influence over policy in several nations is: Harold Wattel, ed., *The Policy Consequences of John Maynard Keynes* (New York: M. E. Sharpe, 1985). However, the nation-specific literature includes some seminal works: Donald Winch, *Economics and Policy: A Historical Study* (London: Hodder & Stoughton, 1969); Herbert Stein, *The Fiscal Revolution in America* (Chicago: University of Chicago Press, 1969); Roger Middleton, *Towards the Managed Economy* (London: Methuen, 1985); Robert M. Collins, *The Business Response to Keynes, 1929–1934* (New York: Columbia University Press, 1981); Michael Held, *Sozialdemokratie und Keynesianismus* (Frankfurt: Campus Verlag, 1982); Susan Howson, *Domestic Monetary Management in Britain, 1919–1938* (Cambridge: Cambridge University Press, 1975); Milo Keynes, ed., *Essays on John Maynard Keynes* (Cambridge: Cambridge University Press, 1975).

considering the transition from Keynesian ideas that took place in the 1970s as the unexpected coincidence of inflation and unemployment led to a search for new economic strategies; but our findings about the rise of Keynesian policies could well inform another study focused on their attenuation.

The second purpose of this book is to identify factors that might explain why some nations embraced Keynesian ideas, while others did not. Few subjects are more important or more intractable. Ideas are generally acknowledged to have an influence over policy making. Even those who seek to expose the bare conflicts of interest hidden behind political rhetoric or historical nostalgia admit that ideas play an important role in affairs of state. But that role is not easily described. Any attempt to specify the conditions under which ideas acquire political influence inevitably teeters on the brink of reductionism, while the failure to make such an attempt leaves a large lacuna at the center of our understanding of public policy. The contributors to this volume cut into a particularly difficult theoretical problem.

Why should we take the ideas of John Maynard Keyes as the case to be studied? Although currently out of fashion, Keynes was the most influential economist of his generation; his work left an indelible mark on modern economic theory. As A. C. Pigou, hardly Keynes' greatest admirer, puts it: "Those of us who disagree in part with his analysis have, nevertheless, undoubtedly been affected by it in our own thinking; and it is very hard to know exactly where we stood before. Not a little of what we now believe ourselves to have known all along, it may well be we owe to him."[3] For most of this century, Keynesian ideas have been central to the major debates about economic policy; and since his works were read and discussed around the world, they are particularly suitable for cross-national study.

Even more important is the larger political role played by Keynesian ideas. Like the concepts of Karl Marx, who died in the year that Keynes was born, the ideas of John Maynard Keynes seem quintessential to a historical era. They are closely associated with a major transformation in the economic role of the state that is one of the hallmarks of this century. Although Keynes was by no means responsible for the expansion of the welfare state that is sometimes linked to his name, his theories placed increasing responsibility for economic performance on the government's shoulders, and his attacks on the priority which classical economics attached to a balanced budget helped to loosen a fiscal constraint that stood in the way of more generous social programs.[4] In these respects, to study

[3] A. C. Pigou, "The Economist," in *John Maynard Keynes 1883–1946* (Cambridge, 1949), p. 21, cited in D. E. Moggridge, *Keynes* (London: Macmillan, 1976), pp. 156–57.

[4] In this context, it is important to distinguish between the ideas of Keynes and those of his followers, as Donald Winch does in his essay below. For representative works emphasizing the

the emerging influence of Keynesian ideas is to consider many of the factors that lie behind the development of the modern state since the 1920s.

Partly for this reason, of course, Keynesianism has acquired a rather broad set of connotations in the contemporary field. On the one hand, the literature is full of debates among fundamentalist Keynesians, neoclassical Keynesians, neo-Keynesians, and post-Keynesians, which cannot be unraveled fully here. On the other hand, the notion of a "Keynesian state" or of a "Keynesian era" is often used more generally to refer to the social and economic practices associated with the management of a capitalist economy in the postwar period. As they trace the growing influence of Keynesian ideas, many of the essays that follow implicitly describe the process whereby a particular economic theory acquired multiple meanings in the political and economic arenas of different nations. Indeed, the very ambiguity of Keynesian ideas was one source of their influence. They became a cloak with which to cover or dress up a wide variety of economic practices.

Nevertheless, all of the chapters in this volume take as their point of departure a set of doctrines closely associated with Keynes' own writings. Some go into detail on this point, and since there are many excellent accounts of Keynes' economic theories, it is not our intention to provide another one.[5] However, it might be useful to identify those aspects of Keynes' thought on which the book as a whole concentrates.

broader significance of Keynesian ideas, see Robert Skidelsky, "The Decline of Keynesian Politics," in Colin Crouch, ed., *State and Economy in Contemporary Capitalism* (London: Croom Helm, 1979), pp. 55–87; and Adam Przeworski, *Capitalism and Social Democracy* (Cambridge: Cambridge University Press, 1984). We should also note the significance of Keynes' ideas for the reconstruction of the international economic system along liberal lines after World War II. On this, see John Williamson, "Keynes and the International Economic Order," in David N. Worswick and James Trevithick, eds., *Keynes and the Modern World* (Cambridge: Cambridge University Press, 1984); John Ruggie, "International Regimes, Transactions and Change: Embedded Liberalism in the Postwar Economic Order," *International Organization* 36 (1982); and the essays by Charles Maier and Stephen Krasner in Peter Katzenstein, ed., *Between Power and Plenty* (Madison: University of Wisconsin Press, 1978).

[5] Keynes' own writings have now been collected by Elizabeth Johnson, Donald Moggridge, and Sir Austin Robinson in *The Collected Writings of John Maynard Keynes*, published by Macmillan and Cambridge University Press, and hereafter cited as *JMK*. For a discussion of Keynes' work in the context of his life, see the biographies by Roy Harrod, *The Life of John Maynard Keynes* (London: Macmillan, 1951); D. E. Moggridge, *Keynes* (London: Macmillan, 1976); and Robert Skidelsky, *John Maynard Keynes* (London: 1986). For some major interpretations of his thought, see Lawrence Klein, *The Keynesian Revolution* (New York: Macmillan, 1947); Alvin H. Hansen, *A Guide to Keynes* (New York: McGraw-Hill, 1953); Don Patinkin, *Keynes' Monetary Thought* (Durham, N.C.: Duke University Press, 1976); A. Leijonhufvud, *On Keynesian Economics and the Economics of Keynes* (New York: Oxford University Press, 1968); S. E. Harris, ed., *The New Economics* (New York: Knopf, 1947); Robert Lekachman, *Keynes' General Theory* (New York: St. Martins, 1964); John C. Wood, ed., *John Maynard Keynes: Critical Assessments* (London: Croom Helm, 1983).

We are primarily concerned with two implications for policy that are foreshadowed in some of Keynes' earlier work but derive most directly from the theoretical analysis of *The General Theory of Employment, Interest and Money* published in 1936. The first follows from Keynes' rejection of Say's Law (that aggregate supply creates its own demand) and the corresponding tenet of marginalist analysis that, left to their own devices, markets will clear, initially through the adjustment of prices rather than quantities. The implication of this classical view is that markets are fundamentally stable and will tend to move the economy toward equilibrium at the highest practicable rate of employment. While leaving open the possibility that this might be true in the long run, Keynes argued that rigidities introduced into markets by producer organizations, the variability of business confidence, and a variety of other common phenomena render the private economy fundamentally unstable and liable to prolonged stagnation at unnecessarily low levels of employment. The conclusion which Keynes drew from this analysis is that some form of government action may be necessary to moderate the fluctuations of the private economy and restore it to full employment. Here Keynes broke with the doctrine of laissez-faire to argue that the state has a responsibility to intervene regularly in the operation of the economy.

A second aspect of the same analysis specifies what kind of policies are likely to be most useful for managing economic fluctuations. In *The General Theory*, Keynes rejected conventional views of the relationship between savings and investment, which held that the best way to increase investment was to lower interest rates (or the price of capital) and to increase its supply by limiting the amount absorbed by the public debt. Instead, he argued that investment responds to many factors and governments might best deal with economic depression by raising the level of aggregate demand for goods. He went on to argue that the government could itself exercise some control over this by increasing its own expenditures (or lowering taxes) because these injections of funds would increase the aggregate purchasing power of consumers by a multiple of the original amount, as the funds were passed from person to person through successive transactions, leaking away only gradually into savings, taxes, and imports. This is the famous "multiplier" analysis adapted from work by Richard Kahn.

The analysis contained three important, and relatively novel, prescriptions. First, it suggested that the government could influence overall levels of growth and employment in the economy by means of a strategy based on the management of aggregate demand. To the existing alternatives of laissez-faire or direct industrial intervention that policy makers seemed to face, Keynes added a third option based on demand management. Second, while Keynes did not discount the usefulness of monetary policy altogether, his analysis put a new emphasis on the role of fiscal policy. Third, Keynesian theory rejected the principle that the government budget should generally be balanced in favor of an approach that justified deficit spending financed by public borrowings in times of economic recession, and budgetary surpluses to counter inflationary pressure when aggregate demand was likely to exceed supply. Together, these are the basic principles behind countercyclical demand management.

At the risk of neglecting Keynes' many other contributions to economic theory, we are primarily concerned with the readiness of governments to intervene in the economy in line with the principles of countercyclical demand management. This is the policy outcome we want to explain. In the postwar period, it refers to the systematic use of fiscal and monetary policy to moderate fluctuations in the economy. In the 1930s, the relevant outcome was more generally a willingness to accept rising public sector deficits in order to finance public works or other spending programs designed to lower unemployment. The reflationary programs of the interwar period often owed little to Keynes' own ideas but could be described in more general terms as Keynesian.[6]

If the adoption of Keynesian policies is one of the firmest measures of the influence of Keynesian ideas and the principal focus of this volume, we will find, however, that those ideas acquired influence in other ways as well. In some cases, they transformed the intellectual environment of economics, and, in others, they altered the terms of political discourse in such a way as to legitimate a variety of policies and make new combinations of political forces possible.

Hence, the essays in this volume tackle three tasks. First, they seek to explain the relative willingness of governments to engage in deficit spending during the 1930s or countercyclical demand management during the postwar period. Second, they attempt to trace and account for the relative influence of Keynesian ideas themselves on the policies of each nation. And, third, they explore the way in which Keynesianism, as a more general set of symbolic ideas, became a component of the class coalitions and political compromises that structured the political economy of the postwar world.

This sort of enterprise involves the development of an appropriate theoretical framework. The theoretical issues surrounding explanations for the relative acceptance of Keynesian ideas and policies across nations have not yet been the subject of extensive inquiry or debate. Very little systematic work has been done in this area. Nevertheless, a review of the literature suggests that we might distin-

[6] For this reason, it is important to distinguish between Keynes' own ideas and a variety of "proto-Keynesian" views, which were often quite similar, as the essays by Bradford Lee, Walter Salant, and Donald Winch do in some detail. From time to time, however, where the distinction is not crucial to the analysis, both sets of views will be described more broadly as "Keynesian" in the essays that follow. Similarly, while I am using the term *countercyclical demand management* to summarize Keynes' policy prescriptions, other terms, such as "discretionary demand management," could just as readily be used instead.

guish between three broad approaches to this kind of problem. These might be termed *economist-centered, state-centered*, and *coalition-centered* perspectives, respectively. The recent literature contains important examples of these approaches and, in nuanced form, each is represented in the essays that follow. Some authors stress one or another as their case seems to dictate; others incorporate elements of each into their account. For analytic clarity, however, it would be useful to begin by examining these approaches in ideal-typical form.

An Economist-Centered Approach

We can begin with the economist-centered approach adopted by a majority of the monographs devoted to the diffusion of Keynesian ideas.[7] It treats the problem of explaining the acceptance of Keynesian policies primarily as a problem of explaining the influence that Keynesian ideas achieved among members of the economics profession. This approach contains an implicit model of the policymaking process that privileges the role of professional economists and stresses the impact of expert advice on policy.[8] Economists are gradually won over to Keynesian modes of analysis and then press their conclusions on politicians. This is a "trickle up" model for the diffusion of Keynesian ideas.

If this approach is taken, the relative influence of Keynesian ideas turns on two sorts of factors. Most important are the theoretical characteristics of the ideas themselves, that is to say, those aspects of the ideas that render them more or less persuasive to other experts. To assess Keynes' ideas in these terms, of course, we need an overarching model of the characteristics that tend to render new ideas economically persuasive.

In his essay for this volume, Walter Salant suggests that Thomas Kuhn's ac-

[7] Although it is not focused on Keynesian ideas per se, one of the best overviews of this approach is A. W. Coats, ed., *Economists in Government: An International Comparative Study* (Durham, N.C.: Duke University Press, 1981).

[8] There is an excellent and growing literature on the role of economists in government. Much of it is reviewed by Robert Nelson, "The Economics Profession and the Making of Economic Policy," *Journal of Economic Literature* (March 1987), pp. 49–90. Particularly useful works include: A. W. Coats, ed., *Economists in Government*; Robert Behn, "Policy Analysis and Policy Politics," *Policy Analysis* 7, 2 (Spring 1981), pp. 199–226; Edward Flash, Jr., *Economic Advice and Presidential Leadership* (New York: Columbia University Press, 1965); Erwin C. Hargrove and Samuel A. Morley, *The President and the Council of Economic Advisors: Interviews with CES Chairmen* (Boulder, Colo.: Westview Press, 1984); Carl Kaysen, "Model-Makers and Decision-Makers: Economists and the Policy Process," *The Public Interest* (Summer 1968), pp. 80–95; Joseph Pechman, "Making Economic Policy: The Role of the Economist," in Fred Greenstein and Nelson Polsby, eds., *Handbook of Political Science*, vol. 6 (Reading, Mass.: Addison-Wesley, 1975), pp. 23–78; Herbert Stein, *Presidential Economics* (New York: Simon & Schuster, 1984); and Alec Cairncross, *Essays in Economic Management* (London: Allen & Unwin, 1971).

count of how scientific paradigms succeed one another might provide an appropriate model for the progress of economic knowledge as well. A Kuhnian account sees economic theorizing as puzzle-solving, and it implies that one theory succeeds another primarily because it defines and solves puzzles in a more satisfying way. In particular, one theory would supersede another because it proved better at explaining the empirical observations that remained anomalous in terms of the earlier theory. The prolonged unemployment of the interwar period could be seen as one such anomaly.

Harry Johnson has taken this approach one step further to argue that the triumph of the Keynesian paradigm over its predecessor also depended on a set of factors specific to the conditions under which economic knowledge is produced. In particular, he ascribes the growing popularity of Keynesian ideas to the clever way in which Keynes opened up new questions susceptible to the kind of quantitative investigations that would constitute a research program for young scholars, reformulated old concepts into new ones, such as the theory of liquidity preference, so as to force those who wanted to use his ideas to speak in a new language, and deliberately posed his propositions in counterintuitive terms in order to mount the kind of challenge to prevailing orthodoxy that would appeal to a new generation of economists.[9]

The second set of factors that becomes especially significant if one adopts this approach are the institutional parameters that structure communication within the economics profession and between economists and policy makers. In any nation, these might include: the degree to which there existed a large and sophisticated body of academic economists; the influence allowed younger economists in the profession (because, as Keynes himself predicted, his ideas appealed particularly to the young); the openness of the public authorities to advice and personnel from centers of academic economics; and the relative influence of professional economists, as opposed to financial administrators, inside the policy-making arms of the government.

Considered as a whole, the economist-centered approach to the impact of Keynesian ideas has one great virtue and one weakness. Its virtue is to draw our attention to the qualities of Keynesian ideas themselves. It suggests that ideas may have a persuasiveness, and hence a political dynamism, of their own; and it forces us to ask which ideational qualities make for persuasiveness and which

[9] See Harry Johnson, "The Keynesian Revolution and the Monetarist Counter-revolution," in Harry Johnson and Elizabeth Johnson, eds., *In the Shadow of Keynes* (Oxford: Basil Blackwell, 1978), pp. 183–202. See also T. W. Hutchinson, *On Revolutions and Progress in Economic Knowledge*; Spiro J. Latsis, ed., *Method and Appraisal in Economics* (Cambridge: Cambridge University Press, 1976); Mark Blaug, *The Methodology of Economics* (Cambridge: Cambridge University Press, 1979); G.L.S. Shackle, *Epistemics and Economics* (Cambridge: Cambridge University Press, 1972).

detract from it. It must be added, however, that the persuasiveness of a new set of economic ideas is always relational, that is to say, it depends not simply on the ideas themselves but on the way in which they fit with other existing ideas, including the pertinent array of existing economic theories, recognized puzzles, and observations of the contemporary economic world.

The approach is problematic, however, in that it may attribute too much influence over policy to the economics profession. Notwithstanding Keynes' famous dictum that practical men are often the slaves of some defunct economist, the essays in this volume show that the degree of influence economists were able to exert over policy varied widely over time and across nations. Even where economists were heavily involved in the policy process, economic theories were often only one of many considerations that went into the ultimate determination of policy.[10] Once again, however, there are pertinent differences between the short and long terms—of the sort Keynes liked to contemplate. As the interwar years gave way to the postwar period, economists gained a more important role in the policy process of almost all the nations studied here. The importance of economic theory to policy may thereby have grown. Similarly, as Keynesian ideas became part of a neoclassical synthesis widely shared among economists across the world, many of those ideas acquired a kind of background significance even where countercyclical demand management was not the reigning policy doctrine. Nevertheless, in most national settings, a full account of the process whereby Keynesian ideas acquired influence must move beyond this economist-centered approach to incorporate a more complete model of the policy-making process as a whole.

A State-Centered Approach

The state-centered approach, to which we now turn, takes a step in this direction. It is elaborated in an influential article by Margaret Weir and Theda Skocpol comparing responses to the 1930s Depression in Sweden, Britain, and the United States.[11] They suggest that the reception accorded new economic ideas will be

[10] On this point, see some of the recent British literature, such as: G. C. Peden, "Keynes, the Treasury and Unemployment in the Later Nineteen-Thirties," *Oxford Economic Papers* 32 (1980), pp. 1–18; Peden, "The 'Treasury View' on Public Works and Employment in the Interwar Period," *Economic History Review* 37 (2), pp. 167–81; and Roger Middleton, *Towards the Managed Economy* (London: Methuen, 1985).

[11] Margaret Weir and Theda Skocpol, "State Structures and the Possibilities for 'Keynesian' Responses to the Great Depression in Sweden, Britain, and the United States," in Peter Evans, Dietrich Rueschemeyer, and Theda Skocpol, eds., *Bringing the State Back In* (Cambridge: Cambridge University Press, 1985), pp. 107–63.

influenced by the institutional configuration of the state and its prior experience with related policies. In the sphere of policy formulation, the relative openness of policy-making institutions to advice from outside economists is said to affect the speed with which developments in economic theory can be incorporated into policy, and the administrative biases implicit in the institutional division of responsibility within the state will condition the receptiveness of key agencies to new ideas. Some states will also have the bureaucratic capacities to implement a new program quite readily, while others that do not may hesitate to embark on such programs. Likewise, this approach suggests that states will be predisposed toward policies with which they already have some favorable experience, and even the demands of political parties and interest groups may be based on their conceptions of state capacities and existing policy legacies.

These are the terms in which a state-centered analysis explains Britain's resistance to Keynes' calls for reflation in the 1930s, Sweden's initiation of reflationary public works, and Roosevelt's belated endorsement of deficit spending during the "second" New Deal. In Britain, prior experience with unemployment insurance fixed the attention of the Labour party and many policy makers on this policy, rather than on alternative proposals for public works; and within the British state a powerful Treasury biased against higher spending tipped the balance away from a reflationary experiment. Sweden, by contrast, had prior experience with public works rather than unemployment insurance and a bureaucracy open to close collaboration with academic economists. In this context, the recommendations of the Stockholm school of economists for a reflationary program of public works carried real weight. The United States stood somewhere between these two countries with a federal government open to outside advice but fragmented into multiple agencies and limited in its capacity to implement large-scale public works. Hence, the initial response to the Depression was a welter of uncoordinated programs that gave way to reflation after 1937 only when a nucleus of economic experts, assembled around Lauchlin Currie and Marriner Eccles, had consolidated their position in the government and constructed an apparatus capable of implementing reflationary policies.

This approach has considerable merit. It draws our attention to the role that administrative, as opposed to purely economic, problems play in the process of economic policy making.[12] It reminds us that the officials responsible for economic policy during the interwar period were usually not economists, and that

[12] The importance of such concerns has also been underscored by several recent studies of British government documents for the 1920s and 1930s. See Peden, "The 'Treasury View' "; Middleton, *Towards the Managed Economy* and "The Treasury in the 1930s: Political and Administrative Constraints to Acceptance of the 'New' Economics," *Oxford Economic Papers* 34 (1982), pp. 49–77. See also Robert Skidelsky, *Politicians and the Slump* (London: Macmillan, 1967).

even in the postwar period, they have had many concerns besides developments in economic theory. Most important, the state-centered approach provides us with a set of tools for explaining cross-national variation in the reception given Keynesian ideas. It suggests that such variation may be explained by reference to the institutional configuration of the policy-making arms of a state and the relevant precedents set by prior economic policies in each nation.

Nevertheless, this approach, too, has a number of drawbacks. It presents a view of the world in which the state apparatus looms very large and the political world appears in relatively diminished form. The state-centered view is one that privileges the role of officials and devalues that of politicians. Given the social import of the issues at stake in the debate over Keynesianism and the intense popular concern they aroused, we might well ask whether this approach does not understate the contribution that political leaders can make to the outcome and overstate the immutability of institutions or the thrall of existing lines of policy.

A Coalition-Centered Approach

A third perspective on this problem returns to the broader political system for its explanation of economic policies. This is the coalition-centered approach which underlies the recent work of Peter Gourevitch.[13] It emphasizes that policies must mobilize support among broad coalitions of economic groups on whose votes and goodwill elected politicians ultimately depend. Hence, a nation's readiness to implement Keynesian policies may be said to turn on the ability of its politicians to forge a coalition of social groups that is large enough to sustain them in office and inclined to regard Keynesian measures as something that is in their interest. The feasibility of such a coalition, in turn, rests on the ingenuity of politicians and the constellation of preferences expressed by the relevant economic groups.

According to this view, Keynesian responses to the Great Depression of the

[13] The interstitial debate between Skocpol and Gourevitch over the most appropriate way to interpret and explain policy making in the 1930s has been one of the most stimulating exchanges in contemporary political science. See Peter Alexis Gourevitch, "Breaking with Orthodoxy: The Politics of Economic Policy Responses to the Depression of the 1930s," *International Organization* 38 (Winter 1984), pp. 95–130, and his *Politics in Hard Times* (Ithaca, N.Y.: Cornell University Press, 1986); Weir and Skocpol, "State Structures"; Theda Skocpol, "Political Responses to Capitalist Crisis: Neo-Marxist Theories of the State and the Case of the New Deal," *Politics and Society* 10, 2 (1980), pp. 155–201. See also Tom Ferguson, "From Normalcy to New Deal: Industrial Structure, Party Competition, and American Public Policy in the Great Depression," *International Organization* 38, 1 (Winter, 1984), pp. 41–94; and James Kurth, "The Political Consequences of the Product Cycle: Industrial History and Political Outcomes," *International Organization* 33, 1 (Winter 1979), pp. 1–34.

1930s can best be explained in terms of each regime's ability to construct a coalition behind reflationary policies. In Sweden, the United States, Nazi Germany and France under the Popular Front, the regime was able to undertake such policies because it managed to forge a coalition between labor and the agrarian sector with additional support from export-oriented industry. Conversely, the failure of Britain, Weimar Germany, and many other nations prior to 1932–1933 to break with economic orthodoxy is said to have reflected their government's failure to construct an equivalent coalition. That, in turn, may be attributable to the presence of an alternative ruling coalition or to long-standing attitudes on the part of potential coalition partners which inclined them against a reflationary strategy.

There is real value in this approach. It gives a renewed emphasis to the broader political context in which Keynesianism figures, and it reminds us that politics is ultimately about the conflict among groups with divergent interests for claims on scarce resources. Economic policy has especially important consequences for the material interests of social groups, and the policy responses to the Great Depression were intimately bound up with the attempts of political entrepreneurs to secure popular support for themselves and the regime among a constellation of economic and electoral groups.

The coalition-centered approach brings politicians and social groups more directly into the explanation of policy. However, it leaves somewhat open the question of how these groups come to define their interests in a particular way. That almost certainly depends on some additional variables, such as the legacy of existing policies, and on the impact that pertinent developments in economic theory can have on conventional ways of perceiving the world. In addition, even if Keynes is not completely right about the slavishness of politicians, his own experiences with the British Treasury suggest that a complete account of policy outcomes in the interwar period must include some consideration of the role that civil servants and economists played in the developing drama.

Contending Perspectives

Each of these approaches views Keynesianism somewhat differently. They all see it as a doctrine for solving puzzles, but the conception of the most important puzzles to be solved changes as we move from one approach to another. The first takes Keynesianism primarily as a doctrine for solving puzzles in economic theory. The second sees it as a doctrine most relevant to the administrative puzzles associated with budgetary policy. The third approach treats Keynesianism as a doctrine for solving the politician's puzzles of coalition formation. In fact, the historical significance of Keynesian ideas rests to a considerable degree on their ability to speak to all three of these puzzles.

Similarly, each of the theoretical perspectives outlined above associates the influence of Keynesian ideas, most centrally at least, with somewhat different groups. We move from an approach that sees economists as the crucial actors, through another that places civil servants and public officials at the center of the analysis, to one that identifies politicians as the key figures in the drama. These are rather like the "concentric circles" that Bradford Lee draws in his chapter for this volume. They correspond to a progression from more technocratic conceptions of policy determination to more broadly political conceptions.

Together, these contending perspectives provided a good deal of the theoretical inspiration for this volume, and the following chapters can be read as an implicit, and frequently explicit, commentary on them. Since we have not tried to impose a uniform view on the authors, but only a common set of questions, the contributions diverge to some degree on the question of which factors were most relevant to the influence of Keynesian ideas in their particular case, and the essays contain a stimulating variety of approaches to this issue. In addition, we asked three prominent contributors to these original perspectives—Walter Salant, Margaret Weir, and Peter Gourevitch—to write for the volume, and their essays follow this introduction.[14] Each presents a nuanced analysis that moves well beyond the ideal-types described above, but there remain interesting differences of emphasis in their accounts.

The volume begins with Walter Salant's examination of the U.S. case. He points out that the New Deal, as Franklin Roosevelt initiated it in 1932, was basically regulatory rather than Keynesian. The budgetary deficits incurred during Roosevelt's first term were almost entirely attributable to the fiscal effects of economic recession; and it was only in the spring of 1938, during the so-called second New Deal, that Roosevelt was finally persuaded to endorse a deliberate increase in the budget deficit so as to stimulate the economy. This move and the acknowledgement of government responsibility for economic performance in the annual report for the 1939 fiscal year of the Secretary of Commerce marked the initial acceptance of Keynesian policies in the United States.

Salant attributes these and subsequent actions embodying Keynesian thinking

[14] It should be noted, however, that the typology I have just presented is composed of ideal-types which are by no means intended to capture the full views of these scholars. As Walter Salant has pointed out to me, for instance, he concentrates on matters of economic theory and economic events because these are the subjects with which he is most familiar, in some cases as a contributor to them; and he would readily acknowledge the role that other factors played in the progress of Keynesianism. Similarly, many aspects of the views of Margaret Weir and Peter Gourevitch go well beyond the cells of this typology, which is presented here primarily as a means for clarifying the different approaches that could be taken to the progress of economic ideas.

to five major factors. The Great Depression itself shook the faith of economists in the classical view of a self-adjusting economy. Since it generally takes a theory to kill a theory, Keynes' own *General Theory* provided an appropriate instrument, received with increasing enthusiasm by U.S. economists in the late 1930s. The development of new quantitative estimates for national income and expenditure of the sort utilized by Keynesians, originally developed by Simon Kuznets in the 1930s and accelerated by the prospect of war, lent momentum to the progress of Keynesian ideas within the administration. The 1937–1938 recession in the United States proved to be a crucial experience. The federal budget deficit dropped sharply between these two years, as the war veterans' bonus paid in 1937 ended and payroll deductions for Social Security began; and partly for this reason, industrial production underwent its sharpest decline in U.S. history from September 1937 to February 1938. This experience was highly congruent with the conclusions of Keynes' *General Theory*, just then being vigorously debated among U.S. economists, and it was instrumental in persuading Roosevelt to reflate during 1938.

The young Keynesian economists who flowed into Washington during the Second World War utilized Keynes' ideas for planning war production, and at the war's end these ideas were then taken up by some trade union leaders and business groups. Their support facilitated passage of the Employment Act of 1946, which acknowledged government responsibility for ensuring maximum levels of employment and established the President's Council of Economic Advisors to advise on measures for doing so. These aspects of the Act lead Salant to argue that it was clearly a Keynesian measure although, under pressure from business interests, Congress deleted provisions in the original bill calling for countercyclical federal spending and a national agency to superintend it. President Truman's Council of Economic Advisors then shifted the emphasis of Keynesian policy from the stability of output and employment to their growth, and President Kennedy revived this theme to persuade Congress to legislate a tax cut in the recessionary conditions of 1963 despite a federal deficit at the time.

As Salant points out, Keynesian ideas acquired influence over U.S. policy in the succession of steps, marked by some backward movement but gradual progression into the 1970s, when the experience of stagflation began to raise new questions about the adequacy of the ideas. Overall, his account suggests that the contribution of Keynes was to inspire an intellectual movement among U.S. economists who then played a key role in bringing the new ideas to bear on government policy.

In the next essay, Margaret Weir explores the structural conditions that allowed U.S. economists so much influence over policy through a comparison of Keynesianism in the United States and Britain. She emphasizes the limited commitment of postwar U.S. governments to Keynesian management, reflected in their dependence on automatic stabilizers, an emphasis on the growth of output rather than employment as the ultimate goal of policy, their overriding concern about inflation, and a reluctance to use countercyclical spending. Accordingly, she sees her task as one of explaining why Keynesian policies were adopted relatively early in the United States but pursued only intermittently thereafter, while they were initially rejected in interwar Britain but became a firm pillar of economic management after the war.

Weir attributes this outcome to differences in the structure of the two states and to the nature of the support coalitions for Keynesian policy that emerged in the two countries. She points out that British economic policy was administered by a closed and hierarchical civil service, dominated by a powerful Treasury, while U.S. policy has always been made by a fragmented bureaucracy in conjunction with outside experts and the Congress. Hence, the British Treasury was well placed to resist calls for reflation during the 1930s, in line with its longstanding bias against further public spending, but once Keynesian ideas had been insinuated into Treasury doctrine under pressure from wartime conditions and an influx of outside advisors, they acquired an entrenched influence over policy by virtue of the Treasury's iron grip over policy making. Conversely, in the United States, a porous administration quickly absorbed Keynesian economists and ideas in the 1930s, but their influence over policy remained tenuous because a fragmented administrative structure nurtured continuing conflict over the appropriate direction of policy.

Weir goes on to argue that the viability of Keynesian policies has also depended on the firmness of support for them in the political arena. In part, that turns on the nature of potential coalition partners. Whereas a powerful trade union movement was united behind Keynesian ideas in postwar Britain, the AFL and CIO split over the Full Employment Bill in the United States, as did a Democratic party divided between northern liberals and southern agrarians. In addition, Weir points out that a policy is not judged simply on its own terms but in terms of its relationship to other policies and issues high on the national political agenda at a given time. Hence, the political attractiveness of Keynesianism depended heavily on the way it was perceived and on the wider set of issues with which it was associated. In postwar Britain, Keynesian ideas were presented as the adjunct to a popular set of social programs and as an alternative to more interventionist forms of planning. In the United States by contrast, Keynesianism was associated with proposals for national planning whose interventionist tone antagonized many business groups and whose administrative implications aroused many concerns about the autonomy of state and congressional jurisdiction in these matters.

Peter Gourevitch follows with a comparative essay that develops and refines his earlier work on the sources of change in economic policy. Although there are many points of contact between the essays of Gourevitch and Weir, where Weir begins from the impact of state structures on the direction of policy, Gourevitch lays even greater stress on the coalitional politics associated with policy making. In his view, policy is made by politicians who must construct coalitions of support for their work from a range of social groups with distinctive views of their own interests and the policies that will best serve them. Hence, Gourevitch suggests that the adoption of Keynesian policies will be constrained by the capacity of politicians to construct new coalitions of support behind them. That, in turn, depends on the skill of political leaders, the underlying interests of social groups, and aspects of the institutional setting that contribute to these groups' conceptions of their interests.

In this vein, Gourevitch points out that the governments which adopted reflationary policies in the 1930s were all seeking political support from a coalition of workers and farmers with some participation from segments of business. Keynesian policies seemed to lend themselves to the construction of such a coalition in this period. Similarly, the political viability of Keynesianism in the postwar period turned on the advantages it offered for constructing a new coalition between business and labor in many nations.

However, Gourevitch is careful to point out that similar groups can conceive of their interests differently and that these conceptions can change over time. Over the course of the twentieth century, for instance, formal associations have come to play an important mediating role between state and society, and their goals, categories, and agendas shape their members' conceptions of interest to an increasing degree. Even more important, in Gourevitch's view, is the way in which a group's conception of its interests changes as its position within the international economy changes. Gourevitch is able to show that one of the principal ways in which international economic developments affect domestic policy outcomes is by altering the interests of the economic groups whose support forms the basis for particular policies, like Keynesianism.

Donald Winch's essay is a nice counterpoint to the ambitious theoretical pieces of Weir and Gourevitch. He provides a thoughtful reevaluation of the relationship between Keynesian policies and administrative arrangements which begins with a discussion of Keynes' own views on this subject. He concludes that Keynes saw his own policy proposals as relatively noninterventionist, open to implementation by any regime, and relatively unconnected to the social programs of the welfare state. We are reminded of Keynes' personal inclination to think that the quality of policy depended primarily on the lucidity, learning, and compassion of the administrative elite who were responsible for it.[15] As Winch points out, there is some irony in this view, given the bureaucratic resistance that Keynes' own proposals met in Britain.

Winch also draws our attention to contemporary debate about the sources of this resistance. Many commentators have attributed it to the reluctance of Treasury officials to accept Keynes' theoretical postulates. They see the disputes of the 1930s primarily as a clash between competing economic theories. By contrast, a revisionist literature has suggested that the Treasury was not altogether hostile to Keynesian theory, but saw compelling administrative and political reasons to resist its implementation. Winch concedes a good deal to the revisionists but he ultimately underlines the importance of theoretical resistance to a policy of self-conscious economic management in interwar Britain.

In a subsequent critique of state-centered explanations for Keynesian outcomes, Winch observes that all attempts to explain past policies must walk a thin line between overly deterministic accounts of events and overly generous interpretations of the opportunities available to policy makers. On the one hand, the analyst is often inclined to think that policy was more fully determined by such factors as policy legacies and administrative constraints than it really was. On the other hand, we may be tempted to posit opportunities for change that would only really have been viable given the clarity of hindsight and could not reasonably have been pursued by policy makers whose vision was restricted to the contemporary train of events.

Winch paints a picture of economic policy making that suggests it is a much more uncertain process than we usually appreciate, one of sifting through pieces of evidence, which often contradict one another, for a view of the current state of the economy and of guessing about the validity of often-untried theories for a sense of the factors that will affect economic performance. A policy must then be chosen in the face of the multiple cross-pressures greeting every government. Winch reminds us that, in such settings, the order in which economic events occurred, the limited means which policy makers had for assessing their significance, and the confines of their view on contemporary events may have been much more important components of the outcome than retrospective accounts often recognize.

Bradford Lee's discussion of economic policy making in Britain, the United States, and France during the 1930s is especially sensitive to these considerations. He provides us with a rich analysis designed to show why a policy of deficit spending was rejected in interwar Britain, pursued late but abortively in France, and accepted hesitantly in the United States only after 1938. He begins by show-

[15] See also D. E. Moggridge, *Keynes* (London: Macmillan, 1976), pp. 38ff.

ing that this was not for want of appropriate ideas: proto-Keynesian theories that mandated deficit spending were well known and to some degree accepted during the 1930s in all three nations. Moreover, the unemployment problem was clearly pressing, and recessionary conditions were already generating budget deficits in these countries. In this context, the principal puzzle is to explain why governments made repeated attempts to balance their budgets instead of gracefully accepting the usefulness of deficit spending.

To resolve this puzzle, Lee sifts carefully through the evidence in the spirit of a historical detective trying to explain why the Holmesian dog did not bark. He suggests that we can conceive of the problem in terms of a series of concentric circles composed of actors and institutional contexts that surround the ultimate political decision makers; and he examines a range of competing hypotheses associated with each of these rings. In the end, Lee rejects the suggestion that policy makers tried to balance their budgets in response to pressure from actors in the wider political system, legislature, interest groups, or the bureaucracy. Instead, he argues that the decision to seek a balanced budget depended most of all on the attitudes of political leaders at the center of these circles, which, in turn, were based on historically specific perceptions of the dangers that public sector deficits posed for the existing boundaries between state and society. In particular, the political leaders of all three nations feared that any move beyond balanced budgets could render the state hostage to its creditors in the financial community and open the floodgates to a potentially ruinous torrent of demands for greater public spending from multiple social groups. Once the bulwark provided by a doctrine of balanced budgets has been breached, the long-standing rationale for resisting such demands would be lost and the autonomy of the state itself could be threatened. Lee is able to show that such considerations loomed large in the minds of interwar policy makers.

Lee's work constitutes an elaboration on the nexus between the thinking of politicians and the nature of state-society relations during the period in which they are governing. It reminds us that we must not judge the actions of interwar leaders exclusively in terms of the ideas with which we are familiar today. The acceptance of Keynesian ideas entailed a profound change in state-society relations; and interwar decision makers were more cognizant of this than we might think, but they were also highly uncertain about what might replace the existing order. Their actions were based, initially at least, on a set of doctrines that, over the course of a hundred years, had become intimately bound up with long-standing views about the appropriate relationship of the state to society. Even in the face of economic crisis, it is not surprising that political leaders should hesitate to forsake these doctrines and the safeguards they provided, before they had a clear sense that there were indeed serviceable alternatives. As Lee's analysis indicates, Keynesian policies were not just a technical solution to economic depression; their acceptance was also a political statement about the appropriate bounds of state behavior.

The more extended account of the French case that Pierre Rosanvallon provides enlarges on these themes. Like Lee, Rosanvallon argues that the progress of Keynesianism in France is best understood, not so much as a Kuhnian revolution in economic theory, but as one dimension of a broader evolution in political culture. Keynesian ideas were largely ignored during the interwar period but became a central component of the transformation in state-society relations that followed the Second World War. Several factors militated against the favorable reception of Keynesianism in interwar France. Keynes' own critique of the Versailles Treaty had been highly unpopular; and reflationary policies were widely associated with the threatening economic strategy of Nazi Germany. Since the French economics profession was small and dominated by a few figures steeped in laissez-faire, French officials tended to view economics as an esoteric discipline that was hostile to their legitimate efforts to intervene in the economy. In a context where interventionist economic policies had a long pedigree and a variety of underconsumptionist theories were already well known, Keynes' views did not seem particularly novel. They were initially received with sympathy only by a few *polytechniciens* and *planistes* widely suspected of fascist leanings by the French left.

In the turbulent years that followed the Second World War, however, Keynesian ideas were taken up by former *résistants* then moving into positions of power, determined to modernize the French economy so as to prevent any repetition of the economic and military defeats of the past. Many of them had been exposed to Keynes or English economics during the war, and they saw Keynesianism as a means to preserve and modernize a capitalist economy at the same time. *The General Theory* was first given a prominent place in the curriculum of the institutions devoted to the training of civil servants. In this case, Keynesianism was not seen as a doctrine that emphasized only demand management but one that inspired a planning commission intervening directly into the flow of goods and capital in order to facilitate reconstruction as well as a variety of statistical agencies that were developing forecasting procedures and a new system of national accounts. Keynes was seen as the advocate of a new conception of the economy as an appropriate field of action for the optimizing efforts of public officials. In that respect, his ideas could inspire demand-side and supply-side actions alike. They became the basis for a kind of national *tutelle*, designed to keep French industry competitive in an increasingly open international economy, and the source of a common language that allowed persons of quite different political sensibilities to rally around such a program. In Rosanvallon's words, Keynesian ideas were "the economic expression of a reformist and modernizing political culture" that legitimated the transformation of state-society relations in postwar France.

Since we are interested in explaining why Keynesian ideas were accepted in some nations but not others, it is not sufficient to look only at cases where those ideas were highly influential. We must also consider the countercases, nations where Keynesian policies were adopted relatively late in the postwar period or not adopted at all. Given the general influence of Keynesian ideas, these countercases are particularly interesting, and we deal with three of them in the next set of essays.

Marcello de Cecco considers the case of Italy. He describes Keynes as an intellectual innovator who outlined reforms necessary for the survival of mature capitalism, much as David Ricardo had specified a framework for the initial triumph of capitalism over a century before. However, few economists in interwar Italy were favorably disposed toward Keynesian ideas, and de Cecco takes some pains to show why. As in France, the academic discipline of economics was dominated by a few influential figures who occupied the principal university chairs. Where the profession was small and hierarchical, Keynesian ideas generally made slow progress. Moreover, these academic economists saw themselves as the upholders of a classical economic tradition to which such Italians as Pareto, Pantaleoni, Einaudi, Bresciani-Turroni, and others had made distinguished contributions. Deeply embedded in their views was a broader set of moral and political prejudices that rendered them especially hostile to the strategy of state-led industrialization which the ruling elites of Italy had employed since the *Risorgimento*, and particularly during the later stages of Mussolini's regime, to transform an agrarian society into a modern economic power. Hence, Keynes appeared to them as an unorthodox interventionist whose attempts to subvert classical economic doctrines were doubly resented because they came from the original home of classical economics itself. Keynes' theories seemed to threaten the image they so valued of a laissez-faire state presiding over a community of self-made men whose prosperity flowed from their industry, thriftiness, and independence rather than from the unchained manipulations of politicians and ambitious public officials. The reaction of the Italian economists might not have surprised Keynes, who always held that "economics is essentially a moral science" but it tends to suggest that Keynesian ideas were rarely judged on scientific grounds alone.[16]

The pragmatic mercantilists who had run the Italian economy since 1860 might have been more sympathetic to Keynes, but they had little need of his

[16] *JMK*, 14: 297, 300; quoted in D. E. Moggridge, *Keynes* (London: Macmillan, 1976), p. 28.

theories. They were already convinced that Italian economic growth depended on an activist public policy; and in an agrarian nation with few mechanisms for mobilizing savings, a limited consumer sector, and plenty of unemployment to depress wages, Keynes' ideas seemed to have little applicability. As a result, during the interwar period, Keynesian concepts were taken up primarily by a few corporatist economists who found them theoretically useful for justifying the economic programs of fascism.

When the war ended, an open debate raged between the classical economists who initially came to power in reaction to the interventionism of Mussolini and Keynesian sympathizers within Italy and on the international agencies superintending the distribution of Marshall Plan aid. Despite stiff resistance, however, Keynesian ideas ultimately came to Italy through the back door. The pragmatic neomercantilists charged with reviving the Mezzogiorno and directing the many nationalized firms that remained after the war soon began to use Keynesian ideas to bolster their case. As Keynesian concepts crept into the construction of the national accounts and the research department of the powerful Bank of Italy, they began to exert an influence over demand management as well. Even then, however, the patronage-based systems of public spending around which the postwar Italian state was organized made coherent demand management difficult and policy was often somewhat haphazard. In short, postwar Italy managed to steer a "middle way" between classical economics and Keynesianism that was very much in keeping with the pragmatism on which most of Italian policy has long been based.

Harold James turns to the case of Germany between the wars. He suggests that Keynesian doctrines were not well received there for at least three reasons. Deficit spending was associated in the minds of many with the hyperinflation of 1919–1923. Civil servants were skeptical of the value of deficits and extremely concerned about how they were to be financed, especially after the financial panic of 1931; and academic economists were not particularly well disposed toward Keynesian policies. One might think that the heirs of the historical school of German economics would be far more sympathetic toward interventionist policy than their classical counterparts elsewhere, but James argues that the German economists working in this tradition were focused on long-term structural problems that left them relatively uninterested in the short-term policy activism that Keynes advocated. Ropke, Lautenbach, and a few others developed proto-Keynesian approaches to policy, but even they felt that reflation was rendered impossible by the fiscal crisis of the early 1930s. This is a case in which international constraints, associated with the reparations plans, banking failures, and capital outflows of the initial Depression years, lay particularly heavily upon policy makers.

In this context, James argues that economic theory played a very small role in the economic policies of interwar Germany. Instead, the structural incapacity of Weimar governments to resist political pressures for higher spending lay behind the deficits of the 1920s; the increasing difficulty of securing financing from strained capital markets inspired the turn toward deflation in 1929–1930; and a variety of political goals, rather than proto-Keynesian theory, inspired reflation under Hitler after 1933. The link between reflation and totalitarianism in the 1930s, in turn, inspired a reaction among many German economists against such policies. Ropke and others came to associate activist economic management with a slide toward centralized control of the economy and the undermining of markets in resource allocation. This set the stage for the turn to a "social market economy" after the war.

Christopher Allen looks more closely at postwar Germany, where Keynesian ideas were strongly resisted until well into the 1960s. We can see several similarities with the Italian case. Free-market economists became influential after the war partly because more interventionist doctrines, including Keynesianism, were discredited through association with the Nazi regime. Concerns about a repetition of the hyperinflationary experience of the 1920s led the founders of the postwar regime to institutionalize a powerful, and relatively independent, central bank that became a major source of resistance to reflationary policies. A desire to reestablish the nation's international economic strength in the wake of military defeat led to an early emphasis on export-led forms of economic growth that stressed the cultivation of savings and the maintenance of low wage levels rather than the stimulation of demand around which Keynesian policies were based. As in Italy and Japan, this strategy may also have been inspired by an appreciation for the role that exports had played in the late industrialization of the nation. Finally, like these two nations, West Germany was ruled by a coalition of conservative parties until the formation of the Grand Coalition in 1966.

Accordingly, Germany moved toward Keynesianism only after the appearance of recession in 1965 and the entry of the Social Democratic party into the governing coalition. Both events raised the priority accorded unemployment issues on the political agenda. The broader sequencing of events was important as well. Germany's initial turn toward social market economics immediately after the war was something of a happenstance, linked to the influence of Ludwig Erhard in the late 1940s. However, the phenomenal levels of growth that Germany experienced in the 1950s and 1960s firmly established the credibility of this doctrine, just as the apparent success of Keynesianism established its credibility in other nations during the 1950s and 1960s. Hence, even after 1966, Germany's interest in Keynesianism remained heavily qualified by a deeper faith in social market principles, especially at the Bundesbank.

Eleanor Hadley discusses Japan, a third nation in which Keynesian ideas made very little progress until the 1960s. The country did benefit from a reflationary experiment in the mid-1930s, initiated by a finance minister who was influenced by Keynes but politically dependent on a military caste that later assassinated him when he tried to reduce public spending. After the war and another Keynesian-inspired reflation in 1946, however, the occupation authorities dealt with high levels of inflation by pressing a policy of balanced budgets on Japan. Faced with a serious shortage of natural resources and potential balance-of-payments problems, Japanese policy makers themselves embraced an economic strategy that relied on active supply-side measures and incentives to savings, rather than demand management, to stimulate export-led growth. Long experience with state-led industrialization inspired a postwar system of economic planning, and many Japanese officials saw the emphasis on exports as a way to regain international economic power and world respect.

Although *The General Theory* was widely read by Japanese economists, the academic profession is more divided than usual among classical, Keynesian, and Marxist schools; and economic policy has been made by career officials whose career track is quite separate from that of academic economists. Partly because most senior economic officials are generally administrators rather than professional economists, Keynesian ideas initially became influential primarily among the members of the Economic Planning Agency charged with the development of national income statistics and macroeconomic forecasting. The 1960s brought some changes, as Tokyo University, from which many government officials are drawn, finally began to teach the neoclassical synthesis and Prime Minister Hayato Ikeda's plan for doubling the national income put a new emphasis on the role of Keynesian-inspired ideas in economic policy making. In 1966, legislation imposing a balanced budget was finally amended, and reflationary policies were employed then and again in 1971 to deal with sudden downturns in economic growth.[17] As Hadley points out, however, the government has been slow to utilize countercyclical demand management, and even the budget deficits of the post-1974 period are more attributable to the impact of rising oil prices, growing political demands for social programs, and international diplomatic pressure than to a wholehearted acceptance of Keynesian ideas.

Jukka Pekkarinen completes the case studies presented here with an ambitious comparison of policy making in the Scandinavian nations. He considers two polar cases in detail: Sweden, which embarked on a famous reflationary experiment in the 1930s and developed a distinctive form of Keynesianism in the postwar pe-

[17] See also Ryutaro Komiya and Kozo Yamamoto, "Japan: The Officer in Charge of Economic Affairs," in Coates, *Economists in Government*, pp. 262–89.

riod, and Finland, where Keynesian ideas exercised virtually no influence over policy before the war or afterwards. To refine his arguments, Pekkarinen also reviews the experience of Norway, where Keynesian ideas had a substantial impact on policy, and Denmark, whose efforts at countercyclical demand management have been considerably more diluted. Pekkarinen argues that in each country policy has been guided by a distinctive economic policy model which defined the boundaries of the policy agenda, the policy instruments to be used, and the principal economic problems to be tackled. At times of crisis, these models are susceptible to the influence of broader economic theories but they otherwise act as relatively fixed templates for national economic policy making. Accordingly, Pekkarinen views the primary analytic problem as one of explaining how each nation acquired a particular policy model and why some were influenced by Keynesian ideas while others were not.

His answer to this question emphasizes four kinds of factors: the structure of each national economy, the balance of power among competing political parties, the institutional structure of the state, and the impact of indigenous schools of economic theory. Although all the Scandinavian countries have small, open economies, Pekkarinen suggests that the degree of product diversification in the export sector varied from one to another in such a way as to tighten the balance-of-payment constraint in some and confer greater room for Keynesian maneuver on others. A nuanced analysis of the way in which the structure of each economy affected its basic policy model is one of the striking features of Pekkarinen's essay. At the political level, he goes on to point out that the nations which adopted Keynesian policies early and pursued them most completely were those with virtually hegemonic social democratic parties backed by a relatively unified trade union movement, while those where Keynesianism made less headway featured social democratic parties that had to share power with strong agrarian or bourgeois parties. Perhaps related to this, in the nations which resisted Keynesian policies, policy making tended to be dominated by strong central banks and a bureaucracy that was relatively insulated from outside economic advice. Those that quickly absorbed Keynesian ideas, Sweden and Norway, had important schools of economic thought of their own that anticipated Keynes' ideas and enjoyed close contacts with economic policy makers. No doubt, many of these factors are historically interconnected in ways too complex to cover in a brief essay, but Pekkarinen has succeeded in identifying an important set of factors affecting the influence of Keynesian ideas.

The book concludes with two broad overviews of the factors that lay behind the diffusion of Keynesian ideas, by Albert Hirschman and myself. Hirschman emphasizes the international dimensions of the process, comparing the dissemination of Keynesian ideas to the spread of free trade doctrine a hundred years before. In each case, the doctrine acquired influence over the economic policies of a major power and was exported as that nation acquired increasing hegemony around the world. Within the United States itself, Keynesian ideas proved highly appealing to a group of young economists in the midst of a "creedal" period; but, since Keynesian policies may only work once the public itself becomes convinced they do so, Hirschman suggests that exogenous events which seemed to demonstrate the viability of the policies, such as the 1938 recession and the experiences of the Second World War, may have been necessary for Keynesian policies to be implemented successfully. Finally, Hirschman calls our attention to three important effects of Keynesian ideas. They helped to reshape political alignments. They infused a generation with a new civic spirit and hope that a variety of social ills could be overcome; and they inspired a number of other movements in economics, not least of which was the economics of development.

While Hirschman emphasizes the uniqueness of the process that lent influence to Keynesian ideas, my own concluding chapter tries to apply the insights of the Keynesian case to the more general problem of identifying the factors that will affect the influence any new set of economic ideas acquires over policy. Drawing on the preceding essays, I argue that Keynesian ideas were ultimately judged in terms of their economic, administrative, and political viability; and I identify four kinds of factors that seemed particularly crucial to the degree of influence that Keynesian ideas achieved across nations.

2

THE SPREAD OF KEYNESIAN DOCTRINES AND PRACTICES IN THE UNITED STATES

Walter S. Salant

THIS CHAPTER attempts to identify the main channels through which Keynes' major book, *The General Theory of Employment, Interest and Money* (hereafter *GT*), influenced economic policy and practice in the United States.

The title of this chapter obviously implies that Keynes' thinking did greatly influence doctrine and policy in the United States. Because the belief that it did so, at least during and after World War II until the late 1960s or early 1970s, is widespread, we should note at the outset that the truth of this belief has been both questioned and denied. This fact deserves serious consideration, both because it has some merit and because such consideration forces us to think hard about what is meant by Keynesian doctrines and policies.

So far as the New Deal is concerned, the passage of time tends to diminish the importance that today's public attaches to recovery from the Great Depression. That was the greatest and most urgent concern at the time, but as generations pass, memories of it fade into the background. Increasingly, the term *New Deal* is associated with reformist and enduring institutional changes—social security, wage and hour legislation, unemployment insurance, legislation governing labor relations, insurance of bank deposits, government insurance of home mortgages and other housing legislation, government regulation of security issues and securities trading, rural electrification, and other changes in the economic structure of the United States. If these institutional changes are what most people think of as the New Deal, it may be agreed that Keynes and Keynesian policies had noth-

This chapter is an expansion of a paper given at a conference, "Keynes and Public Policy After Fifty Years," held at Glendon College, York University, Toronto, Canada, September 26–28, 1986, and at the Ninety-Ninth Annual Meeting of the American Economic Association in New Orleans, December 28–30, 1986. I have received helpful comments on drafts of this paper from V. Lewis Bassie, Lauchlin Currie, and James Duesenberry. An earlier version of this essay appeared in Omar F. Hamond and John N. Smithin, eds., *Keynes and Public Policy After Fifty Years* (London: Edward Elgar; New York: New York University Press, 1988).

ing to do with them.[1] Probably the time will come, if it is not here already, when the institutional reforms also fade into the background; those who know there was once no deposit insurance, no unemployment benefits, no social security, no health insurance, die and are replaced by those who are not aware that once we did not have these things. Thus, what has been said of science may also be said of ignorance: that it progresses funeral by funeral. Before World War II the Depression was predominant in the thinking about current economics of all but a few, and that is what people have in mind if they assume Keynes' thinking influenced U.S. policy then.

Even with regard to the fiscal policy of the New Deal, however, there is ground for denying that Keynes has much to do with the policies which actually followed. Herbert Stein, in the title of a chapter in his book *The Fiscal Revolution in America,* distinguishes between the "fiscal revolution" and the "Keynesian revolution," and says that "it is possible to describe the evolution of fiscal policy in America up to 1940 without reference to him [Keynes]."[2] Keynes' fiscal ideas, as expressed in his pamphlet *The Means to Prosperity* (1933), in his open letter to Franklin D. Roosevelt in the *New York Times* of December 31, 1933, and in his interview with Roosevelt in 1934, do not appear to have had much influence on the president.[3] Referring to the decision to embark on a spending program in the spring of 1938, Stein says that by then "we had reached the stage in which we would not only accept a deficit in depression but would deliberately and substantially increase expenditures . . . for the purpose of raising the general level of the economy. This stage had been reached without a significant contribution from what is now called Keynesianism."[4]

Similar doubts about Keynes' influence have also been expressed with regard to the early years after World War II. Leon Keyserling, who was part of a three-man team revising the first drafts of the Full Employment Bill and also first a member and then chairman of the Council of Economic Advisors from 1946 through 1952, has asserted that "it is a fallacy to think that John Maynard Keynes

[1] On the origins of these and other measures, see Leon H. Keyserling, "Discussion" [of papers by Byrd L. Jones and Alan R. Sweezy], in "The Keynesian Revolution and Its Pioneers," in *American Economic Review, Papers and Proceedings* (May 1972), pp. 134–38; and Leon H. Keyserling, "Discussion" in Frank H. Heller, ed., *Economics and the Truman Administration* (Lawrence, Kans.: Regents Press of Kansas, 1979), pp. 79–109.

[2] Herbert Stein, *The Fiscal Revolution in America* (Chicago: University of Chicago Press, 1969), p. 131.

[3] On this point, Roy Harrod said he "had been at special pains to find out whether the President was profoundly influenced by this interview and guided his policy thereafter to some extent in the light of Keynes's theories. The evidence is conflicting. The preponderant opinion among those in a good position to know is that the influence of Keynes was not great." Cited by Stein, *Fiscal Revolution in America*, pp. 150–51. Harrod does not cite evidence that conflicts with this "preponderant" opinion.

[4] Stein, *Fiscal Revolution in America*, p. 167.

had anything of substance to do with the idea behind the Employment Act of 1946 or with the policies of the Truman administration."[5] In saying this, Keyserling refers to "Keynes's idea, as it is understood by Americans," as mainly compensatory spending. "It is a valuable idea, but it was not the idea underlying the Employment Act of 1946 and it certainly was not the idea underlying the administration of President Truman. . . . Compensatory spending (as we understand it à la Keynes) was never tried during the Truman administration; it was never needed."

If one accepts the common (noneconomist's) interpretation that Keynes' main idea was his advocacy of compensatory spending, it must be agreed that, although it was central to early drafts of the Full Employment Act, it is not, as will be shown later, the idea underlying the Employment Act of 1946 as that legislation was enacted. One reason for the vigorous objection to the Full Employment Bill by some of its opponents was that they did not want to authorize a policy of compensatory spending. The legislation would not have been enacted had the original prescription of such a policy been retained. When it was cleansed of that idea (and with other changes in earlier versions), it was passed by a vote of 320 to 84 in the House of Representatives and without opposition in the Senate.

These points do give some support to the doubts about Keynes' influence on particular acts of U.S. economic policy, especially before World War II. Nevertheless, Keynes' ideas and the ferment they created changed the intellectual climate. It must be recognized that the ideas expressed in Keynes' *The General Theory of Employment, Interest and Money*, the book that is central to what economists think of as his ideas, included much more than compensatory government spending. Indeed, such spending is hardly mentioned; Keynes' emphasis is elsewhere. His attack on Say's Law was important in undermining the view that aggregate demand could not be insufficient, and in explaining that, during depression or when economic activity was threatening decline, government action to increase or sustain demand was desirable, not useless, let alone destructive, as the neoclassical theory expounded by Hayek and others of the "Austrian" school held.

The effect on the intellectual climate manifested itself in many ways. The idea that government could maintain high levels of employment and output and should accept responsibility for doing so, first expressed officially in the *Annual Report of the Secretary of Commerce for the Fiscal Year 1939*, was written into it by Keynesian economists. Keynesians played an important role in the drafting of the Employment Act, as Stephen Bailey's book about that Act makes clear.[6] Bailey

[5] Walter W. Heller, *New Dimensions of Political Economy* (Cambridge, Mass.: Harvard University Press, 1966), pp. 104–5.

[6] See esp. "The Contribution of Keynes," pp. 14–20 and "Keynes to S.380: Connecting Links,"

says, however, that "the name of Keynes is being used [by Bailey, presumably] as a symbol for an intellectual movement." There is no question that Keynes' ideas did affect economic doctrines and policies in the United States.

One more word by way of introduction. An attempt by any one person to give a detailed account of the channels through which writings influenced events is bound to be affected by the window through which that writer has seen the developments he describes; they would undoubtedly look different to someone who has seen them from a different view.

In the case of Keynesian doctrines and policies, it makes a difference not only who does the writing but what the subject is. There is a difference, as is well known and made explicit in the title of Axel Leijonhufvud's book, between "Keynesian economics" and the "economics of Keynes."[7] This chapter could be about either or both. At the narrowest extreme one could interpret Keynesian doctrines and practices as being confined to the adoption of countercyclical fiscal policies or policies designed to combat other specific lapses from full use of the economy's labor and capital stock. At the other extreme, the term could be broadly interpreted as the rejection of the paradigm according to which private market forces can be relied on to maintain or restore high output and employment automatically if the government does not interfere with them, and the replacement of that paradigm by another. Between these extremes are many other possible interpretations of Keynesian doctrines and policies, raising many questions of theory or fact.

What is at issue could be any of these questions or all of them. To understand why Keynes' ideas were a novel contribution, it is necessary to know the ideas about both theory and policy that were accepted before *The General Theory* was published.

PRE-KEYNESIAN IDEAS ABOUT THEORY AND POLICY

The widely accepted view of professional economists before the Depression of the 1930s was that in a free market economy unemployment would be limited

pp. 20–28, in Stephen K. Bailey, *Congress Makes a Law* (New York: Columbia University Press, 1950).

[7] I have written elsewhere about what is often attributed to the Keynes of *The General Theory* but either does not appear or is the opposite of what he said there and about the apparent forgetting of some things he did say, among them the liquidity trap, the reverse-L-shaped supply curve, the neoclassical synthesis, and other matters. See Walter S. Salant, "Response: On Rereading Keynes Today," *Comments on* Donald Moggridge's "Keynes and Our Current Discontents," Brookings Discussion Paper, April 1983, and Suzanne W. Helburn and David W. Hall, eds., *Marx, Schumpeter, Keynes: A Centenary Celebration of Dissent* (Armonk, New York and London: M. E. Sharpe, 1986), pp. 250–57.

to the frictional and casual kind. Displacement of workers caused by structural changes would be overcome by the operation of market forces, such as the competition of workers for jobs. When expenditure on capital goods was too little to use all the saving that would be done at high levels of income, interest rates would fall enough to stimulate greater capital expenditure. According to this view, there could be overproduction of specific goods or types of goods, but there could be no general overproduction, except as a temporary result of frictions, including lack of knowledge due to imperfections of communication and similar obstacles to adjustment that would be overcome in time.

At the same time, it was recognized that actual economic activity exhibited cyclical fluctuations. During the 1920s and 1930s, there were intense efforts to explain such fluctuations.[8] This body of business cycle literature and the classical view that there could be no persistent failure of free markets to clear were incompatible, as noted by two observers commenting on Keynes' *GT* twenty years after its publication.

William A. Salant observes:

> It was in the spirit of classical and neoclassical analysis that a smoothly working economic system would tend toward equilibrium at full employment. The automatic mechanism by which full employment was maintained or restored was not very clearly spelled out. . . . Students of the saving-investment process, beginning with Wicksell . . . dealt with disturbances in the equilibrium of the classical system. Some of them advocated intervention by the monetary authority in order to offset these disturbances rather than reliance on the automatic self-correcting forces inherent in the system. They did not, however, provide an alternative theory of the determination of the level of output. The Keynesian system did provide such a theory.[9]

Tibor Scitovsky notes that "Keynes coordinated already known bits of economic theorizing, supplied some missing links, and created a coherent theory of employment out of it." He then goes on to say:

[8] As James Duesenberry has reminded me, the business cycle literature of the 1920s and early 1930s put greater emphasis on prices, relative to output, than did the subsequent macroeconomic literature. Perhaps a symptom of the focus is the title of D. H. Robertson's difficult but important book, *Banking Policy and the Price Level* (1926). Keynes himself, in his response of November 30, 1930, to Ralph Hawtery's comments on Keynes' *Treatise on Money*, says, "The question *how much* reduction of output is caused, whether by a realized fall of price or an anticipated fall of price, is important, but not strictly a monetary problem. I have not attempted to deal with it in my book, though I have done a good deal of work at it. I am primarily concerned with what governs *prices*; though of course every conceivable factor in the situation comes in somewhere into a complete picture" (*Collected Writings*, 13:145).

[9] William A. Salant, discussion of "Keynesian Economics After Twenty Years," *American Economic Review, Papers and Proceedings* (May 1957), p. 91.

> Let us bear in mind that before the *General Theory* unemployment was regarded as the result of friction, temporary disequilibrium, or the monopoly power of labor unions. This meant that the business cycle had to be explained within a theoretical framework that made no allowance for the possibility of variations in employment and income. It also meant that business cycle policy had to be formulated without the benefit of a conceptually satisfactory measure of prosperity, such as the level of income or output or employment. This may sound absurd to us today; but it was Keynes's *General Theory* that made us realize its absurdity.[10]

The views about what came to be called macroeconomic theory and about policy that most of the established or rising economists held before publication of the *GT* were well indicated in the book by a group of Harvard economists published in 1934.[11] An example of the orthodox theory, advanced there, is the proposition that saving is simply an indirect form of expenditure, so that a cut in consumption automatically causes an increase in investment (i.e., an increase of spending on capital goods or inventory accumulation).

With regard to policy, the prevailing orthodox view was that the government should not interfere with the working of the market, or should do so only in limited ways. Some of the injunctions against propping up markets through creation of what was regarded as "artificially" easy money were based on the view that depressions grew out of the excesses of the preceding prosperities, and that the resulting mistakes had to be liquidated before a recovery could be "sound." This view, associated with Austrian theorists, notably Friedrich von Hayek (*Prices and Production*),[12] and ridiculed by some of its opponents as the "crime and punishment" theory of the business cycle, regarded demand stimulation through either expansionary monetary policy or government budget deficits as positively harmful because it tended to impede "liquidation" of the mistakes of the preceding prosperity, which was a necessary and perhaps sufficient part of the therapy. The *GT* attacked the theoretical propositions underlying those beliefs. The view that Keynes' important contribution was his attack on the validity of classical and neoclassical theory and the offering of an alternative theory has been strongly advanced by Don Patinkin, who has emphasized in several places that the *GT* is a book about theory, with only incidental references to policy.[13]

[10] Tibor Scitovsky, discussion of "Keynesianism Economics After Twenty Years," *American Economic Review, Papers and Proceedings* (May 1957), p. 93.

[11] Douglas V. Brown, *The Economics of the Recovery Program* (New York: McGraw-Hill, 1934; reprint, New York: Da Capo Press, 1971).

[12] Friedrich von Hayek, *Prices and Production* (London: Routledge, 1935).

[13] Don Patinkin, "Keynes and Econometrics: On the Interaction Between the Macroeconomic Revolutions of the Interwar Period," presidential address before the Econometric Society, in *Econometrica, and Other Essays on Keynes* (Chicago: University of Chicago Press, 1982), pp. 223–60.

This view was in fact supported by Keynes himself. In the preface to the *GT* he says, "its main purpose is to deal with different questions of theory, and only in the second place with the applications of this theory to practice."

The more widely held and less sophisticated understanding of Keynesian doctrine is much narrower: that it consisted of advocacy of countercyclical fiscal policy; that is, that when business is slack and there is substantial unemployment, the government should increase its expenditure and/or reduce taxes so as to run a budget deficit, financing it by borrowing from the banking system so that would-be private borrowers will not be deprived of financing, and that during periods of prosperity it should do the opposite.

The orthodoxy of opinion leaders and the general public prevailing prior to the Great Depression held, to the contrary, that the government's budget should be balanced every year, but not for the reasons advanced by professional theorists. The reasons more commonly given were that budget deficits are *necessarily* inflationary regardless of the extent of unemployment of labor, plant, and equipment, and/or that increases in the public debt (or the payment of interest on it?) involve a loss of real national income. These reasons were supplemented by the naive application of "commonsense" precepts of "sound" individual finance to the whole economy. Many other opponents of deficits merely accepted the view of established authority figures.

It should be recognized, however, that before publication of the *GT* and even before publication of Keynes' pamphlet *The Means to Prosperity* (1933), some established and outstanding economists, such as J. M. Clark, James Harvey Rogers, and Jacob Viner, realized that recovery required an expansion of aggregate demand and understood clearly the argument for a planned expansion of loan-financed expenditure. Indeed, J. Ronnie Davis in *The New Economics and the Old Economists*, after examining policy discussions and recommendations in the 1930s, concludes that "a large majority of leading U.S. economists affirmed, as did Keynes, the usefulness of fiscal policy and the uselessness of money wage reductions in fighting business depression"[14] and says that "Keynes cannot claim to have converted leading members of the economics profession to his views on policy; for the reason that the profession already held his views (in some cases, before he did)."[15] Davis emphasizes the prevalence in the early 1930s of those views among economists at the University of Chicago, often thought of as the stronghold of opposition to "Keynesian" policies.[16]

[14] J. Ronnie Davis, *The New Economics and the Old Economists* (Ames, Iowa: Iowa University Press, 1971), p. 6.

[15] Ibid., p. 7.

[16] For other citations of Davis's support for his main thesis, see his discussion of the views of Viner, Sumner Slichter, Virgil Johnson, Simeon Leland, J. M. Clark, and other prominent econo-

Don Patinkin also supports the view that loan-financed increases in government expenditures during depressions were advocated at the University of Chicago independently of the *GT* and adds that "different policy recommendations can emanate from the same conceptual theoretical framework; and different frameworks can lead to the same policy recommendations." He says, "Those of us who studied at Chicago under Henry Simons did not need the conceptual framework of the *General Theory* to advocate government deficits to combat depressions; . . . Simons taught this to his students on the basis of the conceptual framework embodied in Fisher's MV = PT. . . . Simons was far from being a voice in the wilderness at that time in the United States." Patinkin does not specify when "that time" is, but he does refer to Simons' teaching as independent of Keynes "and, indeed, before the *General Theory*."[17] He also cites Pigou as having stated the same policy conclusion in 1933 from a different conceptual background.[18]

Despite the understanding of Clark, Rogers, and Viner of the need for planned expansion of loan-financed expenditure, in 1932 and even later they nevertheless thought such a program unwise. Clark, in responding to a letter from Senator Wagner in the spring of 1932, expressed the opinion that (in Stein's words) "a policy of financing government expenditures by borrowing during a depression was ordinarily sound. Yet he found the problem 'puzzling' at that particular time, the answer depending in part on certain conditions that he was not in a good position to judge. He was concerned about the danger that additional borrowing, with a credit system abnormally contracted and apparently unable to expand, would lower security values and undermine the shaky collateral on which bank credit rests."[19] Similarly, Viner, in February 1933, after pointing out the advantages of a government deficit financed by monetary expansion, said, "I cannot see any justification for confidence that an aggressive inflationary policy of this

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mists of the 1930s and his citation of a memorandum to Congressman Samuel Pettengill of April 1932 written by twelve members of the University of Chicago economics department. This memorandum said among other things, that "if action were needed to raise prices, and the workers believed that it was, then it should take the form of generous Federal expenditures, financed without resort to taxes" (quoted in Stephen W. Baskerville, "Cutting Loose from Prejudice: Economists and the Great Depression," in Stephen W. Baskerville and Ralph Willet, eds., *Nothing Else to Fear: New Perspectives on America in the Thirties* [Manchester, England: Manchester University Press, 1986], p. 272). It should be noted, however, that the second of the above quotations from Davis is immediately followed by his warning that his book is not an attempt "to discredit Keynes and his contributions to economic theory. . . . Keynes's reputation as an innovator in economic theory is not at stake here. The objection raised is solely against Keynes's claim to innovative policy proposals. His original contribution lies not in them but rather in the *theory* with which he supported his policy recommendations" (p. 72).

[17] See Don Patinkin, *Anticipations of the General Theory? and Other Essays on Keynes* (Chicago: University of Chicago Press, 1982), pp. 167–68.

[18] See "Keynesian Monetary Theory and the Cambridge School," in ibid., p. 168.

[19] Stein, *Fiscal Revolution in America*, p. 35.

sort would not immediately result in a flight from the dollar, in panicky anticipation of the effects in business circles of a grossly unbalanced government budget, and therefore in more injury than good, at least as long as we remained on the gold standard.''[20] The reason was the judgment of these economists that, in the shaky financial situation that prevailed after the summer of 1931, the fears of, and opposition to, such a program on the part of domestic and foreign bankers, businessmen, and others would lead to an outflow of capital and declines in security prices, including a fall in the value of collateral for bank loans, that would aggravate the banking crisis and prevent or greatly restrain a recovery of investment. This concern is, in one sense, far from anti-Keynesian. In the *GT*[21] Keynes himself mentions the possibility of such confidence-shaking effects.

Even before the economic situation deteriorated from an ordinary cyclical downturn into devastating depression there were advocates of countercyclical spending. Indeed, there was professional and some official support for such spending during the prosperity of the 1920s. Stein documents this fact with respect to the United States in *The Fiscal Revolution in America*, and George Garvy[22] shows that countercyclical fiscal policy was actively supported by some economists in pre-Hitler Germany. But these supporters either did not have answers to the theoretical objections of classical and neoclassical economists or, if they had such answers, were unable to make them persuasive to supporters of financial orthodoxy before the *GT*.

It is clear that Keynesian doctrine—even in the narrowest definition—was not accepted or even generally respectable up to and through the first Roosevelt administration. Roosevelt himself denounced the budget deficit and advocated balancing the budget during his first (1932) presidential campaign and made moves to cut government expenditures during his first year in office.

In fact the New Deal, at least during Roosevelt's entire first term, was not an exercise in Keynesian economics. The centerpiece of the recovery program in the early years was the National Recovery Administration (NRA), established under the National Industrial Recovery Act, which, among other things, put floors under prices and hourly wages. This legislation did not expand demand for goods and services, and it was the deficiency of demand that was the actual problem.

It should be noted, however, that before the publication of the *GT* some members of the administration did recognize the need to expand demand for goods and services and pressed for the early New Deal legislation partly because they

[20] Ibid., p. 36.

[21] See John Maynard Keynes, *The General Theory of Employment, Interest and Money* (London: Macmillan, 1936), pp. 119–20.

[22] George Garvey, "Keynes and the Economic Activists of Pre-Hitler Germany," *Journal of Political Economy* (April 1973), pp. 391–405.

thought that raising prices and money wage rates would promote such expansion. Even the National Labor Relations Act (commonly known as the Wagner Act), which was primarily an aid to unionization of labor, was thought by some to be a means of raising demand.[23]

Most of the federal budget deficits during the first years of the New Deal were the result not of deliberate expansionary fiscal policy but of the Depression and the consequent fall in tax revenues and the expansion of relief and other Depression-related expenditures. Although some economists supported monetary and fiscal expansion, only a few who did so were prominent in the Roosevelt administration before 1937. The original New Deal intellectuals were not mainly economists, and of the economists among them only a few were students of economic fluctuations or of money or of what we now call macroeconomics.

The Beginnings of Respectability

What might be called Keynesian doctrines and practices was not accepted as part of government policy and respectable thinking until Roosevelt's second term, beginning in 1937 and lasting until the expansion of defense and World War II expenditures in the early 1940s. There were five major influences on governmental thinking during this time: (1) The Great Depression itself; (2) Keynes' *The General Theory of Employment, Interest and Money*, published in 1936, which influenced young instructors and graduate students in the economics departments of leading U.S. universities, mainly Harvard, many of whom were recruited into governmental agencies that had responsibility for or influence on fiscal and monetary policies; (3) the development of quantitative estimates of important economic variables and periodic reporting of them, including system-

[23] Labor supporters are quoted by Patrick Renshaw, "Organised Labour and the Keynesian Revolution," in Baskerville and Willett, eds., *Nothing Else to Fear*, p. 220, as having said in a letter of April 19, 1934, that "recovery depends upon the securing of mass purchasing power," and that "the sure and direct way of accomplishing this is the complete unionisation of labour." Renshaw does not say to whom the letter was addressed. He calls the writers "labour lobbyists," although two of the four he names were the philosopher John Dewey and the theologian Reinhold Niebuhr, labor supporters but by no means lobbyists. An interview in 1986 with Keyserling, probably the main draftsman of the Wagner Act, also shows that he and others thought unionization of labor would promote an increase in purchasing power and that this was a major motive in the minds of some members of the administration for promoting unionization. See Kenneth M. Casebeer, "Holder of the Pen: An Interview with Leon Keyserling on Drafting the Wagner Act," *University of Miami Law Review* (University of Miami School of Law), 42, 2 (November 1987), pp. 285–363. Renshaw's treatment of this view as "Keynesian" brings out sharply how elastic the interpretation of this adjective can be. The Keynes of the *GT* certainly would have regarded increases in money wages as causing a rise of prices and tending, in the absence of monetary expansion, to raise interest rates and inhibit investment, not as expanding demand for output.

atic data on national income and expenditure, at that time not yet developed into the present system of integrated national income and product accounts; (4) the effect of the 1937–1938 recession on thinking about what we now call macroeconomics; and (5) economic expansion in World War II.

The Great Depression

The influence of the Great Depression itself is in one sense obvious. It shook faith in the idea that the economy was self-adjusting, or at least that market forces alone could be relied on to restore high employment quickly enough to avoid an unacceptable amount of human suffering and loss of production.

The General Theory

The second major influence, publication of Keynes' *GT*, was followed by several years of critical reviews by the most eminent members of the economics profession. These adverse reviews included one by Alvin Hansen,[24] written before he moved from the University of Minnesota to Harvard and before he became Keynes' most eminent senior supporter.[25] Since many policy ideas that were expressed in the *GT* or could be deduced from it had been advanced earlier by others inside and outside the United States, it may well be asked why this book was so influential and is so widely regarded as revolutionary.

The most plausible explanation arises from the view of Thomas Kuhn about how paradigms are replaced. Prevailing paradigms may become subject to question as facts inconsistent with them come to light, and the questioning intensifies as such facts accumulate. However, they are rarely overthrown unless some alternative theory that accounts for those facts is advanced. In 1971, when I was asked to organize a session on "Keynesians in Government" for the 1971 annual meeting of the American Economic Association, Alvin Hansen threw cold water on the idea of such a session. One of his objections was that it was hard to know whom to identify as a Keynesian. He said, "You mention Eccles for whom I have great respect—a brilliant and original mind—but by no stretch of the imagination a Keynesian. He never knew anything about Keynesian economics. He strongly favored public spending in the deep Depression, but that does not make him a Keynesian." And similarly about Ickes, Wesley Mitchell, and others. Hansen then quoted a statement which he attributed to James Conant: it takes a theory to kill a theory. That idea points to an interpretation of why the *GT* was so im-

[24] Alvin H. Hansen, *Full Recovery or Stagnation?* (New York: Norton, 1938).

[25] But it is worth noting that Paul Samuelson, in the first of his Godkin Lectures delivered in November 1986 says that in later years Hansen thought of his review as favorable.

portant: it provided an alternative to the classical and neoclassical theory, which most of the other supporters of countercyclical fiscal policies did not do. Advocates of the heretical policies were thereby given a theory that they could bring to bear against the theoretical objections of the orthodox.[26]

The perceived lack of correspondence between classical and neoclassical theory on the one hand and the disastrously deep Depression on the other had created an appetite for a more satisfactory explanation of what was going on in the world, an appetite that was until then unsatisfied. In other words, the *GT* made respectable what seemed obvious to commonsense observations of the lay observer but was rejected by sophisticated theorists as fallacy indulged in by amateurs.

There were a number of fallacies in which the orthodox thought the heretics were indulging. One was the amateur's idea that because an increase in one person's money income increases his real income, this conclusion can be generalized: that an increase in everyone's money income will raise total real income. The classical economist "knew" that a general increase in money incomes would simply raise the price level.

Again, as noted earlier, the naive view was that acts of saving might cause underconsumption and thereby reduce aggregate demand. The more sophisticated view denied this; it asserted instead that saving merely diverted some demand for consumption to demand for investment (i.e., spending on capital goods or on increasing inventories). The *GT* made clear that the classical conclusions on these points were not true or not wholly true when resources were unemployed. The idea that "there is no such thing as a free lunch," that is, that an increase of one kind of output involves foregoing another, is now often referred to as something recently learned. Actually, it is what economics had been teaching for approximately two centuries. What Keynes argued and what was actually new was that under some conditions there is a "free lunch." In short, by showing that what classical economics found naive and wrong was sometimes correct, Keynes made the disreputable respectable.

Some of the rebels against orthodox economics were already in the government, although few of them had been students of macroeconomics. By far the most notable was Lauchlin B. Currie, an independent-minded and creative economist who in 1934 had become the main economic advisor to Marriner Eccles, chairman of the Board of Governors of the Federal Reserve System. Before the *GT* was published, this activist economist, whose intellectual fertility is still insufficiently recognized, had independently developed ideas that were not greatly different from those of the *GT*, although his first published reaction to the book

[26] The prevailing classical paradigm and Keynes' answers are clearly described by Stein, *Fiscal Revolution in America*, pp. 37–44.

was negative.[27] Earlier than most, perhaps even Keynes, Currie had become discouraged about the possibility of obtaining economic recovery through expansionary monetary policy alone and had become convinced that an expansionary fiscal policy involving a government deficit was needed. With his assistant, Martin Krost, at the Federal Reserve, he continued and further developed a statistical series begun at the Treasury designed to measure the monthly net contribution of the federal government's fiscal operations to the flow of money income or purchasing power.[28]

In early 1935 Currie not only estimated the size of what he then called "the pump priming or income producing deficit" of the federal government but attempted to estimate the amount needed to revive privately financed construction, which he thought necessary before "it will become safe to decrease public expenditures." He "hazard[ed] the guess" that "the monthly deficit should range between 400 and 500 millions [dollars]. It is highly questionable whether anything less can make a significant headway against the many forces making for continued depression."[29] This figure compared with his estimate of a monthly average for December 1934 to June 1935 of only 254 million.[30]

Currie goes on to say, "No mention has been made here of the secondary effect of public expenditures for the reason that I know of no way of estimating its magnitude. . . . All that I think we can safely affirm is that there is a *tendency* for incomes and expenditures in a given period to be increased by more than the amount of initial spending. Whether such an increase *actually* occurs depends on a large number of circumstances."[31]

Largely through the recruiting efforts of Currie and others, or independently through the attractions of the New Deal, young pro-Keynesian economists,

[27] For a full account of the matters here discussed, see Stein, *Fiscal Revolution in America*, chaps. 6 and 7. For Currie's contributions, see also the items under his name and the articles by Byrd Jones in the list of references.

[28] On this, see Alan R. Sweezy, "The Keynesians and Government Policy, 1933–1939," *American Economic Review, Papers and Proceedings* (May 1972), pp. 116–24.

[29] Lauchlin B. Currie, in a memorandum of 1935, reprinted as "Comments on Pump Priming," *History of Political Economy* (Winter 1978), p. 528.

[30] Ibid., p. 529. As printed in *HOPE* and perhaps also in Currie's original memo, figures in the table are said to be in billions of dollars, but this is obviously an error.

[31] It is of interest that, at an early stage of his thinking about public spending, Keynes seems to have agreed with this observation of Currie's about the magnitude of secondary effects. The pamphlet by Keynes and Hubert Henderson published in 1929, "Can Lloyd George Do It?," recognized what we now call induced effects but said, "It is not possible to measure effects of this character with any sort of precision. . . . But, in our opinion, these effects are of immense importance." It is not clear, however, that this referred only to increases of consumer spending induced by increases in government spending; it seems to have referred to all induced increases in spending, including induced investment. See Keynes' *Collected Writings* (10: 106–7) or Patinkin's essay, "Keynes and the Multiplier," in his *Anticipations*, p. 194.

mostly graduate students and young instructors from Harvard, were brought into strategic places in the government.[32]

The use of the term *pump priming* to describe the deficit that Currie and Krost calculated is significant as an indicator of how the supporters of loan-financed government expenditures then expected such expenditures to affect the economy. The basic idea is that the increase of such expenditures would stimulate a recovery of business activity and that this, in turn, would induce an expansion of private capital expenditure inducing further expansion so that the recovery could go on by itself. This would permit the increase in government expenditure to be reversed without reversing the recovery, exactly as when a water pump is primed. Currie stated the conditions necessary for this to happen in his 1935 memorandum.[33] Keynes himself stated the idea, without using the apt descriptive metaphor, in 1930 in testimony before Britain's Macmillan Committee. As Keynes notes, if a depression so shakes business confidence and reduces profit expectations that even a very large reduction of interest rates will not stimulate private investment, then "government investment will break the vicious circle. If you can do that for a couple of years, it will have the effect, if my diagnosis is right, of restoring business profits more nearly to normal, and if that can be achieved, then private enterprise will be revived. I believe you have first of all to do something to restore profits and then rely on private enterprise to carry the thing along."[34]

The Development of Statistical Data

Another development that gained impetus in the early 1930s and was related to the development and spread of Keynesian ideas was the intensification of quantitative work on the economy—the development of statistics on economic variables. Expansion of such work covered all aspects of the economy: production,

[32] Among the new recruits concerned with domestic macroeconomic policy to attain and maintain high employment were V. Lewis Bassie, Gerhard Colm, Emile Despres, Evsey Domar, G. Griffith Johnson, Milton Gilbert, Richard V. Gilbert, Lloyd Metzler, Richard Musgrave, Robert R. Nathan (brought in by Kuznets in 1933), Walter S. Salant, William A. Salant, and Alan R. Sweezy. Consultants included John Kenneth Galbraith, Alvin H. Hansen, and Paul A. Samuelson. Those sympathetic to policies called Keynesian, already in the government or brought in at an early stage, whether they had much or little understanding of macroeconomic theory, included (besides Eccles and Currie) Mordecai Ezekiel, Leon Henderson, Isador Lubin, and Harry White. On the large proportion of the recruits that came from Harvard and other aspects of Harvard's influence, see J. K. Galbraith, "How Keynes Came to America," *New York Times Book Review*, May 16, 1965. (Also in *Economics, Peace and Laughter* [Boston: Houghton Mifflin, 1971.]).

[33] Lauchlin B. Currie, "Comments on Pump Priming" (memo ca. Feb.–March 1935), *History of Political Economy* (Winter 1978), p. 527.

[34] Keynes, quoted in Stein, *Fiscal Revolution in America*, p. 145, citing Harrod's *Life of Keynes*.

employment, finance, prices, expenditure on consumption and capital goods, and other variables, and, perhaps most notably, first, the estimation by a group under the leadership of Simon Kuznets and, later, the assembly of these estimates into an integrated whole, now called the National Income and Product Accounts (NIPA). These accounts permitted the student to evaluate the relative importance of components of aggregate production, consumption, and other variables and to trace the aggregates and their components over time.

As Patinkin has made explicit, this quantitative work and *The General Theory* interacted; the book defined concepts that could be quantified and invited quantification, and thereby "defined the framework of research in macroeconomics for many decades which followed,"[35] while the quantification put flesh on the bones of the book's concepts. For example, even during the second Roosevelt administration there were no reliable figures on unemployment. Those now used for periods before World War II are postwar estimates based on the scattered information available at that time. Another example relates to the important concept of investment (meaning by that capital formation). In the absence of figures on capital expenditure, its amount was taken to be indicated by the volume of new security issues until an article analyzing the uses of such financing by George Eddy showed that to be a very misleading indicator.

This quantitative work is well described in a book by Joseph Duncan and William Shelton entitled *Revolution in United States Government Statistics, 1926–1976*.[36] As they show in a chapter entitled "National Income and Product Accounts and Their Uses," the prospect and then the actuality of World War II gave a great impetus to this work, and the results of the work, in turn, were used in the development of U.S. economic policy for the prewar defense program and for the prosecution of the war, and in wartime planning for the postwar period. In the early years of the war, several economists—most of them in the government—made quantitative estimates of the potential output of the U.S. economy, both to appraise the feasibility of various proposed defense programs and to help in formulating ideas about the intensity of inflationary pressures that they could be expected to generate.[37] On the quantitative work required for the application

[35] Patinkin, *Anticipation of the General Theory*, p. 223.

[36] Joseph Duncan and William Shelton, *Revolution in United States Government Statistics, 1926–1976* (U.S. Department of Commerce, 1978).

[37] On these matters, see by Byrd L. Jones, "The Role of Keynesians in Wartime Policy and Postwar Planning, 1940–1946," *American Economic Review Papers and Proceedings* (May 1972), pp. 125–33; and Duncan and Shelton, *Revolution*. For an example of an estimate that preceded the stimulus of the prospective defense program, having been stimulated by the need for recovery from the Depression, see Walter S. Salant, assisted by George Shaskan, Jr., "The Magnitude of the Recovery Problem," May 13, 1940, mimeographed, in author's possession and in the files of the De-

of the essentially Keynesian concepts, economists in the U.S. government were the pioneers in the first half of the 1940s. In contrast to academic economists, they were pressured to formulate advice on policy, to face up to applying macroeconomic concepts, and, in the process of doing so, to clarify those concepts.

The 1937–1938 Recession

Another influence on official and unofficial thinking about macroeconomic policy was the 1937–1938 recession. The Federal Reserve's index of industrial production plunged 29 percent in the five months between September 1937 and February 1938 and 33 percent in the ten months between July 1937 and May 1938, still the fastest fall on record.

Fiscal actions in 1936 and 1937 were major causes of that recession, and monetary policy may also have been involved, although this is disputed. The budget deficit fell more than $3 billion from 1936 to 1937. That may sound insignificant to us now, but to get a perspective on what its equivalent would have been in 1986, one must consider it as a fraction of the GNP. That would require multiplying by 50 (using round numbers), so it would be equivalent to a change in one year of about 3.5 percent of the 1936 GNP, which would amount to a change of roughly $150 billion in 1986.

That decrease did not reflect either adherence to Keynesian policies or repudiation of them. It was accounted for mainly by two things. One was that expenditures in 1936 had been swollen by the payment of the veterans' "bonus," and none was paid in 1937. The other cause was the coming into effect for the first time in 1937 of the payroll taxes under the new Social Security legislation.

The administration had opposed the bonus and Roosevelt had vetoed the bill, but it was passed over his veto. His veto message offers an answer to the question of how "Keynesian" the administration was during FDR's first term. The message denied the efficacy of "mere spending" for the sake of recovery.[38]

The payroll taxes were of course part of the long-run Social Security plan, the enactment of which was entirely unrelated to recovery policy. Those new taxes were not offset in their effects by payment of Social Security benefits, which did not begin in substantial amounts until 1938.

Federal Reserve policy in 1936–1937 may also have borne some responsibility for the 1937–1938 recession. In the spring of 1936 the price level began to rise

fense Economics Section of the Office of Price Administration and Civilian Supply, National Archives.

[38] Stein, *Fiscal Revolution in America*, p. 58.

sharply, although unemployment, despite its great decline since 1933, was still probably between 16 and 18 percent of the labor force. The Fed was greatly concerned that the rise of prices would continue and that the huge expansion of bank reserves (which greatly exceeded legal requirements) and the money supply might later become too hard to control. Because of this concern, in August 1936 the Fed raised reserve requirements for member banks by 50 percent, announcing at the same time that the existing easy money policy was still unchanged. Then it raised them another one-third through equal increases in March and May of 1937. These increases in legal reserve requirements greatly reduced the excess reserves of member banks, but because they remained at substantial levels, the Fed was again led to express confidence that the increase in legal requirements would have little effect on credit conditions. There seems to be no evidence that the Fed recognized that reserves that were "excess" in a legal sense may not be excessive in an economic sense, although the mere fact that banks held them instead of investing in more earning assets should have suggested that they might not be excess in an economic sense, that the demand of banks for liquidity was high.[39]

There were three failures: (1) the Fed apparently did not recognize that banks have a demand for liquidity and that it may exceed levels that satisfy legal requirements. Perhaps this failure is evidence that Keynes' analysis of liquidity had not been completely absorbed; (2) it was not sufficiently appreciated that large unused capacity would make a general demand-induced rise of prices temporary or at least limit it; and (3) it was not recognized that a rise in the price level may reflect a widespread autonomous rise in costs of production at given levels of output. The first two failures may be indications that some aspects of Keynesian

[39] It has been argued that interest rates were so low that it did not pay banks to invest excess reserves. Yields on three-month U.S. Treasury bills were two-tenths of one percent or less in every month of 1935 and 1936. This is an alternative to the explanation suggested in the text. Federal Reserve policy and the monetary aspects of treasury policy are discussed and evaluated in: Kenneth D. Roose, *The Economics of Recession and Revival: An Interpretation of 1937-38* (New Haven: Yale University Press, 1954), chaps. 6 and 7; Milton Friedman and Anna Schwartz, *A Monetary History of the United States, 1867-1960* (Princeton: Princeton University Press, 1963), chap. 9; Thomas Mayer, *Monetary Policy in the United States* (New York: Random House, 1968), pp. 217–25; and Lauchlin B. Currie, "Causes of the [1938] Recession" (memo of April 1, 1938), *History of Political Economy* (Fall 1980), pp. 325–29. Currie concludes that monetary policy "cannot be held responsible either as an initiating or contributory factor in the recession" (p. 328). That conclusion, however, does not deny the point being made here, which is that at the time and for many years after 1936, the economics profession apparently failed to recognize that the existence of huge reserves in excess of legal requirements indicated that banks, like members of the nonbanking public, had liquidity preference apart from legal requirements and that the existence of excess reserves was incompatible with the standard assumption of economics that banks are always "loaned up." These points were made in Walter S. Salant, "The Demand for Money and the Concept of Income Velocity," *Journal of Political Economy* (June 1941), pp. 395–421.

views were rejected or not absorbed for years after the 1936–1938 episode. The third was taken into account in *The General Theory*, where Keynes referred to it as a movement in the aggregate supply curve, but he seems to have included it more for formal completeness than because he thought it of great practical importance, for he gave it little emphasis.

The 1937–1938 recession undermined the theory that increased government spending need only get recovery of the economy started, that the resulting expansion would revive private investment, that output and employment would then continue to expand without benefit of the expanded government spending, so that the economy could maintain prosperity on its own and government spending could then return to its normal level, the idea underlying what was felicitously called pump priming. The recession of 1937–1938 persuaded many supporters of this theory that it was incorrect.

The 1937–1938 recession happened to have occurred when macroeconomists were debating Keynes' *General Theory*. One of the book's main themes—the distinguished economist D. H. Robertson thought its *main* theme—was that in a market economy involuntary unemployment could persist. Economists who doubted that the classical and neoclassical theory was applicable to the real world and who supported expansionary fiscal policy as a means to prosperity took the reversal of the recovery as support for this anticlassical idea; the economy's decline when the fiscal stimulus was withdrawn could be interpreted as a relapse to its "normal" state of underemployment equilibrium. A symptom of this new view was Alvin Hansen's book, *Full Recovery or Stagnation?* published in 1938.[40] The displacement of the pump priming idea may be regarded as a step in promoting acceptance of this Keynesian thesis, or at least in having reduced resistance to it.

The discouraging and frustrating recession of 1937–1938 led the administration to abandon "some moves in a budget-balancing direction." In the spring of 1938 Roosevelt was persuaded by his advisors to embark on what Stein calls "the first major and single-minded use of the budget to stimulate the economy."[41]

Perhaps the first official expression of the government's responsibility for maintaining full use of the nation's resources, but with an optimistic rather than the pessimistic tone so often associated with the stagnationist hypothesis, is to be found in the *Annual Report of the Secretary of Commerce for the Fiscal Year 1939* (pp. v-xiv), written by the late Richard V. Gilbert, Director of the Division

[40] Alvin H. Hansen, *Full Recovery or Stagnation?* (New York: Norton, 1938).

[41] Stein, *Fiscal Revolution in America*, p. 465.

of Industrial Economics in the Office of the Secretary, with the assistance of his colleague Roderick H. Riley.[42]

Economic Expansion in World War II

When war broke out in Europe in 1939, the United States began to increase its exports to the Allies and to build up its own defenses. As U.S. participation in the war became increasingly likely, some research units in the government began studies of the U.S. production potential, which was still far from being realized. The Keynesians in government, led by Richard Gilbert and Robert Nathan, pressed hard for increases in the defense program unaccompanied at this early stage by curtailment of public and private civilian spending. Indeed, they supported incentives to expand plant capacity so as to realize the still large unused potential. The size of this potential became the subject of intense controversy and, as defense expenditures rose, so did the question of when it was desirable to begin limiting the expansion of demand to avoid or minimize inflation.

It is not necessary to go into those controversies here; it is sufficient to note that the most optimistic views, Gilbert's and Nathan's, as to how large output could be if the economy were operating at full blast were actually exceeded by a wide margin at the peak of wartime production, and that the government economists were miles ahead of those in the universities in efforts to quantify the variables that Keynesian models emphasized. Unemployment, which was later estimated to have been 25 percent of the civilian labor forces in 1933 and 17 percent in 1939, was brought down to less than 2 percent in 1943, 1944, and 1945 under the combined pressure of the great increase in the armed forces and the government's largely loan-financed war expenditures. This economic expansion was widely interpreted as showing how effective an expansion of government spending could be in putting unemployed resources to work. At the same time, of course, it showed the danger of inflation from excessive demand if prices were not controlled.

The elimination of unemployment during World War II was one of the greatest influences on postwar views about the role of government in attaining and maintaining high employment and production, and the possibility of avoiding serious depressions in the future. The idea that this was a responsibility of government had, by war's end, become widespread enough to result in passage of the Employment Act of 1946. Although that legislation, as finally enacted, did not spec-

[42] U.S. Department of Commerce, *Annual Report of the Secretary of Commerce for the Fiscal Year 1939* (Washington, D.C.: General Printing Office, 1939).

ify the policies by which its goals were to be attained, it did represent a consensus that the government not only had the obligation to try to achieve the Act's objectives but had the power to do so.

After World War II

By the end of World War II Keynesian theoretical ideas had become much more acceptable to the economics profession. The violent controversy among academic economists during the first few years after publication of the *GT*, to a large extent intergenerational, had died down—not because many anti-Keynesians had died, because many had been won over.

A few business groups also came to support compensatory fiscal policy. Notable among them were the Committee for Economic Development (CED) and, less prominently, the National Planning Association (NPA). In 1943, well before the end of the war, Beardsley Ruml, an energetic businessman who became an important figure in the CED, publicly advocated an active compensatory fiscal policy, and in 1944 he and H. Christian Sonne, a liberal banker who took the lead in organizing and financing the NPA, wrote a pamphlet which stressed that reduction of tax rates is an alternative to increasing government spending as a way of pursuing a compensatory fiscal policy. They stated their arguments in a way that made the fiscal policy they proposed more acceptable to the business community; instead of saying that deficits should be run when employment and output were low, they said that tax rates should be set at figures that enable the country to balance the budget when employment and production are at a "satisfactory high level."[43]

In addition, the generations of rising undergraduates—both those who would be going into business and those going into other occupations—were increasingly being brought up on Keynesian theory. Although the first postwar college textbook in economics written along Keynesian lines, Lorie Tarshis's *Elements of Economics*, was not published until 1947, Tarshis and other economists had been teaching their students and drafting their textbooks for several years before they were actually published. Paul A. Samuelson's *Economics: An Introductory Analysis*, also a Keynesian text, was not published until the following year. Samuelson's textbook had gone through twelve editions as of 1985 and has sold several tens of millions of copies in more than twenty-five languages, so it may be regarded as having educated students all around the world for several decades. Those books were supplemented by Alvin Hansen's *Guide to Keynes* (1953).

[43] For an account of the activities of Ruml and the CED and for further references, see Stein, *Fiscal Revolution in America*, pp. 184 ff and chap. 9.

Thus, college and university students of economics, from whom the rising generations of government officials, businessmen, journalists, and other opinion leaders would come, were being educated along Keynesian lines. This fact was another important part of the tide toward first the adoption and then the increasing entrenchment of Keynesian views about macroeconomic policy.

If the term *Keynesian doctrine* is used in the loose sense of belief that government has both the ability and the obligation to maintain high output and employment, enactment of the Employment Act of 1946 marked a major step in its official acceptance.

Whether that is also true on a narrower interpretation of the term—as reliance on fiscal policy to accomplish its objectives—is more arguable. Most of those who originally conceived the Employment Act were Keynesians in that sense, too. But the early versions of the bill, which called the proposed law a *Full* Employment Act, were strongly and successfully resisted. One reason was that they made *full* employment the target. Another was that the early versions prescribed countercyclical change in government spending as the means of attaining it. The legislation that was finally enacted was, as Sidney Alexander put it, "completely purged of the fighting words: 'investment and expenditure,' as in 'such Federal investment and expenditure as will be sufficient to bring the aggregate volume of investment and expenditure by [all sources] up to the level required to assure a full employment volume of production'; 'full' as in 'full employment,' and other expressions in the original draft."[44]

As enacted, the legislation deleted that definition of the target and that means of hitting it, and merely permitted the president to do what the original bill would have directed him to do. These changes can be regarded as evidence that acceptance of Keynesian ideas was then limited. The legislation that was enacted set targets—maximum employment, production, and purchasing power—but did not and still does not specify the substantive means of attaining or maintaining them; it only prescribed organizational means for giving the president and the Congress economic advice. However, it did require that the federal government should promote the Act's objectives by means that are "practicable" and "consistent with its needs and obligations and other essential considerations of national policy" and be "calculated to foster and promote free competitive enterprise and the general welfare" (Section 2 of the Employment Act of 1946). Thus, if "Keynesian doctrine" is interpreted to mean fiscal policy, and still more if it is inter-

[44] See Sidney S. Alexander, "Opposition to Deficit Spending for the Prevention of Unemployment," in Lloyd A. Metzler, et al., *Income, Employment and Public Policy: Essays in Honor of Alvin H. Hansen* (New York: Norton, 1948), p. 192.

preted to mean only countercyclical fiscal policy, the Employment Act of 1946 was not a step in the progressive adoption of Keynesian doctrines and policy.

On a broader view, however, it was. For one thing, the government's acceptance of responsibility for seeking to achieve the specified economic goals can be interpreted to imply that many of the members of Congress who favored the legislation thought that the government had the ability, not merely the desire or obligation, to achieve those goals.

A second reason for considering the Employment Act of 1946 as "Keynesian" is that it is not concerned merely with stabilizing the business cycle. Stability might be maintained at or around levels, including rising trends, of production that are less than the "maximum" potential of the economy on anyone's definition, but the Act sought the "maximum." In that respect it is like *The General Theory*, the main concern of which is the level of output and employment, not cyclical fluctuations.

The emphasis on maintaining maximum employment rather than merely stabilization and the explicit emphasis on growth first came with Truman's Council of Economic Advisors. That council, the first one, was organized by Edwin Nourse, but the emphasis on growth reflected the initiative of Leon Keyserling, one of the original members and Nourse's successor as chairman. Members of the Kennedy Council thought that they initiated the emphasis on growth, as opposed to dampening cyclical fluctuations. They did not initiate that emphasis, but they did revive it.[45]

If the shift of emphasis in policy from stabilization of the cycle to continuing maximum employment is regarded as part of the absorption of Keynesian doctrines and policy into governmental thinking, it should be dated as having occurred during the Truman administration, then reversed or displaced by other considerations or ignored during the Eisenhower administration, and then restored during the Kennedy administration. These shifts may then be regarded as evidence that long-term change in doctrine occurs through a succession of steps,

[45] The belief of members of the Kennedy Council that they initiated the redirection of policy from stabilization, that is, countercyclical policy, to "full-employment economics" is expressed in James Tobin, "The Intellectual Revolution in U.S. Economic Policy-Making," Second Noel Buxton Lecture of the University of Essex, January 18, 1966 (London: Longmans & Green, 1966); Walter W. Heller, *New Dimensions of Political Economy* (Cambridge: Harvard University Press, 1966), pp. 61–62, 180; and Walter W. Heller, "Activist Government: Key to Growth," *Challenge* (March–April 1986), p. 59. Evidence that the Council's emphasis on maintenance of maximum employment first came with Truman's Council is provided by Walter S. Salant, "Some Intellectual Contributions of the Truman Council of Economic Advisers to Policy-Making," *History of Political Economy* (Spring 1973), pp. 36–49 (also Brookings Institution Reprint No. 269, 1973); and by Walter S. Salant, *op. cit.*, 1986; and is graciously accepted by Heller in "Response: A Distinction with a Difference," *Challenge* (July–August 1986), p. 59.

first several in one direction, then a lull or a few steps in the opposite direction, then more in the first direction, and so on.

Aside from restoring the focus of policy to continuing high production and employment, the most important contribution during the 1960s to institutionalizing Keynesianism in government policy was probably the tax cut of 1964. This has been heralded as the beginning of a "new fiscal policy." But Stein evidently does not believe that this can be regarded as one of the first applications of Keynesian doctrine, or even any application of it at all; he observes that "nothing was less in need of a sophisticated theory to explain it than the willingness of Congress to reduce taxes." This observation, however, appears to ignore the fact that there was then a large budget deficit. The proposal to reduce taxes in such a situation met considerable opposition because it was so contrary to fiscal orthodoxy.

From the point of view of 1986 it appears that economic policy ideas and practices in the 1960s represented a high point in the acceptance of Keynesian doctrines by government and private concerns in the United States. Since approximately the mid- or late 1960s those doctrines have been under increasing attack, first by academic monetarists, whose views found increasing acceptance, then by rational-expectations theorists, and more recently by "short-term supply-siders." (I add "short-term" to their usual label to distinguish them and what they say that is new and almost unanimously rejected by trained economists from supply-side considerations that are widely accepted by the profession but are hoary with age.) All these groups have been anti-Keynesian. With the Reagan administration, Keynesians have on the whole been displaced from government positions with macroeconomic responsibilities.

The increase in the acceptability of monetarism does not appear to be related to economic developments in the real world so much as to the persuasiveness of its leading proponents, but the intensified criticism of Keynesian theory and the increase in the influence of the other schools of thought were related to actual developments. Some of these developments were indeed different from what Keynesian theory led its proponents to expect. First, there was the increasing rise in the general price level. If, as is widely believed, this was initiated by excessively expansionary policy when output was at or near its potential, it offered no challenge to Keynesian doctrine; it was a failure to apply that doctrine. But the continuation of that inflation when output was below capacity and there was significant unemployment, and indeed even when both were actually becoming worse (i.e., stagflation), was a challenge to Keynesian doctrine and not at all what was expected by Keynesians, who tended to think mainly of deficiencies of aggregate demand, not of aggregate supply, as the chronic source of macroeconomic problems. The role of the sharp increases in oil prices in 1973–1974 and

1979–1980 on the general price level had not then been fully taken into account. By the time it was, Keynesianism had already been discredited in the eyes of many economists and probably most laymen.

After 1981 those doubts were further intensified by the election and entry into office of a new administration that vigorously repudiated Keynesian doctrines. During 1983 and 1984 the rate of inflation declined while the budget deficit was not only increasing but was surpassing all previous peacetime records in relation to the GNP. This raised further questions in people's minds about the validity of Keynesian doctrines.

Concluding Observations

Reviewing the past half-century of experience in the United States, several things stand out.

1. The "Keynesianizing" of governmental thought and practice and of opinion leaders was a gradual, evolutionary process. It was not a steady one, however; it included not merely differences in the rates of movement in one direction but at least one reversal of direction.
2. In the United States the intellectuals in government, especially those in the civil service, were more important influences on thought about economic policy than politicians, political parties, or nongovernmental interest groups.
3. From approximately the mid-1930s to the end of World War II, economists in the government were ahead of those in the universities in developing the policy aspects of Keynesian macroeconomic theory and especially in its application to empirical data.[46]
4. The development of quantitative economic data—the national income and product accounts, unemployment statistics, and other statistical information—permitted increasing application of theoretical concepts. By now, data have been developed to a degree unknown and unimagined before World War II.
5. Peacetime government before 1933 was so small that it could not have done much to stabilize the economy by use of fiscal policy even if it had intended to do so. In 1929 the federal government's purchases of goods and services were about 1.4 percent of the gross national product and its

[46] See Jones, "Role of Keynesians"; Stein, *Fiscal Revolution in America*; Sweezy, "Keynesians and Government Policy"; and Duncan and Shelton, *Revolution*.

total expenditures about 2.6 percent. By 1985 these figures had grown to 8.9 percent and 24.6 percent.

6. It is clear that Keynes had no direct influence on policy in the United States and, until perhaps 1938 or 1939, very little indirect influence. His influence later was on the intellectual atmosphere, and there it was immense.

3

IDEAS AND POLITICS: THE ACCEPTANCE OF KEYNESIANISM IN BRITAIN AND THE UNITED STATES

Margaret Weir

IN HIS preface to *The General Theory*, John Maynard Keynes lamented the decline of the "practical influence of economic theory," and expressed the hope that his work would help to resolve the "deep divergence of opinion among fellow economists," on which he blamed the political irrelevance of economic theory.[1] Over the course of the next three decades, Keynes' theory would, as he predicted, revolutionize thinking in the economics profession and catapult economists into positions of unprecedented influence over policy making in most of the Western industrial world. Keynesian economics would, moreover, provide the underpinnings for redefining the relationship between state and society in mature capitalist economies, and in so doing would recast the terms on which major social actors, most notably capital and labor, confronted one another in the postwar world.

Transformations of the magnitude associated with the "Keynesian revolution," pose the greatest challenge to students of policy innovation. The social and political upheaval that accompanied the major economic depression of the 1930s, the Second World War, and the emergence of the working class as a central political actor all provided the backdrop to the emergence of Keynesianism and its eventual adoption as economic orthodoxy. An understanding of how Keynesianism became the dominant economic philosophy of the postwar world thus requires sorting through the massive changes that followed in the wake of depression and war and untangling the relationships among them. But such an undertaking cannot be carried out without looking at how Keynesianism was introduced in different national settings; for the diffusion of Keynesianism did not follow a linear

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[1] John Maynard Keynes, *The General Theory of Employment, Interest and Money* (New York: Harcourt Brace Jovanovich, 1964), p. vi.

path. Rather, its influence was felt at varying times and in different ways in each nation that eventually sought to manage its economy with Keynesian tools.

This chapter will address the question of how ideas were translated into policy in different national settings by examining the diffusion of Keynesianism in Great Britain and the United States. Although each country had, by the mid-1960s, embraced Keynesianism as the overarching framework for economic management, the obstacles to adoption differed in each country, as did the timing of the introduction of Keynesianism. The United States was one of the first countries where advocates of "proto-Keynesianism" and Keynesianism made their voices heard at the center of national policy making and, by 1938, had had some of their policy recommendations adopted. Despite these early successes, it was not until a quarter of a century later that Keynesian ideas, for a time, achieved recognition as the appropriate basis of national economic policy. In Britain, by contrast, Keynesianism made little headway during the 1930s; its advocates remained unable to influence national policy significantly. However, during World War II a rapid acceptance of Keynesian budgetary principles broke with long-standing patterns of national economic policy and proved the first step toward the broad acceptance of Keynesian policy that emerged soon after the war in Britain.

How can we make sense of the differences in the receptivity to Keynes' economic ideas in these two national settings? Why did these ideas initially make rapid headway in the United States, only to be relegated to an ambiguous status for the next twenty-five years? Why in Great Britain was a period of strong resistance to economic policy innovation along Keynesian lines succeeded by the acceptance of Keynesianism and a swift consolidation of support across the political spectrum? Answers to these questions require us to identify the salient national characteristics that affected openness to Keynesian ideas and to examine the way such differences interacted with shifting contextual factors such as depression and war. Before we sort through these interactions, it will be useful to examine two possible explanations that emphasize a single cause for the difference between the two countries. The lacunae in such accounts will provide insights useful for constructing an alternative explanation.

Explaining the Diffusion of Keynesian Ideas

Ideas and Interests

One obvious factor that must be examined in assessing the possibilities for policy innovation is the availability of the ideas that provide the rationale for policy departures. Clearly, if such ideas are missing in a national setting or are only advocated by those without access to centers of national power, there is little chance that they can emerge as the basis for redesigning policy. However, in both Great Britain and in the United States advocates of proto-Keynesian and Keynesian ideas pressed their views during the Great Depression and World War II, making their voices heard within the inner circles of policy making.

In Great Britain, Keynes himself had urged a "Keynesian-style" policy of deficit spending on public works even before he had worked out the theoretical apparatus in *The General Theory*. As co-author of the Liberal pamphlet *Can Lloyd George Do It?*, Keynes and like-minded members of the Liberal party laid out a clear alternative to economic orthodoxy during the 1929 election.[2] Even when their ideas had been rejected by the new Labour government, advocates of public spending, and after 1936, of economic management guided by the principles Keynes had presented in *The General Theory* continued to make their voices heard through the Economic Advisory Council. Appointed in 1930, the council and its successor, the Committee on Economic Information, advised the government throughout the decade.[3] Once Britain entered the war, Keynesians found niches guiding the economy for the war effort; Keynes himself was given an office in the Treasury from which to pursue the many aspects of wartime economic administration in which he became involved. As government officials turned their eyes toward postwar planning by 1943, Keynesian economists were deeply involved in the deliberations.

Keynesian ideas were no less visible in the United States throughout the depression decade and the war. In fact, proto-Keynesian ideas were, if anything, more widely diffused in the United States than in Britain. Popular economic writers like William T. Foster and Waddill Catchings helped to disseminate the idea that the government need not sit idly by waiting for automatic market forces to restore employment to higher levels.[4] Within the Roosevelt administration, Federal Reserve chief Marriner Eccles argued to restore prosperity. As Eccles sought to bring like-minded allies into government, he tapped the first of the Keynesian economists emerging from academia at the time. Bolstered by the economic arguments of Lauchlin Currie, one of Eccles' earliest recruits, and the administrative-political weight of Harry Hopkins and other administrators of national relief

[2] On the Liberal program, see Robert Skidelsky, *Politicians and the Slump: The Labour Government of 1929–1931* (Harmondsworth: Penguin Books, 1970), pp. 67–74.

[3] Susan Howson and Donald Winch, *The Economic Advisory Council, 1930–1939: A Study in Economic Advice During Depression and Recovery* (Cambridge: Cambridge University Press, 1977).

[4] On Foster and Catchings, see Bradford Lee's chapter in this volume; see also Arthur M. Schlesinger, Jr., *The Crisis of the Old Order* (Boston: Houghton Mifflin, 1956), pp. 134–36, 186–91; Alan H. Gleason, "Foster and Catchings: A Reappraisal," *Journal of Political Economy* 67 (Feb.–Dec. 1959), pp. 156–72. Foster and Catchings' most widely read work was *The Road to Plenty* (Boston, 1928).

efforts, Eccles' lone outpost within the Roosevelt administration quickly grew to include a variety of federal agencies. The pace at which Keynesian economists entered the federal government accelerated as Currie drew on his academic ties to recruit more Keynesians into the federal government. By the late 1930s Keynesians occupied positions in the Treasury, the Budget Bureau, and the Department of Commerce.[5] During the war the presence of Keynesians was enhanced as they moved into strategic positions in the Office of Price Administration and the National Resources Planning Board, charged by Roosevelt with getting postwar planning underway.

Thus, if we compare the mere presence of ideas advocating Keynesian or Keynesian-style policy options, there seems to be little substantial difference between Britain and the United States. In both countries such ideas were available and had advocates who were able to make their views known within the governments of the day. Yet, the timing and the manner in which these ideas influenced policy varied significantly. If the availability of ideas is to be rescued as a potential influence on policy innovation, we must look beyond the simple presence of innovative ideas to probe the routes by which some ideas become influential in different national settings. This will require us to examine the way different administrative arrangements at the national level facilitate or discourage innovation and to consider the role of individual national leaders, assessing the extent to which choices among policies are structured for them and to what extent choices are the product of strategic choices made by political leaders.

A second possible explanation for the differences in the acceptance of Keynesian policies in the United States and Britain looks to the role of relevant social groups or coalitions in supporting or opposing policy innovation. In this view the weakness of organized labor in the United States and the concomitant strength of business is responsible for the belated acceptance of Keynesianism in the United States. By contrast the political strength of organized labor in Britain, as exercised through the Labour party, accounts for the much earlier consolidation of Keynesian policies there. There would appear to be considerable merit in this view: the striking victory of the Labour party in the immediate postwar election of 1945 gave Labour the means with which to enact the program they desired; while by contrast in the United States organized labor suffered numerous political setbacks in the postwar era. However, if we look more closely at the politics of economic and social policy in the postwar era in each of these countries

[5] Herbert Stein, *The Fiscal Revolution in America* (Chicago: University of Chicago Press, 1969), p. 168; Alan Sweezy, "The Keynesians and Government Policy, 1933–1939," *American Economic Review* 62 (May 1972), pp. 116–24. On Lauchlin Currie, see Byrd L. Jones, "Lauchlin Currie, Pump Priming, and New Deal Fiscal Policy, 1934-1936," *History of Political Economy* 10 (1978), pp. 507–48.

we can question the utility of drawing any simple connection between the political power of particular social groups and the adoption of Keynesian policies.

Throughout the 1930s, the British Labour party had largely continued to stand by its longtime economic platform of nationalization and planning. After the failure of the 1929–1931 Labour government, the Labour party renewed its dedication to socialist principles, which left little room for compromises with capital—compromises implicit in Keynesianism.[6] Nor as participants in the wartime coalition government did Labour party politicians play a significant role in the formulation of the Keynesian ideas that guided the war budgets from 1941 on. Rather these were primarily a product of the collaboration of Keynes, several of his allies in the economic offices of the cabinet, and the conservative Chancellor of the Exchequer Kingsley Wood.[7] The first great triumph of Keynesian economics in Britain took place quite removed from the participation of leading Labour officials.

Nor after the war, when Labour took power, was it clear that Labour officials had rejected nationalization and planning in favor of Keynesianism. In accordance with Labour's 1945 election manifesto, nationalization was a central thrust of economic policy after 1945. There is general agreement that Hugh Dalton, Labour's first Chancellor of the Exchequer, had little understanding of Keynesian budgetary tools and that his main concern was manpower planning and resource allocation.[8] In fact, his insistence on collecting national income and expenditure data on a calendar year basis, and calculating the national budget on a different financial year, made Keynesian economic management nearly impossible.[9] Only after major reorganization of national economic policy making in 1947 did the Labour government begin to embrace the Keynesian economic management. By that time nationalization appeared to have exhausted its political appeal, and the manpower controls and rationing on which Dalton had relied appeared ill-suited to managing the postwar economy. Labour's acceptance of Keynesian policies was thus a considerably more complex affair than a simple societal model would suggest.

[6] On the Labour party's economic policies in the interwar period, see Alan Booth and Melvyn Pack, *Employment, Capital and Economic Policy: Great Britain 1918–1939* (Oxford: Basil Blackwell, 1985); Samuel H. Beer, *British Politics in the Collectivist Age* (New York: Vintage Books, 1969), chap. 5.

[7] Paul Addison, *The Road to 1945: British Politics and the Second World War* (London: Jonathan Cape, 1975), pp. 170–72; Donald Winch, *Economics and Policy: A Historical Study* (London: Hodder & Stoughton, 1969), pp. 262–63.

[8] Winch, *Economics and Policy*, pp. 282–83; Booth and Pack, *Employment, Capital and Economic Policy*, pp. 119–21; Kenneth O. Morgan, *Labour in Power, 1945–1951* (Oxford: Oxford University Press, 1985), p. 130.

[9] Alan Booth, "The 'Keynesian Revolution' in Economic Policy-making," *Economic History Review* 36 (Feb. 1983), p. 119.

In the United States, the problem with a monocausal society-based argument about the acceptance of Keynesianism is less connected with the policy positions of labor and Democratic party liberals; more puzzling is the virulent opposition to Keynesianism on the part of business and farm groups. In Britain, business and financial interests offered only minimal resistance to Keynesian policies, whereas leading U.S. business groups—including the Chamber of Commerce and the National Association of Manufacturers—joined forces with powerful farm organizatons such as the Farm Bureau to oppose Keynesian economic policies. This opposition came to a head in the debate over the Full Employment Bill of 1945, the central piece of legislation offered by Keynesians in the postwar period. The bill sought to legislate a legal commitment to full employment, and to create the administrative machinery necessary for Keynesian economic management in the United States.[10] Denouncing the bill, allies of business and farm interests ridiculed the idea of compensatory finance and raised the specter of mounting national debt that would never be paid. Their opposition to Keynesian economic management was instrumental in the passage of the much less sweeping Employment Act of 1946 that left Keynesian policy in an ambiguous status for the next twenty years.

These contrasts highlight the fact that social group position may not translate into similar policy positions across national boundaries. If we want to make sense of the roles that social interests played in accepting or rejecting Keynesian policies, we must study more closely the meaning of these policies in each national setting, not simply assume policy preferences on the basis of "objective" economic interests. In particular, we must examine the position that the debate over Keynesianism occupied in relation to past policies and to current issues, such as the proposals for planning and for extending the welfare state that were on national agendas after the war. We must likewise be sensitive to the ways in which national differences in policy-making institutions favor some interests over others. In both Britain and the United States, we shall see that the role of social interests was much more mediated than a simple coalitional model would suggest.

Policy Making and Coalition Building in an Institutional and Historical Context

In contrast to these single cause explanations of policy innovation, we will account for the differences in the timing of the adoption of Keynesian policies in

[10] A thorough case study of the Employment Act is presented in Stephen Kemp Bailey, *Congress Makes a Law: The Story Behind the Employment Act of 1946* (New York: Vintage Books, 1950).

the United States and Great Britain by looking at the differences in the processes of policy making and coalition building in each of these nations. We shall see that particularities of national institutional arrangements and the array of policy alternatives available affect possibilities for the emergence and political acceptance of Keynesian economic policies.

The institutional arrangements for policy making play a critical role in impeding or facilitating the entry of innovative ideas into policy.[11] Patterns of recruitment to administrative posts and procedures governing advancement are both critical factors in determining whether innovative ideas will emerge within national bureaucracies. When recruitment is governed by rigid guidelines that emphasize conformity to established civil service norms, bureaucrats are more likely to display attachment to standard procedures and established policy positions than a willingness to strike out in innovative policy directions. Likewise, a hierarchical pattern of authority reflected in a tightly controlled information flow within individual bureaucracies and in the relationship between political and administrative officials will reduce the possibilities for innovative policy proposals to reach the centers of decision making.

A contrasting pattern of administration, characterized by flexible standards of recruitment that allow individual departments to bring in outsiders whose career advancement is not tied to existing procedures, provides a much more hospitable setting for innovative policy proposals. The prospects for innovation are further enhanced when the relationship between political officials and administrative agencies is not controlled by hierarchical arrangements that serve to restrict the flow of information from various levels of the bureaucracy to political decision makers. Numerous competing centers of advice, however, may prevent the emergence of an authoritative center for policy recommendations, making early advances in policy innovation difficult to consolidate.

Administrative arrangements may facilitate or stifle the emergence of innovative ideas, but without the acquiescence of important social groups, these innovations are unlikely to endure. Thus, building coalitions of support for particular policies is the second process needed to produce lasting policy innovation. To make sense of the position of a social or economic group around a particular policy issue, we need to look beyond the economic interests of individual groups: policy preferences are not simply a reflection of economic interests but rather represent a choice among an array of alternatives. A single policy is unlikely to be judged simply on its own terms; rather it will be considered as part of a constellation of policies that seem to be related. To understand the potential of dif-

[11] On the relationship between policy innovation and state structure, see Peter A. Hall, "Policy Innovation and the Structure of the State: The Politics-Administration Nexus in France and Britain," *Annals* 466 (March 1983), pp. 43–59.

ferent policies to attract support, we must accordingly examine the range of alternatives under consideration at any one time and assess how a particular policy is politically packaged with other policies. We must, moreover, examine the way the policy in question is related, or appears to be related, to past policies. Social interests may reject or approve policies depending on past experiences with similar measures or with policies that appear similar.

We turn now to examine the diffusion of Keynesianism in the United States and Great Britain. First, we examine the role of administrative arrangements and policy-making processes in allowing innovative ideas to reach the centers of decision making and their influence on consolidating innovation. We then explore the process by which coalitions of support did or did not emerge in each country, paying special attention to the pattern of policy packaging and the role of political parties in institutionalizing innovation.

State Structure and Policy Innovation

Why did the United States appear to embark on Keynesian economic management during the Depression only to pull back from such policy for a prolonged period after the war? And why did Britain exhibit an opposite pattern of resistance to economic innovation during the Depression, and relatively swift acceptance after the war? We answer these questions by contrasting patterns of administration and the relationship between politics and administration in each country.

Economic Policy and Depression

In Britain the most critical factor accounting for the resistance to innovation in economic policy during the 1930s was the closed and hierarchical character of the British bureaucracy, and, in particular, the central control exercised by the Treasury. The "Treasury view" presented a formidable block to Keynesian-style policies throughout the interwar period. A reaction to the massive government spending of World War I, this view advocated low government expenditures and balanced budgets. Arguing against calls for increasing government aid to the unemployed in the aftermath of the war, Treasury officials maintained that the only way to relieve unemployment was to lower wages. Government spending, they claimed, would only lead to inflation and undermine the economic incentives of the private sector.[12]

[12] On the Treasury in this period, see Henry Roseveare, *The Treasury: The Evolution of a British Institution* (New York: Columbia University Press, 1969), chap. 8; Robert Skidelsky, "Keynes and the Treasury View: The Case For and Against an Active Unemployment Policy 1920–1939," in

The Treasury's strategic position within the bureaucracy gave it considerable opportunity to stamp its view on the whole of government. In 1919, the Permanent Secretary of the Treasury had been made head of the Civil Service, a position that gave the Treasury enormous control over the entire British bureaucracy. The 1919 reform had intended to prevent the wasteful spending and duplication of effort that had occurred during World War I.[13] Until Britain entered World War II, the Treasury used its position to monitor carefully departmental expenses, using a variety of means at its disposal. The Treasury was able to veto expensive departmental proposals through its power to review policy initiatives from each department before they could be presented to the Cabinet. It could also restrict the scope of individual department activity with its control over staffing levels for individual departments. In the 1930s, for example, Treasury restrictions on staffing levels resulted in the disbanding of departmental statistical staffs critical to policy innovation.[14] The Treasury also enforced patterns of recruitment and advancement that discouraged policy innovation. Recruitment was conducted in accordance with guidelines that emphasized conformity to civil service norms and undermined possibilities for recruiting problem-oriented individuals who might be more amenable to policy innovation.[15] The Treasury's control of career advancement provided a further block to innovation. Bureaucratic arrangements thus served to bar policy innovation from within the bureaucracy.

The hierarchical character of British administration also prevented "outside" voices from making much political headway. Without Treasury approval, proposals for new directions in economic policy could hope for little practical influence on policy. Thus, the Economic Advisory Council, set up in 1930 to advise the government on economic policy, found its recommendations largely ignored by the government. Its successor, the Committee on Economic Information, likewise found itself unable to change the course of economic policy, although it might have made some chinks in the Treasury view by the end of the decade.[16]

W. J. Mommsen, ed., *The Emergence of the Welfare State in Britain and Germany* (London: Croom Helm, 1981), pp. 167–87.

[13] R. Davidson and R. Lowe, "Bureaucracy and Innovation in British Welfare Policy 1970–1945," in W. J. Mommsen, ed., *Emergence of the Welfare State*, pp. 264–77.

[14] Ibid., p. 282.

[15] Richard A. Chapman and J. R. Greenaway, *The Dynamics of Administrative Reform* (London: Croom Helm, 1980), pp. 158–59.

[16] Howson and Winch, *Economic Advisory Council*, pp. 128–32, argue that the Treasury had begun to embrace some aspects of Keynesian analysis—particularly the usefulness of public works—by the late 1930s. This view has been questioned by other economic historians; particularly important are several articles by G. C. Peden, "Keynes, the Treasury and Unemployment in the Later Nineteen-Thirties," *Oxford Economic Papers* 32 (March 1980), pp. 1–18; G. C. Peden, "Sir Richard Hopkins and the 'Keynesian Revolution' in Employment Policy, 1929–1945," *Economic History Review* 36 (May 1983), pp. 281–96; and G. C. Peden, "The 'Treasury View' on Public Works and Employ-

Keynes himself despaired of getting his policy ideas seriously considered by the British government and turned to write *The General Theory*, believing it would be easier to convince the economics profession of his ideas than the British government.

The political and administrative strength of economic orthodoxy was evident in the policies of the second Labour government, which came to power in 1929. Still attached to an economic platform of nationalization and transformation to socialism, the Labour party had no program to deal with the immediate economic crisis which struck soon after it took power. In the absence of any real Labour position on such issues as the loan-financed public works advocated by the Liberals, the Labour government clung to the orthodox advice offered by the Treasury. Although Prime Minister Ramsey McDonald's appointment of the Economic Advisory Committee stemmed from his desire to have access to new sources of economic advice, its authority was insufficiently established to counter the weight of the Treasury's advice, a vewpoint with which much of the Labour party was sympathetic.

After the resignation of the Labour government in 1931, the new National government proved equally unreceptive to calls for stimulating the economy with deficit-financed public works. Although the government's decision to take Britain off the gold standard removed a critical barrier to stimulating the domestic economy, attachment to balanced budgets continued to guide Treasury policy.[17] In 1935, the government rejected Lloyd George's proposal for a British "New Deal" in the form of deficit-financed public works.[18] Only under the pressure of war preparation did Britain embark on deficit-financed public spending in the 1937 Defence Loan and its successors.[19]

Recent study of Treasury documents from the 1930s has raised several questions about the basis for the Treasury view and about how strictly it was adhered to throughout the 1930s. This new research challenges the older notion that the Treasury view was simply based on adherence to principles of economic theory and argues that it was derived as much from the political and administrative difficulties of implementing stimulatory spending proposals. Thus, numerous documents from the 1930s show the Treasury arguing that public works proposals were not feasible primarily for administrative reasons.[20] Likewise, new evidence

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ment in the Interwar Period," *Economic History Review* 38 (May 1984), pp. 167–81; Roger Middleton, *Towards the Managed Economy: Keynes, the Treasury and the Fiscal Policy Debate of the 1930s* (London and New York: Methuen, 1985), pp. 165–71.

[17] Winch, *Economics and Policy*, pp. 204–9.

[18] Ibid., p. 211.

[19] Skidelsky, "Keynes and the 'Treasury View,' " p. 186.

[20] See Roger Middleton, "The Treasury in the 1930s: Political and Administrative Constraints to Acceptance of the 'New' Economics," *Oxford Economic Papers* 34 (March 1982), pp. 49–77; Roger

suggests that the Treasury view was not as monolithic as it has been portrayed. By the late 1930s, there is some evidence that the strict Treasury view had been replaced by one more open to the possible benefits of public works. However, these modifications within the Treasury thinking fell short of any wholesale conversion—especially when viewed together with the administrative barriers to public works, to which the Treasury was quite attentive.[21] Thus, whether it was based primarily on economic theory or on administrative difficulties, the practical implication of Treasury power throughout the 1930s was to prevent policy experimentation along Keynesian lines.

In the face of well-established channels of economic advice there was little chance for radically different ideas to emerge from within the British government, and it was unlikely that ideas emerging from ad hoc commissions could provide the basis for bold policy departures. These barriers to innovation were reinforced by entrenched patterns of administrative responsibility, especially with regard to public works. Proposals to break with long-standing administrative practices in order to facilitate public works found little support. Such drastic action was unwarranted in the eyes of the Treasury, which argued that there was no "real analogy between the [Depression] and the national emergency of the war period. . . ."[22] Not until another war emergency occurred would the path be opened to such innovative policies.

The pattern of administration during the Depression in the United States differed substantially from that of Britain. In contrast to the restricted scope of recruitment to public agencies and the hierarchical channeling of advice, the U.S. government exhibited a fluid, disorderly quality that allowed a variety of innovative ideas, including those of Keynes, to find their way into policy making. When the Great Depression hit the United States, there was no agency with authority comparable to the British Treasury, nor was the U.S. civil service as firmly established as that in Britain. Unresolved political battles from the Progressive era had left the United States with competing sets of institutions through which Congress and the executive struggled for control of national administration.[23] Executive authority to control finances was housed in the Bureau of the Budget, a small, ineffectual agency established only a decade earlier.[24] The U.S. civil service, only recently reformed, was likewise far less established than its

Middleton, "The Treasury and Public Investment: A Perspective on Inter-War Economic Management," *Public Administration* 61 (Winter 1983), pp. 351–70.

[21] Peden, "Treasury View," pp. 173–74.

[22] Middleton, "Treasury and Public Investment," pp. 364–65.

[23] See Stephen Skowronek, *Building a New American State: The Expansion of National Administrative Capacities, 1877–1920* (Cambridge: Cambridge University Press, 1982), p. 208.

[24] Larry Berman, *The Office of Management and Budget and the Presidency, 1921–1979* (Princeton, N.J.: Princeton University Press, 1979), pp. 3–9.

British counterpart. Its practice of departmental recruitment and advancement made it more open to innovation.

The relative weakness and fragmented quality of the U.S. national bureaucracy made it far easier to experiment during the Depression. Because no single agency commanded the authority of the British Treasury, policy advice from the bureaucracy could be ignored or countered with conflicting recommendations from other agencies. In the absence of hierarchical control on channels of advice to government, numerous viewpoints were available for the consideration of policy makers. Roosevelt amplified this diversity by simply bypassing the existing structure of public administration to set up a wide variety of ad hoc advisory groups. He also created emergency administrative agencies staffed without regard to civil service requirements.[25] The attachment to established administrative practices that created such a barrier in Britain was thus less likely to prevent experimentation with new policies in the United States.

The multiple channels of advice were reflected in the diverse policy thrusts of the early New Deal. Although the allegiance to balanced budgets that Roosevelt professed in his campaign for president found expression in budget-cutting measures soon after he took office, adherence to economy rapidly gave way in the face of massive relief expenditures. However, these expenses were not conceived of as part of a deliberate stimulatory policy and were segregated into a separate emergency budget.[26] The main policy direction of the early New Deal was embodied in the regulatory measures of the National Recovery Administration.[27] Despite the centrality of the regulatory measures, the structure of the U.S. state allowed spending programs to flourish with little interference once the decision to tolerate budget deficits had been made. Within agencies such as the Public Works Administration (PWA), the temporary Civil Works Administration (CWA), and the Works Progress Administration (WPA), there emerged a core of administrative expertise and advocacy that never had the opportunity to develop in the far more restrictive confines of the British bureaucracy.

The fragmentation of the national administration and the freedom of individual departments to conduct their own recruitment also allowed a core of proto-Keynesians (and later Keynesians) to emerge within the national bureaucracy. Marriner Eccles, the Utah banker appointed to head the Federal Reserve in 1934, had come to favor expansionary fiscal policy to combat the Depression. Starting with Lauchlin Currie, whom he recruited from the fiscally conservative Treasury

[25] Richard Polenberg, *Reorganizing Roosevelt's Government: The Controversy Over Executive Reorganization* (Cambridge, Mass.: Harvard University Press, 1966), p. 22.

[26] Stein, *Fiscal Revolution in America*, pp. 63–66.

[27] On the NRA, see Ellis Hawley, *The New Deal and the Problem of Monopoly* (Princeton, N.J.: Princeton University Press, 1966), pp. 9–146.

Department, Eccles created an institutional niche within the national government for advisors with Keynesian leanings.[28] Thus, by 1937 when the regulatory approach of the first New Deal had collapsed, and the nation was threatened with another major economic downturn, the Keynesian viewpoint was well positioned to be taken seriously by President Roosevelt. With the support of Harry Hopkins, head of the WPA, and Harold Ickes, director of the PWA, compensatory fiscal policy proved attractive to Roosevelt. His decision to heed their advice and propose a substantial increase in public spending in 1938 marked the first conscious effort to stimulate the economy with deficit-financed public spending.[29] Thus, from within the U.S. national bureaucracy, there had emerged pressure for deficit-financed spending from economists arguing from a macroeconomic viewpoint as well as from administrators affirming the feasibility of implementing a large package of public works. The bureaucratic dominance of the British Treasury blocked the emergence of any comparable base of support within the British government.

Economic Policy in War

In Britain, the Second World War provided the shock to economic orthodoxy that the Depression had been unable to produce. During the war the "whole of Whitehall [was] opened up, ventilated and dramatically challenged. . . ."[30] Long-entrenched patterns of administration were disrupted as the exigencies of wartime opened the national bureaucracy to new voices. Established hierarchical channels of information within agencies and between the administration and political officials were replaced with a more diverse set of linkages, as multiple sources of information and expertise emerged within the national bureaucracy. These changes paved the way for the eventual acceptance of Keynesianism as the cornerstone of British economic policy.

In the realm of economic policy, the most significant change the war brought with it was the loss of preeminence for the Treasury. As the importance of physical controls in regulating the economy escalated, the centrality of finance declined. As it did, the rationale for Treasury control diminished correspondingly. For much of the war, in fact, the Chancellor of the Exchequer was not even in the war Cabinet.[31] The pressures of mobilizing the national economy for war also

[28] Sweezy, "Keynesians and Government Policy."

[29] Stein, *Fiscal Revolution in America*, chap. 6; Robert M. Collins, *The Business Response to Keynes, 1929–1964* (New York: Columbia University Press, 1981), pp. 4–6.

[30] Michael R. Gordon, "Civil Servants, Politicians and Parties: Shortcomings in the British Policy Process," *Comparative Politics* 4 (1971), p. 50.

[31] R. J. MacLeod, "The Development of Full Employment Policy, 1938–1945" (D. Phil. thesis, Oxford University, 1978), pp. 117–22; Samuel H. Beer, *Treasury Control: the Co-Ordination of*

led to the recruitment of numerous temporary civil servants and the creation of alternate centers of economic advice. The most famed of the temporary recruits was Keynes himself, who was made advisor to the Treasury in 1940. The economic section of the war Cabinet proved the most important of the new agencies for the diffusion of Keynesianism in Britain.[32] With a staff that included several dedicated Keynesian economists, the economic section used its central position to keep issues of Keynesian economic policy on the national agenda throughout the war.

The sharpest evidence of the break with past orthodox economic practices was the 1941 budget, which reflected a triumph for Keynes and his allies in government. Drawing on ideas that Keynes had advanced in his 1940 pamphlet *How to Pay for the War?*, the budget employed Keynesian concepts to produce a financial plan aimed at reducing demand. Estimates of national income and expenditure made by James Meade and Richard Stone, both economists attached to the war Cabinet and later to the economic section, provided the basis for the new budget.[33] Along with its financial features was an array of controls over manpower and physical resources that made the 1941 budget a blend of Keynesianism and planning.

Although Treasury officials had collaborated in the creation of the 1941 budget, it is unclear that principles acceptable for wartime emergencies were equally acceptable in peacetime. The continued resistance of important parts of the Treasury to Keynesian economics was evident in the discussions over postwar employment policy, that eventually resulted in the government's 1944 White Paper on Employment Policy.[34] In these debates the economic section pressed vigorously for an employment policy designed in accordance with Keynesian principles, while leading Treasury officials expressed doubts.[35] In place of the general stimulatory measures proposed by the Keynesians, such as countercyclical public investment and variations in the contributions to social security, Treasury officials repeatedly expressed a preference for structural and selective measures that

Financial and Economic Policy in Great Britain (Oxford: Clarendon Press, 1957), p. 73; Roseveare, *Treasury*, p. 273.

[32] Winch, *Economics and Policy*, p. 266; see also D. N. Chester, "The Central Machinery for Economic Policy," in D. N. Chester, ed., *Lessons of the British War Economy* (Cambridge: Cambridge University Press, 1951), pp. 14–19; Alan Booth and A. W. Coates, "Some Wartime Observations on the Role of the Economist in Government," *Oxford Economic Papers* 32 (July 1980), pp. 177–99.

[33] Addison, *Road to 1945*, p. 170; Richard Stone, "The Use and Development of National Income and Expenditure Estimates," D. N. Chester, ed., *Lessons of the British War Economy* (Cambridge: Cambridge University Press, 1951), pp. 83–101.

[34] *Employment Policy* Cmd. 6527. (London: Her Majesty's Stationery Office, 1944.)

[35] Booth, "Keynesian Revolution," pp. 108–9; Peden, "Sir Richard Hopkins and the 'Keynesian Revolution,' " pp. 281–96.

would not unbalance the budget.[36] Reflecting the divisions between the Treasury and the economic section, the 1944 White Paper fell short of fully endorsing Keynesian policy to control unemployment.

As the war drew to a close, then, the future of Keynesian policy was in some doubt. Although Keynesian ideas had attracted younger Labour economists since the early 1930s, Labour's victory at the polls did little to secure the future of these ideas. Labour's election manifesto had stressed nationalization and planning as economic objectives, and, as we have seen, its Chancellor of the Exchequer Hugh Dalton stressed manpower planning and showed little understanding of Keynesian policy.[37] Neither the Keynesians nor proponents of orthodoxy within the Treasury controlled economic policy in the first years of the Labour government. Instead, responsibility for economic policy was lodged in a Lord President's Committee appointed by the Cabinet and overseen by Herbert Morrison. A longtime Labour politician, Morrison never succeeded in establishing a coherent direction for his committee's work. His efforts at planning were unsystematic at best; at the same time he showed little interest in the advice of the Keynesians in the economic section.[38]

Despite the official ascendance of planning, advocates of Keynesian policy had not been dislodged by the Labour government. Beneath the structure of committees that Labour created, many of the wartime administrative changes that had allowed Keynesian policy to gain a foothold during the war remained undisturbed. As the war ended, the Treasury was at work on national income and expenditure statistics that would provide the basis for Keynesian policy.[39] Moreover, the economic section provided economists with a voice in the central machinery of government that they had not had before the war. Although its attachment to the Cabinet made the economic section something of a "stranded whale" between the Treasury and the Lord President's Committee, leading Keynesians were able to use it as a base from which to influence the Treasury from the top down.[40] As a condition for assuming leadership of the economic section in 1945, James Meade obtained an official place in the Treasury's budget committee and had considerable contact with senior civil servants in the Treasury.[41] Although

[36] Booth, "Keynesian Revolution," p. 112.

[37] On Labour economists in the 1930s, see Elisabeth Durbin, *New Jerusalems: The Labour Party and the Economics of Democratic Socialism* (London: Routledge & Kegan Paul, 1985); on the Labour party election manifesto and Dalton, see Morgan, *Labour in Power*, pp. 95, 130, and Winch, *Economics and Policy*, p. 283.

[38] Ibid., pp. 131–32; Alec Cairncross, *Years of Recovery: British Economic Policy 1945–51* (London and New York: Methuen, 1985), p. 52.

[39] Booth, "Keynesian Revolution," p. 118.

[40] Cairncross, *Years of Recovery*, p. 409.

[41] Ibid., p. 52; Booth, "Keynesian Revolution," p. 118.

they had not fully embraced the economic management envisioned by the Keynesians, these civil servants had cooperated with economists during the war and were receptive to continued consultation. With the only concentration of economists (numbering little more than a dozen) in the government, the economic section used this entree to press untiringly for demand management to guide the budget-making process.[42]

These efforts ultimately paid off in 1947 when a series of crises undermined the planning approach and paved the way for the Treasury to regain its preeminence. This time, however, the Treasury emerged as an advocate of Keynesianism, manipulating aggregate demand to control inflation. In 1947 an unusually cold winter precipitated a serious fuel shortage, which government controls proved ill-equipped to handle. Following on the heels of this debacle, a major balance-of-payment crisis further underscored the inability of current government machinery to cope with the economic problems of postwar Britain.[43] The government's mismanagment of each of these crises provided the pretext for reorganizing the machinery of economic policy making. Stafford Cripps moved from the Board of Trade to the new Ministry of Economic Affairs, henceforth charged with overall responsibility for economic policy. With Dalton's resignation, Cripps became Chancellor of the Exchequer and responsibility for economic affairs was consolidated in the Treasury.[44]

The centralization of economic policy-making machinery offered the Treasury the opportunity to recapture its former dominance over economic affairs. It also presented the Treasury with the challenge of designing policies to get the badly shaken economy back on track. In the wake of balance-of-payment problems and the subsequent convertibility crisis, inflation was widely regarded as the chief danger facing the British economy.[45] And, as during the war, the Keynesians in the economic section pressed for demand management as the best means for controlling inflationary pressure. For over a year, the economic surveys drafted by Meade had warned of the buildup of excessive demand and urged that a budget surplus be created to restrain demand before inflation began to cause serious problems.[46] The deflationary budget that Dalton reluctantly accepted in 1947 provided a model for the subsequent austerity budgets of the Cripps era.[47] The aim was to

[42] Cairncross, *Years of Recovery*, pp. 54–55; Booth and Coates, "Wartime Observations," pp. 197–98.

[43] Morgan, *Labour in Power*, chap. 8.

[44] J.C.R. Dow, *The Management of the British Economy* (Cambridge: Cambridge University Press, 1964), pp. 33–34.

[45] Cairncross, *Years of Recovery*, p. 442.

[46] Ibid.; Booth, "Keynesian Revolution," pp. 121–22.

[47] Morgan, *Labour in Power*, p. 348.

manage domestic demand to control inflation without straying from the goal of full employment.

The year 1947 was thus a turning point in the acceptance of Keynesianism in Britain; after that time, the Treasury viewed economic stabilization as a central responsibility and used the principles of demand management—albeit in a relatively crude guise—to guide its budget making.[48] The transformation had been effected almost entirely at the upper realms of the Treasury civil service; there had been little change in recruitment at the lower levels, which continued to be staffed in accordance with time-honored civil service standards.[49] The economic section continued to play a key role throughout Cripps' tenure as Chancellor and, although the relationship was less close when Hugh Gaitskell took over in 1950, demand management considerations and the advice of the economic section were both well-established features of the budget-making process when Conservatives formed their new government in 1951.

In the United States, the war had a much less favorable effect on the prospects for Keynesianism than in Britain. As in Britain, war brought a flood of temporary administrators into the federal government and subverted peacetime patterns of administration for the national emergency. And, as in Britain, many of the temporary government employees in the war agencies were economists who used the challenge of the war economy to bring Keynesian tools into policy analysis. However, in the United States there was no agency like the Treasury whose "capture" could place Keynesians in an authoritative position in the postwar period. When efforts to create such an institution failed, the future of Keynesianism as a guide to national policy in the United States became ambiguous.

Even before the war, Keynesian economists were to be found in many niches within the U.S. federal government. The National Resources Planning Board, the Bureau of the Budget, and the Commerce Department all had growing contingents of Keynesians. In 1939, when federal government reorganization allowed Roosevelt to name six presidential assistants, the president chose Lauchlin Currie, one of the economists who had played a pivotal role in recruiting like-minded colleagues to Washington, as assistant for economic affairs. This influence continued to mount during the war. Keynesian economists staffed several of the key war agencies concerned with financial affairs, such as the Office of Price Administration, and guided wartime thinking about such central problems as how to maximize production while controlling inflation.[50]

[48] Cairncross, *Years of Recovery*, pp. 424–425.

[49] Booth and Coates, "Wartime Observations," pp. 197–99.

[50] Byrd L. Jones, "The Role of Keynesians in Wartime Policy and Postwar Planning, 1940–1946," *American Economic Review* 62 (May 1972), pp. 125–33; Carol S. Carson, "The History of

This growing presence of Keynesians within government and the widespread use of Keynesian techniques of economic management did not, however, translate into a postwar consolidation of Keynesianism. Although the dispersal of authority within the executive branch had facilitated the emergence of compensatory spending during the New Deal, such fragmentation was ill-suited to institutionalizing a single authoritative framework for economic policy making, such as Keynesianism, in the postwar United States. Without such a centralized framework for assessing the state of the economy and making policy recommendations, Keynesian prescriptions for economic policy would have to battle with competing approaches for the right to define economic problems and their solutions. Aware of the administrative obstacles to their success, Keynesian economists supported two major efforts to redesign the administrative framework for economic policy making.

The first effort centered on enhancing the authority of the National Resources Planning Board (NRPB) as a central coordinating and long-range planning body. Having existed in various guises throughout the New Deal, the NRPB was a small agency that became a center for planners, Keynesian economists, and supporters of reshaping Social Security in more universal directions. Roosevelt's ambitious 1938 reorganization plan sought to transform the NRPB into a kind of superagency responsible for planning and coordinating the work of other executive agencies.[51] When Congress rejected this sweeping reorganization plan and approved a less comprehensive set of proposals, the NRPB remained a small agency located within the new Executive Office of the President.

Despite its precarious status and low level of funding, the NRPB's very existence created possibilities for enhancing the coherence of executive social and economic policy making. In 1940 Roosevelt entrusted the NRPB with the task of postdefense planning, a mandate the agency used to publish a series of pamphlets that sketched out the shape of policy for the postwar United States. The proposals wove Keynesian assumptions, planning, and social welfare together into a comprehensive reform program for the U.S. government. These themes were addressed most elaborately in two sweeping and detailed reports issued in 1942 and 1943.[52] Echoing earlier proposals for using the budget as an instrument for plan-

the United States National Income and Product Accounts: The Development of an Analytic Tool," *Review of Income and Wealth* (1975), pp. 175–77.

[51] On the reorganization plan and its initial failure, see Plenberg, *Reorganizing Roosevelt's Government*.

[52] U.S. National Resources Planning Board, *Security, Work, and Relief Policies: Report of the Committee on Long-Range Work and Relief Policies to the National Resources Planning Board* (Washington, D.C.: U.S. Government Printing Office, 1942); U.S. National Resources Planning Board, *National Resources Development Report for 1943, Part I. Postwar Plan and Program* (Washington, D.C.: U.S. Government Printing Office, 1943).

ning full employment, and increased public provision for social welfare, the reports also called for the federalization of many existing social programs.

Not surprisingly, these proposals triggered congressional opposition to any tampering with the decentralized framework for designing social and economic policy. Denouncing the NRPB as an instrument for executive usurpation of power, opponents pointed to conservative gains in the 1942 congressional elections as "a strong protest against the federal bureaucracy and its dictatorial tactics. . . ."[53] They argued that the board's proposals would mean constant increases in public spending and "unlimited Government interference in and regulation of all business activity plus a very large amount of Government regulation of what is now private industry."[54] Finally, repeated charges of insensitivity to regional interests were voiced by congressmen who found it "indefensible to think of a planning board which is not at least regional, reflecting the interests of every area in the United States."[55] In 1943, the Senate voted to cut off funds to the NRPB, thereby eliminating the agency. And, underscoring its determination to guide postwar planning, the Senate appointed its own committee on postwar plans, chaired by conservative southern Democratic Senator Walter George.

After the demise of the NRPB, proponents of Keynesianism tried once more to concentrate authority for economic policy within the executive branch. The Full Employment Bill of 1945 called for the creation of a National Employment and Production Budget, a planning device that would have committed the executive branch to using Keynesian assumptions to ensure full employment.[56] Unlike the reorganization plan eight years earlier, the Full Employment Bill sought to lodge responsibility for economic policy within an executive agency that had grown strong in recent years, the Bureau of the Budget.[57] Having increased its staff sevenfold during the war, the bureau also had in its Division of Fiscal Analysis a coterie of Keynesian economists hoping to carve out a role for the bureau in economic stabilization.[58]

Denounced in much the same terms as the NRPB had been, the Full Employment Bill was defeated and a far less sweeping Employment Act was passed in

[53] U.S. *Congressional Record*, Feb. 8, 1943, p. 717.

[54] U.S. *Congressional Record*, May 27, 1943, pp. 4924–25.

[55] Ibid., p. 4950.

[56] Collins, *Business Response to Keynes*, pp. 100–101.

[57] On the growth of the Budget Bureau in the 1940s, see Berman, *Office of Management and Budget*, chap. 2; see also Gerhard Colm, "Fiscal Policy and the Federal Budget," in Max F. Millikan, ed., *Income Stabilization for a Developing Democracy: A Study of the Politics and Economics of High Employment Without Inflation* (New Haven: Yale University Press, 1953), pp. 227–32.

[58] On the Division of Fiscal Analysis, see Arthur Smithies, "The Coordination of Budget and Economic Policies in the Executive Branch," in Gerhard Colm, ed., *The Employment Act Past and Future: A Tenth Anniversary Symposium* (Washington, D.C.: National Planning Association, 1956), p. 159.

1946. The act established an institutional structure for economic policy making that would make it difficult to assemble more than an ambiguous commitment to Keynesian policy for much of the postwar period. Moreover, the institutional innovations it created would make the ambitious program of compensatory spending that advocates of the Full Employment Bill envisioned nearly impossible.

In place of the National Employment and Production Budget drawn up by the Bureau of the Budget, the new act created a small Council of Economic Advisors (CEA). As a new agency, which had to compete with large, well-established departments including the Treasury, the Federal Reserve, and the Budget Bureau, the CEA had neither the authoritative position nor the institutional strength to control policy as the British Treasury had. The CEA's early years were spent trying to determine its status: the relationship among the three members of the council had to be thrashed out, as did the council's relationship to the president.[59] Similar growing pains were experienced by the Joint Economic Committee, the congressional counterpart of the CEA. Although the committee quickly established a role for itself by conducting hearings on the economy, it could not report legislation nor did it possess the authority to coordinate economic policy in Congress.[60]

The United States left the era of war and depression with a new administrative structure for making economic policy decisions. Yet the several efforts to create authoritative and centralized settings for economic policy making had fallen short and many of the institutional innovations of the 1930s and 1940s were abandoned after the war. The tremendous advance in collecting economic statistics to guide policy making was slowed by congressional decisions that amounted to a "statistical demobilization."[61] The foothold that Keynesians had secured in the Budget Bureau was destroyed when the Fiscal Division was scattered among newly cre-

[59] For an overview, see William J. Barber, "The United States: Economists in a Pluralistic Policy," *History of Political Economy* 13 (1981), pp. 513–47; Edward Flash, *Economic Advice and Presidential Leadership* (New York and London: Columbia University Press, 1965), chap. 2; the first CEA chairman under Truman gives his account in Edwin G. Nourse, *Economics in the Public Service* (New York: Harcourt, Brace & Co., 1953); see also the introductory essay and interview with Leon Keyserling, the second head of the CEA, in Erwin C. Hargrove and Samuel A. Morley, eds., *The President and the Council of Economic Advisers: Interviews with CEA Chairmen* (Boulder, Colo.: Westview Press, 1984), pp. 47–88.

[60] On Congress and economic decision making, see Victor Jones, "The Political Framework of Stabilization Policy," in F. Millikan, ed., *Income Stabilization for a Developing Democracy: A Study of the Politics and Economics of High Employment Without Inflation* (New Haven: Yale University Press, 1953), pp. 604–10; and Alvin Hansen, "The Reports Prepared Under the Employment Act," in *Employment Act Past and Future*, pp. 92–97; Edwin Nourse, "Taking Root (First Decade of the Employment Act)," in *Employment Act Past and Future*, pp. 62–65.

[61] Stuart Rice, "Statistical Needs for the Effectuation of Employment Act Objectives," in *Employment Act Past and Future*, pp. 136–37.

ated program divisions.[62] The remaining innovations, the CEA and the JEC, suffered an uncertain status. Keynesianism's fate would depend very much on the composition of the CEA—which each president could staff as he saw fit—and on the ability of the CEA to market itself to the president as the source of the best advice on the economy. Under these arrangements, Keynesianism remained contentious in the United States far longer than in Britain.

In both the United States and in Britain, then, patterns of administration had important consequences for the timing of the diffusion of Keynesianism. Throughout the 1930s the hierarchical nature of the bureaucracy and the narrow range of staff recruitment in Britain undermined potential experimentation with innovative ideas. Only when normal channels of administration were drastically disrupted by Britain's entry into World War II did Keynesian ideas find their way into the centers of national policy making. Once breaches in orthodox practices had been successfully made and alternative policy routes defeated, the possibilities for consolidating new policy directions were quite favorable. In the United States, by contrast, the much more fluid institutional structure made the entry of innovative policy proposals easier, but created a more difficult process of consolidation. If Keynesian economic policy were to be institutionalized, new executive authority of some sort would have to be created. The fear of extending federal and executive power was thus critical to the failure to create institutions that would have committed the U.S. government to Keynesian economic policy in the immediate postwar period.

Social Interests, Policy Alternatives, and Parties

Administrative-political processes help account for the political relevance of Keynesian ideas. However, without the confirmation of sociopolitical forces, innovation would be short-lived. Such coalitional factors played a critical role in the political viability of Keynesianism in Britain and the United States in the late 1940s and 1950s. In Britain, the lack of significant opposition to Keynesianism allowed the Labour government to embark on economic management with little controversy and, once the Conservatives had assumed office in 1951, the new government continued using Keynesian policy. In the United States, by contrast, strong opposition to Keynesianism on the part of business and agricultural interests prevented the institutionalization of Keynesian policies in the immediate postwar period. And, throughout the 1950s, the Eisenhower administration retained an ambiguous stance toward Keynesian economic management.

[62] Smithies, "Coordination of Budget and Economic Policies," pp. 157–59.

To make sense of these diverse patterns of support for and opposition to Keynesianism we need to go beyond simple accounts detailing the strengths and weaknesses of different social groups. The array of oppositional forces can only be understood by exploring how Keynesianism was linked or not linked to other policy initiatives of the postwar period; in particular, the relationships among Keynesianism, planning, and extensions of the welfare state must be examined. In a similar manner, the durability of Keynesianism is related to the ways competing political parties define economic goals, and the place of those goals in party competition. Understanding this process requires examining how parties formulate policy objectives and analyzing the terms on which they mobilize constituencies. On both counts, we shall see, Keynesianism was favorably positioned in Britain and politically vulnerable in the United States.

Planning the Welfare State, and Keynesianism

In Britain Keynesianism emerged as the moderate alternative to planning and, as such, promised relief from government intervention. Intellectually, Keynesianism had developed quite independently from planning in Britain. Throughout the 1930s Keynes had remained aloof from the growing movement supporting planning as a way to alleviate unemployment. Keynes' macroeconomic approach to unemployment aimed to obviate the need for the kind of microlevel intervention that planners favored.[63] In politics as well, planning and Keynesianism remained distinctly identified. Keynes was, of course, a member of the Liberal party, and as that party declined, Keynesian ideas became associated more with technical experts than with any political party. Planning had quite different political associations. Although the Conservative-dominated National government of the 1930s adopted some policies that marked a departure from strict laissez-faire, the version of planning that became most relevant after the war was that articulated by the Labour party during the 1930s. In this guise, a rather ill-defined notion of planning was seen as an adjunct to a process of nationalization that would eventually lead the nation to socialism.[64]

When Labour came to power in 1945 it was a program of nationalization and planning that the government sought to put into place, a program that was neither rhetorically nor programmatically linked to Keynesianism. Nationalization of the Bank of England, the coal mines, electricity, and railways marked the culmina-

[63] See Winch, *Economics and Policy*, pp. 212–18.

[64] Booth and Pack, *Employment, Capital and Economic Policy*, chap. 6; H. M. Drucker, *Doctrine and Ethos in the Labour Party* (London: Allen & Unwin, 1979), pp. 68–75.

tion of Labour goals since the early 1930s. Aimed at least in part to make production more efficient, these initial moves did not arouse much opposition.[65] Much more controversy attended the efforts to nationalize the iron and steel industry, the sugar industry, and the government's efforts to plan. In the absence of any clearly articulated vision, the government experimented with a variety of measures including use of the wartime physical controls to direct the economy, and the establishment of tripartite Development Councils to regulate industry.[66] Neither labor nor business was happy with the practical implications of planning. The Federation of British Industries resented the intrusion of the councils into the prerogatives of management and organized to resist the movement of nationalization into the manufacturing sector.[67] The Trades Union Congress resisted any manpower policies, including a wages policy that might have interfered with free collective bargaining.[68] Finally, as the war receded into the past, broad public dissatisfaction with rationing and controls added to the political drawbacks of planning.

Faced with the multifaceted unpopularity of planning, and its apparent inability to forestall economic crises like those of 1947, the Labour government shifted the emphasis of its economic policy to economic management, conducted in accordance with Keynesian principles. Controls were gradually relaxed and the detailed targets for industrial production that had characterized the Economic Survey of 1947 were replaced by much more vague goals in later Surveys.[69] For both labor and business, Keynesian economic management's much less intrusive approach to economic regulation afforded welcome relief from the unprecedented peacetime intervention occasioned by Labour's planning efforts.

In contrast to Britain, where Keynesianism provided a less interventionist alternative to planning, Keynesianism in the United States, throughout most of the 1930s and 1940s, was conflated intellectually and politically with planning and increased government intervention. As in Britain, U.S. Keynesians differentiated themselves from old-style advocates of planning, whose remedies for economic depression called for increasing control over private sector activity through central government direction or through regulating industrial production with corporatist-style agreements. In the United States, the political possibilities of such

[65] A. A. Rogow, *The Labour Government and British Industry, 1945–1951* (Ithaca, New York: Cornell University Press, 1955), chap. 8.

[66] Morgan, *Labour in Power*, pp. 127–34; Alan Budd, *The Politics of Economic Planning* (Manchester: Manchester University Press, 1978), chap. 4; see also Jacques Leruez, *Economic Planning and Politics in Britain* (New York: Barnes & Noble, 1976), chap. 2.

[67] Morgan, *Labour in Power*, p. 129.

[68] Beer, *British Politics in the Collectivist Age*, chap. 7.

[69] Budd, *Politics of Economic Planning*, pp. 58–72; Leruez, *Economic Planning and Politics in Britain*, pp. 60–61.

planning were effectively destroyed by 1935 with the failure of the National Recovery Administration.[70]

Yet, U.S. economists articulated a version of Keynesianism that would inevitably require some form of national planning. The most prominent academic proponent of Keynesianism, Harvard economics professor Alvin Hansen, argued that as a mature capitalist economy, the United States suffered from "secular stagnation." Hansen envisioned a permanent program of government investment to compensate for expected shortfalls in private investment.[71] In a prominent statement building on Hansen's analysis, seven young Harvard and Tufts economists outlined a major program of public investment which could serve to stimulate the economy. In addition to expanding government activity into many new areas, these economists called for a selective program of public ownership and increased regulation to control monopoly.[72] Thus, although Keynesians developed an economic analysis that differed from earlier proponents of centralized planning, Keynesianism in the United States was closely identified with more limited forms of planning and with substantial expansion of the role of the federal government in the economy and society.

U.S. Keynesianism was not only intellectually identified with planning, the two were also bound together by political and institutional ties. Once business leaders had soured on economic planning with the failure of the NRA, planning and Keynesianism found a home among northern liberal Democrats. More important, however, Keynesianism and planning were widely identified with the National Resources Planning Board. Hansen used the NRPB mandate to launch a public education campaign for seeing the public deficit as "an instrument of public policy." He also called for a postwar program of large-scale public investment and expansion of public spending on social welfare.[73] Hansen's influence also provided a target for opponents of the NRPB. In the debate over the future of the NRPB in 1943, opponents declared Hansen "probably the most influential adviser of the Board."[74]

The close connection between planning and Keynesianism in the United States was evident in the various proposals for ensuring full employment in the postwar United States. As the war drew to a close, Keynesians and their sympathizers

[70] See Hawley, *New Deal and the Problem of Monopoly*, esp. chap. 9.

[71] Alvin H. Hansen, *Full Recovery or Stagnation?* (New York: W. W. Norton, 1938), esp. chap. 19.

[72] Richard V. Gilbert, et al., *An Economic Program for American Democracy* (New York: Vanguard Press, 1938), pp. 74–79.

[73] See, for example, National Resources Planning Board, Alvin Hansen, *After the War—Full Employment* (Washington, D.C.: U.S. Government Printing Office, 1942; rev. version, Feb. 1943); see also Alvin Hansen, "Our Coming Prosperity," *Common Sense* 11 (April 1942), pp. 489–500.

[74] U.S. *Congressional Record*, May 27, 1943, p. 4944.

were suggesting that some sort of planning branch would be needed to maintain full employment after the war.[75] This support for federal planning was evident in the Full Employment Bill's National Production and Employment Budget, which would operate as a planning mechanism mandating the federal government to project levels of private economic activity in order to set the amount of public investment needed to ensure full employment.[76] This increase in the planning role of the federal executive was one of the targets of opponents of the 1945 bill. Fearing the power of "an anonymous group of economic planners," opponents sought and succeeded in greatly circumscribing the planning mandate in the Employment Act.[77]

Opposition to Keynesianism in the United States stemmed not only from its identification with planning but also from the fear that Keynesianism would lead to extensions of the welfare state. Although Hansen generally stressed that compensatory spending should take the form of public investment, such as urban and rural development projects and infrastructural improvements, he also called for more generous standards of Social Security, federal aid to education, and family allowances.[78] Other U.S. Keynesians, however, believed that boosting consumption through such schemes as food stamps provided the best means of increasing government spending.[79] The political link between Keynesianism and extension of the welfare state in the United States was further emphasized by the connections of Keynesians with the NRPB, whose 1943 report entitled *Security, Work and Relief Policies* called for major revisions in the administration, reach, and generosity of social welfare policies in the United States.

In contrast to Britain, where the expansion of the welfare state laid out in the Beveridge Report was extremely popular, such proposals were highly controversial in the United States. In Britain, the Beveridge plan would greatly extend the reach of the welfare state, and remedy long-standing inequalities in the coverage of different categories of recipients. But the report did not call for major departures from established administrative and financing arrangements as did the 1943

[75] Collins, *Business Response to Keynes*, p. 96. Hansen stressed the need for "democratic planning" in postwar America. See Alvin Hansen, "Social Planning for Tomorrow," in Alvin Hansen, et al., eds., *The United States After the War* (Ithaca, New York: Cornell University Press, 1945), pp. 15–34; Alvin Hansen, "The Postwar Economy," in Seymour Harris, ed., *Postwar Economic Problems* (New York: McGraw-Hill, 1943), pp. 12–16; Alvin Hansen, "Planning Full Employment," *Nation* 159 (October 21, 1944), p. 492; Alvin Hansen, "The New Crusade Against Planning," *New Republic* 112 (June 1, 1945), pp. 9–12 (an attack on Hayek's antiplanning crusade).

[76] Collins, *Business Response to Keynes*, pp. 100–9.

[77] Bailey, *Congress Makes a Law*, p. 168.

[78] Hansen, *After the War—Full Employment*; Hansen, "Postwar Economy," pp. 14–15, 22–26.

[79] Bailey, *Congress Makes a Law*, p. 47; see John Pierson, *Full Employment* (New Haven: Yale University Press, 1941) for the viewpoint that government spending should boost private consumption.

NRPB report. Moreover, although the Beveridge Report would increase the power of the central government, it would not require the major recasting of federal-state relations needed to implement the proposals of the NRPB.[80] In the United States the political, if not programmatic, linking of Keynesianism with the welfare state increased political opposition to Keynesianism, whereas in Great Britain no comparable obstacle existed.

Politically handicapped by its association with planning and the creation of a national welfare state, Keynesianism proved too controversial to provide the framework for economic management as the United States charted its postwar course. The political failures suffered by advocates of Keynesianism did not, however, mark the demise of Keynesianism in the United States. For, even as those who associated Keynesianism with planning and the welfare state were facing political defeat, an alternative version of Keynesianism, stripped of such entanglements, was being worked out by the Committee of Economic Development. A business-oriented economic research association set up in 1942 to examine the prospects of the postwar economy, the CED was staffed by economists drawn largely from the University of Chicago.

As it sought to create a policy framework for economic stability, the CED used Keynesian insights to outline policies that were far less interventionist than those advocated by the stagnationist Keynesians. The committee accepted a role for the federal government in economic management and it sanctioned Keynesian prescriptions about leaving national budgets unbalanced during periods of economic decline. At the same time, the organization sought to minimize the discretion of political leaders in the management of the economy and endorsed variations in the tax rates rather than in spending, when such discretion was necessary.[81] Inherent in the committee's approach was antagonism to public sector growth that put its version of Keynesianism at odds with welfare state expansion. Only in this form, disassociated from planning and the welfare state, was Keynesianism eventually accepted as the framework for economic policy making in the United States.

In sum, Keynesianism meant quite different things in Britain and the United States during the postwar period. In Britain, Keynesianism offered relief from industrial planning and the system of controls with which the Labour government first sought to regulate the economy. In the United States, Keynesianism meant

[80] Jose Harris, "Some Aspects of Social Policy in Britain During the Second World War," in *Emergence of the Welfare State*, p. 259; see National Planning Resources Board, *Security, Work and Relief Policies*, for some of the many changes that were proposed in federal-state relations (pp. 526–49).

[81] The CED also advocated the use of monetary policy. See Collins, *Business Response to Keynes*, p. 137.

increasing government intervention into social and economic life, linked as it was in the immediate postwar period with an ill-defined notion of national planning and with proposals to create a U.S. welfare state. These distinct meanings produced quite different patterns of support and opposition, making the acceptance of Keynesianism in Britain a relatively noncontroversial affair, while causing heated public debate and only partial acceptance on the other side of the Atlantic.

Political Parties and Full Employment

Although government officials and economists debated the wisdom of Keynesianism, Keynesianism never became the pivot of political competition in Britain or the United States. Rather its political fate was tied to the issue of full employment, a major concern for postwar governments. When full employment became the axis for political competition and partisan mobilization, the incentives to use Keynesian economic management became strong for both conservative and liberal parties. Where full employment was not an organizing principle for partisan struggle and mobilization, the fate of Keynesianism would be less certain. In both Britain and the United States, full employment was a major concern after the war, but in Britain it emerged as the overriding concern of political competition, whereas in the United States its force as an issue diminished when postwar depression failed to materialize.

By 1942, when Britain began to consider the problems of conversion to a peacetime economy, full employment emerged as one of the central issues of postwar planning. Fear of a return to the high unemployment levels of the interwar period generated a variety of proposals for achieving full employment. The widespread popularity of the Beveridge Report, which based its policy recommendations on the assumption of full employment, catapulted the issue to the center of public discussion.[82] Anxious to avoid losing control of the agenda for postwar employment policy, the government hurried to produce its own plan for full employment before Beveridge's promised sequel on full employment appeared.[83] The product was the government's 1944 White Paper on Employment Policy, which promised that the government would "accept as one of their primary aims and responsibilities the maintenance of a high and stable level of employment after the war."[84]

[82] The level of unemployment which Beveridge designated as "full" was 8.5. See William Beveridge, *Social Insurance and Allied Services* (New York: Macmillan, 1942), pp. 163–65; on the inclusion of the full employment assumption see Jose Harris, "Social Planning in War-Time: Some Aspects of the Beveridge Report," in J. M. Winter, ed., *War And Economic Development: Essays in Memory of David Joslin* (Cambridge: Cambridge University Press, 1975), pp. 249–50.

[83] Addison, *Road to 1945*, pp. 242–44.

[84] *Employment Policy*, Cmd. 6527, p. 3.

The emergence of full employment as a political issue became particularly significant for the Labour party as it contemplated its role in the postwar world. After the Labour government of 1931 failed to redeem its pledge to combat unemployment and fell from power, the party had retreated to a socialist program that emphasized nationalization.[85] Nationalization remained the central Labour goal in 1945, but at the same time, the party began to stress full employment and welfare state protections as aims of the new government. This new emphasis was loosely joined to the older goals of nationalization by the argument that nationalization was necessary to achieve full employment. The left wing of the Labour party resisted any suggestions that full employment could be achieved by means other than nationalization. Aneurin Bevan, for example, denounced the 1944 White Paper on Employment Policy, arguing that if the measures presented in the paper could prevent unemployment, "then there is no justification for public ownership and there is no argument for it."[86]

In a process that continued into the 1950s, the Labour party rebuilt a new identity around full employment and the welfare state.[87] As support for nationalization collapsed, and Keynesianism emerged as the dominant economic strategy, Labour gradually came to embrace it as the means to ensure full employment. The Labour party's adoption of full employment as a central political issue was facilitated by the strength of British organized labor and the priority that labor attached to avoiding unemployment. But support for full employment, like support for the welfare state, crossed social class lines. A full employment strategy that did not create new possibilities for division in the electorate was likely to enjoy substantial political success. The 1945–1951 Labour governments were not able to reap the full political benefits of such a consensual policy because of the opposition that their continued attachment to controls provoked.[88]

The political importance of full employment was not lost on the Conservative party. Even during the Labour government, Conservatives had announced their support for full employment in the 1947 Industrial Charter. Opposing the physical controls employed by the Labour government, Conservatives backed the full employment policy articulated by the 1944 White Paper, and went further to embrace demand management.[89] Conservatives saw Keynesianism as a way to maintain high employment with minimal intervention, even as its proponents

[85] Booth and Pack, *Employment, Capital and Economic Policy*, chap. 6; James E. Cronin, *Labour and Society in Britain, 1918–1979* (New York: Schocken, 1984), p. 99.

[86] Quoted in Addison, *Road to 1945*, p. 246.

[87] The argument for this new identity was fully articulated in 1956 by C.A.R. Crosland in *The Future of Socialism* (London: Jonathan Cape, 1956).

[88] On Labour and controls, see Andrew Shonfield, *British Economic Policy Since the War* (Baltimore: Penguin Books, 1958), pp. 167–73; Morgan, *Labour in Power*, pp. 367–79.

[89] *Conservativism, 1945–1950* (London: Conservative Political Centre, 1950), p. 59.

touted it as a means of controlling inflation. With Keynesian practices already becoming institutionalized in the Treasury, Keynesian principles provided a non-controversial formula for preserving Conservative political power.

Conservative support for full employment and demand management was facilitated by two factors. The first was the limited opportunity for mobilizing around alternative issues. Conservatives had provided spectacular leadership during the war but the party's credibility in domestic economic matters remained tarnished by its inaction during the prolonged period of high unemployment during the 1920s and 1930s.[90] Apart from campaigning against controls and nationalization, which it did, the Conservative party had few other plausible issues on which to base an alternative electoral appeal given the widespread support for extensions of the welfare state and full employment that Labour had launched.

Second, the centralized processes of policy formulation within the party allowed the party to abandon its position of negative opposition to Labour and facilitated adoption of more positive policy, including the acceptance of demand management. Under the leadership of R. A. Butler, moderates used the policy-making organs of the party to move the parameters of debate to the left of the bulk of the parliamentary or mass party. Under Butler's tutelage the Conservative Research Department worked with the Industrial Policy Committee appointed by Churchill in 1946 to map a route for reconciling conservative interests with full employment. The Industrial Charter they produced embraced Keynesian economic management, but rejected the coercive features of Labour's economic controls. The committee's detailed studies and its influence over party debates prodded Conservative constituencies, including business, to recognize that their interests could be made compatible with a Keynesian strategy for full employment.[91]

In the United States the political goal of full employment also attracted substantial attention as the war drew to a close. As in Britain, fear of postwar recession and return to the mass unemployment of the Great Depression was widespread, spurring a variety of proposals for maintaining full employment after the war. The NRPB had led the way in the early 1940s with numerous pamphlets authored by Alvin Hansen arguing that full employment was the "key to national prosperity" and that compensatory spending was the route to full employment.[92]

[90] J. D. Hoffman, *The Conservative Party in Opposition, 1945–51* (London: MacGibbon & Kee, 1964), pp. 24–29; Henry Pelling, *The Labour Governments, 1945–51* (New York: St. Martin's Press, 1984), pp. 30–31.

[91] Beer, *British Politics in the Collectivist Age*, chap. 9; Lord Butler, *The Art of the Possible: The Memoirs of Lord Butler* (Boston: Gambit, 1971), pp. 133–53; Hoffman, *Conservative Party in Opposition*, chap. 5.

[92] National Resources Planning Board, *After Defense—What? Full Employment, Security, Upbuilding America* (Washington, D.C.: U.S. Government Printing Office, 1941), pp. 1, 5.

President Roosevelt picked up this theme in his 1944 State of the Union address, which proposed an economic bill of rights, including the "right to a useful and remunerative job."[93] In October of the same year, the president called for the creation of sixty million jobs for a healthy postwar economy. Even his Republican opponent, Thomas Dewey, proclaimed that "if at any time there are not sufficient jobs in private employment to go around, the government can and must create job opportunities, because there must be jobs for all in this country."[94]

But in the United States the demand for full employment could not be sustained as the central political issue of the postwar era. Unlike the British Labour party the fractious constituencies of the Democratic party could not unite around a means for achieving full employment. The divided character of organized labor in the United States was the first obstacle. Fearing that the Full Employment Bill of 1945 was too closely identified with the Congress of Industrial Organizations, the American Federation of Labor lent the legislation only weak support. The CIO was more favorable, but even so did not want the whole of its postwar program of reform to be subsumed under the 1945 bill.[95] The divisions in the labor movement deprived the Full Employment Bill of a core of support like that in Britain.

Compounding this barrier to assembling politically meaningful support for full employment was the fundamentally divided character of the Democratic party. The New Deal coalition, reflecting the policy stalemate at the end of the 1930s, brought Democrats together on an electoral basis but did not represent agreement on policy issues. Thus, Roosevelt embraced full employment rhetorically but was far more reticent when it came to committing himself to specific policy measures aimed to achieve the goal.[96] Truman came out forthrightly in favor of the Full Employment Bill but was unable to persuade key southern Democrats to join him.[97] The opposition of southern Democrats, particularly those from agricultural regions, prevented the Democratic party from coming to agreement on the issue of full employment.

The defection of southern Democrats points to the existence of alternative bases of coalition and political mobilization in the United States. In contrast to Britain, where conservatives had no alternative issue on which to mobilize voters, in the United States, antipathy toward expanding the role of the federal government could undermine attempts to mobilize constituencies around full em-

[93] *The State of the Union Messages of the Presidents 1790–1966*, Fred L. Israel, ed. (New York: Chelsea House, Robert Hector Publishers, 1966), 3: 2894–96.

[94] Cited in Francis H. Heller, ed., *Economics and the Truman Administration* (Lawrence: Regents Press of Kansas, 1981), p. 97.

[95] Bailey, *Congress Makes a Law*, pp. 92–96.

[96] Ibid., pp. 610–61.

[97] Ibid.

ployment. The New Deal had left the United States with political cleavages far different than those in Britain after the war. Although Roosevelt retained enormous personal popularity, opposition to growing federal power was a theme that southern Democrats and Republicans could successfully use to appeal to their constituencies. Moreover, the issue of local autonomy and freedom from government control resonated with the local bases of political mobilization in the United States. The power of these appeals was apparent in Congress, where southern Democrats and Republicans opposed to the centralizing features of the New Deal steadily gained strength throughout the war.[98] They were also apparent in the debate over the Full Employment Bill. The need to create a new administrative apparatus in the national government and the effort to create this new capacity through federal legislation created a forum for mobilizing opposition around extensions of federal government power. Thus, opponents of the bill pledged their support for high employment but assailed the means for getting there.

The structure of political opportunities in the United States thus gave Republicans little cause to formulate anything akin to the Industrial Charter of the British Conservatives. Effectively represented in Congress, the small and medium-sized businesses who most feared the extensions of federal power had no incentive to reconcile their interests with full employment. Yet even if incentives to find a compromise had been stronger, the relationship of the Republican party to its constituents would have made such a policy shift unlikely. Neither the Republican party nor the Democratic party had the centralized policy-making apparatus that could insulate party moderates as they sought to reset terms of debate within the party. It was outside the political arena, in organizations such as the CED, that such compromising strategies could be fashioned effectively.

Because U.S. political processes had discouraged the creation of a compromise over full employment immediately after the war, Republicans were not committed to a Keynesian economic strategy when they regained control of the presidency in 1952. Moreover, with the control of inflation now a central economic concern, Keynesianism seemed less relevant since U.S. Keynesians had rarely presented it as a means of controlling inflation, as had British economists. There was, accordingly, little reason for Eisenhower to continue on the Keynesian path that Truman's Council of Economic Advisors had begun to chart.[99] Given the

[98] On Congress during the war, see Richard Polenberg, *War and Society: The United States, 1941-1945* (New York: J. B. Lippincott, 1972), chap. 7; and David Brody, "The New Deal and World War II," in John Braeman, et al., eds., *The New Deal: The National Level* (Columbus, Ohio: Ohio State University Press, 1975), pp. 272–81.

[99] On Truman's CEA see Walter S. Salant, "Some Intellectual Contributions of the Truman Council of Economic Advisers to Policy-Making," *History of Political Economy* 5 (Spring 1973), pp. 36–49; Leon H. Keyserling, "The View from the Council of Economic Advisers," in *Economics and the Truman Administration*, pp. 79–95; see also the account of the first chairman of the CEA,

structure of U.S. economic policy-making institutions, the new president could switch economic approaches simply by appointing a new Council of Economic Advisors less sympathetic to Keynesianism. The process of institutionalizing Keynesianism that had begun in the British Treasury could have no counterpart in the United States. Although economic policy making during the two Eisenhower administrations did not revert to the strict orthodoxy of balanced budgets, neither did it embrace the active demand management of Keynesianism.[100]

The pressure of full employment as a political issue thus spurred the acceptance of Keynesianism during the Labour government and ensured its survival once the Conservatives came to power in Britain. In the absence of such pressure, the fate of Keynesianism remained in limbo in the United States. Although the political salience of full employment was linked to the differential power of organized labor in each nation, it was ultimately the structure of party competition and the terms of political debate over employment policy that determined whether full employment would remain a central policy goal and Keynesianism the guiding philosophy of economic management as Britain and the United States confronted the new economic challenges of the postwar world.

Conclusion

The acceptance of Keynesianism in Britain and the United States occurred in two stages. Administrative arrangements were critical in determining when this innovative approach to the economy would be made part of government policy. In the United States, the open recruitment procedures and the nonhierarchical arrangement of administrative agencies allowed for experimentation with a variety of approaches to the Great Depression, which ultimately positioned Keynesian ideas to be tried when the dominant strategy of regulation had exhausted itself. In Britain, the closed and hierarchical bureaucracy discouraged experimentation and kept Keynesian ideas off the national agenda throughout the 1930s. The consolidation of the Keynesian approach likewise depended on administrative factors. Administratively, Keynesianism was easier to consolidate in Britain than in the United States. Once the war had upset established hierarchical patterns and admitted Keynesians into positions of influence, the triumph of Keynesianism depended on "converting" the Treasury and restoring its old prominence in economic policy making. In the United States the administrative task was much

Edwin G. Nourse, in *Economics in the Public Service*, and the recent interview with Keyserling in *President and the Council of Economic Advisers*, pp. 47–88.

[100] On Eisenhower's economic policy, see Stein, *Fiscal Revolution in America*, chaps. 11–14; on the role of the CEA, see Flash, *Economic Advice and Presidential Leadership*, chaps. 4–5.

more difficult, as it required vesting entirely new power in the national government, authority that would require undermining the entire framework of state and local authority.

The process of consolidation also required the acquiescence of sociopolitical actors to Keynesianism. However, the fate of Keynesianism in each country cannot be read simply from the strength or weakness of particular social groups. Rather, political factors mediated the meaning of Keynesianism in each country. In Britain, Keynesianism meant freedom from excessive intervention, whereas in the United States it meant license for the federal government to intervene in new ways. These differences in meaning partly derived from the distinct relationship between Keynesianism and planning in each country. But they stemmed also from the prior structure of the state. In the United States, the need to grant formally new power to the federal government in the Full Employment Bill was a strong factor behind much of the opposition to Keynesianism. The political strength of the demand for full employment was a second critical factor in the institutionalization of Keynesianism because it determined whether conservative governments would continue the Keynesian policies launched by their liberal predecessors. In Britain, the way full employment emerged into political debate made it a powerful political demand, whereas in the United States, full employment could not sustain its political potency.

The fate of Keynesianism in the immediate postwar period established the framework for economic policy in the decades that followed. Britain implemented a limited kind of Keynesianism that sought to avoid the more directive measures of the postwar Labour government. In the United States, Keynesianism continued to have a doubtful status until Democrats regained control of the White House and Congress in 1961.

By the 1960s the administrative obstacles that had disadvantaged advocates of Keynesianism had diminished and the political meaning of Keynesianism had been transformed. In existence now for fifteen years, the Council of Economic Advisors enjoyed a more secure status than during the Truman administration. President Kennedy staffed the council with leading liberal economists—all Keynesians—and frequently turned to them for advice.[101] Complementing the increased legitimacy of the CEA was the growing visibility of the Joint Economic Committee in Congress. In the latter half of the 1950s the JEC emerged as a platform for Democrats and their allies to advocate Keynesian measures aimed at reducing the mounting unemployment of the late 1950s.[102] At the same time the

[101] On Kennedy's CEA, see Flash, *Economic Advice and Presidential Leadership*, chaps. 6–7; and the interview with Kennedy's CEA chairman, Walter Heller, in Hargrove and Morley, *President and the Council of Economic Advisers*, chap. 4.

[102] See Stein, *Fiscal Revolution in America*, pp. 310, 325–42; see also the Eckstein Report, the

Keynesianism espoused by liberals had increasingly come to resemble that fashioned by the CED. No longer was Keynesianism politically or intellectually conflated with planning or the welfare state. Now variation in the tax rates—not spending—was the preferred way of stimulating the economy. And it was in this form that the United States finally embraced Keynesianism with the tax cut that Kennedy proposed in 1962 and Congress passed in 1964.[103]

Whether Keynesianism had been "institutionalized" during the 1960s in the United States is questionable. The structure of economic policy making left room for a range of voices to offer interpretations of economic affairs and prescribe alternative policies. Thus, the ascendency of the Keynesian Council of Economic Advisors in the 1960s was a precarious one and, as the limits of Keynesianism as a tool of economic management quickly became apparent, competing perspectives threatened to dislodge Keynesianism less than a decade after its triumph in the United States.

1959 report of the Democratic majority on the Joint Economic Committee, which urged reductions in taxes to combat recession (U.S. Congress/Senate, *Employment, Growth, and Price Levels*. Report of the Joint Economic Committee of Congress, Report No. 1043, 86th Cong., 2d sess., January 26, 1960).

[103] For an account of the Kennedy tax cut, see Stein, *Fiscal Revolution in America*, chaps. 15–17; Collins, *Business Response to Keynes*, chap. 7.

4

KEYNESIAN POLITICS: THE POLITICAL SOURCES OF ECONOMIC POLICY CHOICES

Peter A. Gourevitch

THE ECONOMIC downturn of the 1930s was worldwide. The magnitude of the contraction subjected all countries to a universal shock. For the very imperfect laboratory of the social sciences, this provides an unusual opportunity—a chance to measure national particularities through different responses to a common stimulus. While countries responded to the shock of the 1930s by changing their economic policies, the actual content of those changes differed. In some cases we find early forerunners of demand stimulus, in other cases more habitual deviations from classical orthodoxy, such as devaluation and tariffs. The differences have to do with politics, with the political context of the debate over demand stimulus.

Looking at the economic content of Keynesian policies defines the topic as one in the history of ideas. The innovation to be explained in this way is an intellectual one: who actually conformed to the policy prescription and through what intellectual mechanisms did its influence spread? But the 1930s was marked not only by intellectual innovation, but by political innovation as well. Sharp departures in tradition occurred, established constitutions were overthrown, political alliances disintegrated, new party alignments emerged, and new mechanisms of decision making were formed. The period from which the seeds of Keynesianism came was also fertile ground for new political growth. The two are related. Experimentation in economic policy was, as usual, intimately linked to innovation in politics.

The adoption of Keynesian policies is thus a problem not only in the history of ideas, but in political sociology. Good ideas do not always win. Many interesting and powerful theoretical constructs have been developed, be it in economics or other domains, which have had little or no impact on policy. To become policy, ideas must link up with politics—the mobilization of consent for policy. Politics involves power. Even a good idea cannot become policy if it meets certain kinds of opposition, and a bad idea can become policy if it is able to obtain support. An explanation of the pursuit of Keynesian policies (as opposed to a description of measures taken, or an account of the intellectual trajectory of ideas) must therefore explore the politics which surrounded the conflict over policy responses in the period when such policies emerged—the 1930s and the years after World War II.

One step in a political analysis would be to identify the decision makers who took up these policies. In the 1930s several important figures supported such policies. These included Ernst Wigforss in Sweden, Adolf Hitler in Germany, and Franklin D. Roosevelt in the United States. These individuals had power and their countries experimented with such policies. Others expressed support for these ideas, but lacked the power to make them national policy, at least in a constitutional political framework—Vladimir Woytinsky in Germany, David Lloyd George in Great Britain, and Keynes himself. Individuals surely matter; individual proclivities provide some leverage for understanding—the flexibility of Wigforss and Woytinsky, the rigidity of Philip Snowden and Rudolf Hilferding.

Nonetheless, identifying the individuals involved is not a sufficient political explanation. We must explore the broader political context that allowed the predilections of specific individuals to become policy. The emphasis must be on politics—on the processes that link together several elements of power, each operating in partial autonomy following a somewhat different logic.

A Brief Political Theory of Economic Policy Making

From the standpoint of politics, economic policies derive from the interaction of several sets of societal actors.[1]

Public policy passes ultimately through the hands of office holders, individuals who occupy positions defined by institutional arrangements, be these constitutions or less formal political parties. Politicians must be concerned with the mobilization of consent, the ability to elicit support from those with the power to allow or block whatever the politicians seek to do. In constitutionalist systems, a major source of power involves the ability to win elections. Other forms of power matter in these systems as well, such as coercion (military and police), law ad-

[1] A fuller account of the policy options and political variables shaping their choice may be found in Peter Gourevitch, *Politics in Hard Times: Comparative Responses to International Economics Crises* (Ithaca: Cornell University Press, 1986). Gourevitch compares the crises of 1873–1896, 1929–1949, and 1971–1973 to the present, examining the cases of Sweden, Germany, the United Kingdom, France, and the United States. The notes contain a fuller account of the sources used for this essay.

judication (courts), information (media and schools), and economic power. To govern, politicians must attain office, and then obtain consent while holding office. Politicians judge economic policy alternatives at least in part by the effects these have on the holding of office and the ability to govern.

A second group of key actors in the making of economic policy are economic actors, those individuals and organizations of individuals which occupy another set of key institutional positions, those in the economy which confer a functional power on economic activity. These actors have leverage over policy because of their control over vital economic activities: manual and skilled labor, investment, management, professions. These actors can apply pressure by offering or withholding their services, by working or striking.

How do economic actors evaluate policy alternatives? Policy preferences are strongly, though not exclusively, shaped by economic "location," by the incentives which location in the economy provides; for example, workers and owners in industries facing severe competition from foreign producers are more likely to support tariff barriers than are their counterparts in companies which are highly competitive. Economic interest shaped by economic location is not wholly adequate as a predictor of policy preference, but it tells us a lot. Other influences on preference include economic ideology, religion, ethnicity, and party loyalty.

Like politicians, economic actors cannot act alone. No economic group is strong enough to prevail on its own. It needs allies. Getting allies requires bargains, trades, exchanges, giving up something to get something—in short, politics. Hence, economic actors and politicians interact. Each needs the other. Politicians need the support of economic actors to win office and to govern. Economic actors need the support of politicians to construct winning coalitions for getting their policy preferences accepted.

Each looks at economic policy from a somewhat different angle. Economic actors begin with an economic situation, to which they link an economic policy preference, and then seek out a political strategy to make that preference prevail. Politicians begin with a political situation, for which they need support, and then seek economic policies which provide that support. In sum, politicians seek policies that suit their politics. Economic actors seek politics that suit their policies.

The interaction of politicians and economic actors is not wholly straightforward, that is, it does not happen in simple, direct ways. Rather, the interaction is refracted through institutions. Politicians and economic interests work through mechanisms set up to aggregate preferences, make decisions, and provide modalities of enforcement. These mechanisms themselves influence the character of the interaction, hence the outcome. And the operators of these mechanisms (civil servants and others) themselves have influence over the results.

The Dependent Variable

The economic policy outcome of interest to us in this volume is Keynesianism. However, Keynesianism was only one form of policy discussed in the 1930s. There were others, also quite capable of generating intense controversy and attention. There were several policy options available, at least in principle, to decision makers. It was the job of the political process to choose among these options.[2]

Among the policy alternatives was an orthodox one—deflation—and an orthodox deviation from orthodoxy—protectionism. Deflation, the dominant neoclassical view which prevailed before 1929, held that the right way to handle depressions was to do little, allowing market forces to provide the needed self-correction: unemployment would force down costs, which would allow prices to fall to the appropriate level of demand, which would then start the cycle of buying and selling back upward. Governments should aid this process in a procyclical way by cutting taxes (and spending) to help lower costs.

Nearly all governments tried deflation as a first response to the Depression of 1929. As economic conditions continued to worsen and cause rising dissension, most governments turned toward alternatives. As this was not the first depression in economic history, this would not be the first occasion of deviation from orthodoxy. In earlier periods, many countries turned toward protectionism—tariff barriers that forced domestic demand upon domestic production. At the same time, many countries abandoned the neoclassical emphasis on stable exchange rates by devaluing their currency. As Keynes noted, three policy options could be seen as different ways of doing the same thing: demand stimulus, protectionism, and devaluation were all ways of boosting domestic demand for national products.

Two other policy options figured in these debates. Neomercantilism—or in current parlance, industrial policy—involved regulation of markets through price supports, production sharing, aid to specific companies or industries, and special credits; in the 1930s, many called this "corporatism." Nationalization, by contrast, involved public ownership of industry and physical planning rather than market mechanisms for economic decision making.

These alternative policies—neoclassical deflation, protectionism, demand stimulus, neomercantilism, and nationalization/planning—were to varying degrees debated in all the industrial countries during this period. A careful unraveling of the policy trajectory of each country would show specific sequences,

[2] See Gourevitch, *Politics in Hard Times*.

where policies were tried then abandoned, then new policies or parts of policies were tried, and so on. The trajectories are too complex to trace here.

It is notable, however, that in the 1930s few countries tried demand stimulus. Some discussions and partial efforts appear to have taken place in Sweden under the Social Democrats and in France under the Popular Front; but the effective policy in Sweden relied mostly on devaluation and market regulation, and the same was true in France. The most extensive fiscal stimulus seems to have taken place in Nazi Germany from 1933–1935 and to a lesser degree in the United States in 1938–1939. The weakest prewar impulse to demand management appears to have been in the United Kingdom.[3]

The major usage of demand stimulus as a policy option occurred after World War II. In the 1930s, political obstacles toward such policies remained great. To understand these obstacles, the situations which allowed some experimentation in those years, and the shifts after the war, an examination of political processes is necessary.

Applications of the Theory

Political pressure and economic analysis interacted in the 1930s to produce novel arrangements in politics and sharp departures from economic orthodoxy. When the Depression began, all countries started by pursuing the orthodox policy of deflation. This did not work fast enough to satisfy very many people. Economic actors began to question their economic analyses. If unemployment and collapsing profits could not be satisfied by orthodoxy, something else would have to be found. Politicians noted considerable distress among voters, interest groups, party leaders, and others. They too began looking for policy options which would have both better results and stronger support.

Orthodoxy gave ground under pressure. Economic pressure forced the initial moves. The banking community insisted on defending the pound in 1930 and 1931, which provoked a split in the Labour party. But when investors abandoned the pound in September 1931, bankers then told the government it had no choice. This event shows rather starkly the connection between policy and economic actors. But it is atypical in its clarity. More common are structural shifts in the behavior of economic actors and their relationship to the government. Several patterns can be noted.

[3] H. W. Arndt, *The Economic Lessons of the Nineteen-Thirties* (Oxford: Oxford University Press, 1944); Andrew Shonfield, *Modern Capitalism* (London: Oxford University Press, 1965).

The Importance of Farmer-Labor Alliances

Among the most striking political innovations of the 1930s was the cooperation of farmers and labor associations.[4] Prior to this period these two groups generally fought. Farmers wanted cheap industrial goods and high prices for farm output. Labor wanted cheap food and high prices for industrial goods to support high wages. By and large, this conflict between producers predominated. Economic policy issues put them on opposite sides: free trade versus protectionism, union-organizing rights, urban welfare legislation, agricultural price supports, and extension services.

There were potential grounds for cooperation. Both farmers and workers had grievances against capitalism and the market. Farmers complained about industrialist control of transportation, tight money, retailing, and the instability of agricultural markets. Labor complained about working conditions, wages, unemployment compensation, and other welfare services. In some places, farmers saw that high wages could support higher consumption of quality food products like meat and cheese; and in some places, labor saw that farmers could be consumers of industrial output. But through most of the nineteenth century and well into the twentieth, the potential sources of cooperation between agriculture and labor were overwhelmed by the grounds for antagonism. Producer conflicts predominated.

The Depression of the 1930s changed this. Desperation shook people loose from established moorings. Farmer and labor associations cast about for other options. Orthodox business elements had trouble with their demands. Assistance either to farmers or workers could not fit classical assumptions.

Some political actors were not so bound by tradition. In Sweden, the Social Democratic leadership saw its opportunity.[5] It proposed a trade with the agrarian leadership: price supports and market regulation for agriculture; unemployment compensation and other labor market measures for labor. The deal became known as the cow trade. It formed the basis of over four decades of Social Democratic leadership in Sweden.

[4] Alexander Gerschenkron, *Bread and Democracy in Germany* (New York: Fertig, 1943, 1966); Barrington Moore, *Social Origins of Dictatorship and Democracy* (Boston: Beacon, 1966).

[5] From the substantial literature on Sweden, see Andrew Martin, "The Dynamics of Change in a Keynesian Political Economy: The Swedish Case and Its Implications," in Colin Crouch, ed., *State and Economy in Contemporary Capitalism* (London: Croom Helm, 1979), pp. 88–121; Bo Gustafsson, "A Perennial of Doctrinal History: Keynes and the 'Stockholm' School," *Economy and History* 16 (1973), pp. 114–28; Lars Johnung, "The Depression in Sweden and the United States: A Comparison of Causes and Policies," in Karl Brunner, ed., *The Great Depression Revisited* (Boston: Nijhoff, 1981), pp. 286–315; Donald Winch, "The Keynesian Revolution in Sweden," *Journal of Political Economy* 74 (April 1966), pp. 168–76; Stephen Koblik, ed., *Sweden's Development from Poverty to Affluence* (Minneapolis: University of Minnesota Press, 1975).

The leaders of this alignment talked about demand stimulus. They were aware of these ideas and had participated in international and domestic discussions of them. However, the actual usage they made of pump priming was quite limited. The pre-Social Democratic government had already caved in to the devaluation of the pound by devaluing the Swedish crown. Swedish recovery was fueled by the revival of demand outside Sweden, especially in Great Britain and Germany.

But the break with orthodoxy became institutionalized by the political changes associated with this new alignment. The coalition used government power to develop regulated markets for labor and agriculture as well as various forms of public service. Political power forced business owners into an accommodation. The election of 1936 made it clear that the new political alignment was not reversible. In its wake, tripartite negotiations began among labor, farmers, and business under government leadership. They produced the Saltsjobaden accord of 1938: labor agreed to avoid strikes and accept private ownership of companies and investment; business agreed to high wages and a full employment commitment.

It was this agreement which continued the economic experimentation of Swedish governments. The commitment to full employment arising out of this political arrangement generated a need for policies that would implement it. The regulatory system of labor market intervention was one such policy. Demand management was another. The Swedes worked on this early.

The role of demand management ideas in this process was largely a political one. It did not immediately shape government policy. This came later, mostly during and after World War II. Rather, demand management ideas helped to redefine the political environment. It changed political leaders' views of the definition of friends and enemies. Classical orthodoxy, like classical Marxism, had a stark view of conflicts, which pit groups against each other. Demand management saw the potential for a collective game, where high purchasing power everywhere was good for everybody. This helped people find allies. Certainly other factors played a large role in the emergence of this compromise among historic antagonists. But the alliance itself was vital to progress in economic policy.

Comparison to other countries is instructive. Farmer-labor alliances were vital to the New Deal. From the Civil War to the election of 1932, the economic issues of U.S. politics were strongly shaped by conflicts between agriculture and industry. On commercial policy, most farmers were free traders, while the industrialists of the U.S. heartland were protectionist. There were certainly exceptions in both cases (Eastern shippers and financiers thought internationally; midwestern dairy and meat producers thought about urban markets, hence industrial interests). But with the McKinley-Bryan battle of 1896, agrarian-populist concerns left many labor and urban ethic groups disaffected. Some farmer-labor experiments were tried in states like Wisconsin and Minnesota.[6]

It took the Depression to generalize these to national politics. Through the New Deal coalition, agriculture and labor worked out an accommodation rather like that of their Swedish counterparts: strong support for agricultural prices and market regulation in exchange for union-organizing rights, unemployment benefits, and Social Security. Major political support for the first and second New Deals came from the large bloc of urban and farmer voters and interest groups. So did support for the demand stimulus experiment of 1938. As many authors have noted, Roosevelt did not start out having much interest in deficit-financed pump priming. The attitude toward budget balancing was relatively orthodox. The policy changes of the first half-decade of the New Deal came in commercial and monetary policy (tariffs, devaluation, floating currency), in regulation of markets (in labor, industry, agriculture), price supports, welfare subsidies, and the like. Demand management emerged by experience, after other things were tried. Efforts to balance the budget in 1936–1937 caused a recession. By then policy makers understood the relationship. Six years of experimentation with policy made them more willing to think in different terms. Political support for activism in those years ultimately set the groundwork for Keynesian forms of activism.[7]

In France, farmer-labor collaboration was vital to the Popular Front. Political cleavage lines in that country were sharply fragmented by many issues besides those of political economy (religion, political ideology, foreign policy, and constitutionalism, to name a few). But there again, farmer and labor organizations had not had an easy time working through political arrangements for common policy purposes. The alignment of the Radicals with the Socialists and the Communists that emerged in the 1930s derived largely from the political goal of saving the Republic from right-wing attacks. However, it had the effect of allowing substantial experimentation with policy toward worker issues, agriculture, and demand stimulus. The alliance was fragile. Neither the political accommodation nor much of the economic one lasted.[8]

[6] From the vast literature on the United States, see W. A. Williams, *Roots of the Modern American Empire* (New York: Random House, 1969); Margaret Weir and Theda Skocpol, "State Structures and the Possibilities for Keynesian Responses to the Great Depression in Sweden, Britain and the United States," in Peter Evans, et al., eds., *Bringing the State Back In* (New York: Cambridge University Press, 1985), pp. 107–68; Tom Ferguson, "From Normalcy to New Deal: Industrial Structure, Party Competition and American Public Policy in the Great Depression," *International Organization* 38 (Winter 1984), pp. 41–94.

[7] Herbert Stein, *The Fiscal Revolution in America* (Chicago: University of Chicago Press, 1969).

[8] Francois Goguel, *La politique des partis sous la III'e Republique* (Paris: Le Seuil, 1946); Henry Ehrmann, *Organized Business in France* (Princeton: Princeton University Press, 1957).

Two coalitional failures underline the importance of farmer-labor alignments: the United Kingdom and Germany. In Great Britain, the weakness of agricultural organizations helps account for the failure of the Lib-Lab coalition and for the relative lack of policy experimentation as well. With the onset of the Depression there was much talk of a Lib-Lab coalition (between the Liberal party, where Keynes was active, and Labour). It never came about. Great Britain had the smallest agrarian sector of any of the countries in question; it lacked a mass base of small farmers able to provide swing support for new policy moves. While many contingent factors shaped alignments, we may see the relative weakness of agriculture in British political economy as a contributing structural factor.[9]

The Lib-Lab coalition had the ingredients for policy innovation: a diverse base of support in the electorate and key economic interest groups and the intellectual ideas, developed by Keynes and endorsed by labor leaders like Bevin. Without the coalition, there was less experimentation. Britain certainly did deviate from its classical orthodoxy: devaluation and tariffs surely did not fit the free market principles developed in the nineteenth century. And these did have some significant effects on revival. But the British experience in these years was narrower and more orthodox in its deviations.

In Germany, farmer and labor groups were unable to come to accommodation within the framework of a constitutional order.[10] Such an alignment was explicitly proposed: the WTB plan was written up by activists in trade unions and farm organizations. It had the policy outlook of the Swedish cow trade and the U.S. New Deal. But the actual organizational leaderships could not agree on how to bring their organizations and membership in line. Too many elements of conflict blocked the way. Socialist groups tended to see farmers as petty capitalists. And business organizations refused to give up their orthodox dislike of market interventions in order to subsidize agriculture.

The Nazis were not so scrupulous. They were quite willing to advocate significant farmer assistance. And they won very strong political support for doing so. The sociology of Nazi support is rather complicated. They did poorly among organized union members and among Catholics. Among Protestants they did pro-

[9] Robert Skidelsky, *Politicians and the Slump* (London: Macmillan, 1967); Donald Winch, *Economics and Policy: A Historical Study* (New York: Walker, 1969); Dennis A. Kavanagh, "Crisis Management and Incremental Adaptation in British Politics: The 1931 Crisis of the British Party System," in Gabriel Almond, et al., eds., *Crisis, Choice, and Change* (Boston: Little, Brown, 1973), pp. 152–223.

[10] Dietrich Bracher, *The German Dictatorship* (New York: Praeger, 1970); David Abraham, *The Collapse of the Weimar Republic* (Princeton: Princeton University Press, 1981; rev. ed., 1987); H. W. Turner, *German Big Business and the Rise of Hitler* (New York: Oxford University Press, 1985); Richard Hamilton, *Who Voted for Hitler?* (Princeton: Princeton University Press, 1982); Gershenkron, *Bread and Democracy.*

portionally about as well in a given socioeconomic category as that group had in the general population. They did disproportionately well among farmers.

The Nazi coalition was a perverse one, not only because of what it did (terror) but also because of its mode of construction. In other countries, the coalitions were formed by direct bargaining among group and party leaders. However, the Nazi coalition was formed by destroying organizations, repressing their leaders, and mobilizing mass support through new, party-controlled organizations. This perversity should not obscure an important point of comparison. As in the other countries, the Nazi support base was unusual. They linked together historically antagonistic groups, which had in earlier periods found cooperation difficult if not impossible. The inability of groups to reach a policy accommodation within the constitutional framework of the Weimar Republic contributed to the paralysis which the Nazis so skillfully exploited. Their authoritarian coalition provided the political basis for their own deviations from economic orthodoxy. As in other countries, the Nazis intervened in markets through regulatory mechanisms. And more than in other countries, the Nazis appear to have tried more extensive deficit-spending pump priming, even before the onset of military expenditure later in the decade. Their policy approach was not at all that which business groups would themselves have tried had they held power directly.

In each country, then, policy experimentation required political support. A major source of that support lay in farmer-labor coalitions. Labor support for full employment policies has always been a key ingredient for such policies. But it has never been enough. Agriculture has provided one major source of support. Business support is another.

Business Attitudes Toward Demand-Stimulus

Like any large, complex group, business has not been uniform in its attitudes toward economic policy options. No government can operate effectively in a constitutional capitalist polity without the support of a substantial portion of owners and managers of business. This truism applies to the politics of demand stimulus. Important elements of business have been supportive of breaks from economic orthodoxy, but the sharp disagreements among business elements have been critical to the policy debate.

To simplify greatly, we may differentiate business groups according to different "marginal propensities" toward "progressive" or "conservative" political alignment. Business groups must always make some choices of political economy, of how to link up market imperatives with political realities. A "progressive" posture links business, labor, and agriculture around programs of better wages and working conditions, institutionalized industrial relations, social insurance systems, and constitutional government involving respect for civil liberties, political rights, and some power sharing. A "conservative" posture links these groups around programs that favor investment-led growth, limited wages, weak unions, limited social insurance, and, in some instances, the use of state power to coerce labor into passivity.[11]

Political alignments and conflict turn on the axis of cleavage, on the issue being fought over. In some respects, business groups, be they progressive or conservative, have common interests in relation to labor: control of investment, strong managerial authority over wages, work organization, employment, taxation rates, and so on. On other issues, business groups may come into conflict: over foreign economic policy, credit costs, inflation rates, subsidies and taxes, regulation, and so on. One industry's product may be another industry's input. And when different branches of business find themselves with divergent interests and goals, each may seek allies from other social categories.

As historical conditions change, the social location of the ideological categories "progressive" and "conservative" shifts. Among the most vital influences upon the social location of the labels has been the international economy, in particular, battles between free trade and protectionism. On the issue of the proper relationship to the international economy, business groups have split very intensely. Roughly speaking, competitive firms and leading-edge industries within a country have supported free trade. These have often been dynamic and expansive high-technology industries, generally those at the export stages of the product cycle.[12] Conversely, firms facing strong competitive challenges and difficult international market conditions have supported protectionism. That disagreement cuts across other issues on which the owners of capital might agree: control of unions, defense of property rights, conflicts with the agrarian sector, business regulation, and so on. But on many occasions, these disagreements have been strong enough to break through common "class" positions and assert "sectoral" ones. At times these conflicts have led business leaders to make common cause with "class" enemies ("labor") or sectoral ones ("agriculture").

In nearly all countries in Europe and North America, one can find examples of these alignments. The Anti-Corn Law movement in the United Kingdom is the most famous—business, labor, and even farming elements united in the press for free international trade. Their counterparts in the United States include the Democratic party from the Civil War down to the 1920s, an alliance of southern farming which was free trade, and internationalist northern business elements with

[11] See Gourevitch, *Politics in Hard Times*, chap. 6; Ehrmann, *Organized Business*; Richard Kuisel, *Ernst Mercier: French Technocrat* (Berkeley: University of California Press, 1967).

[12] James Kurth, "Political Consequences of the Product Cycle," *International Organization* 33 (Winter 1979), pp. 1–34; Helen Milner, *Resisting Protectionism* (Princeton: Princeton University Press, 1988).

some labor support against other domestic manufacturing elements and their work force. The move for free trade was one of the prime elements leading businessmen to seek labor allies. Free trade industrialists were generally the most willing to explore such alliances.

The Depression of 1929 shattered these relationships. Business groups shifted about in complex gyrations. When the Depression began, most groups overcame earlier disagreements in favor of deflation—the orthodox line of cutting government and labor costs to restore market viability. But under the hammer blow of worsening economic conditions, consensus crumbled. The collapse of international trade naturally undermined internationalist arguments and bolstered domestically-oriented ones. Industrialists looked to domestic markets to replace foreign ones and stabilize economic conditions. In place of an open but fluctuating world economy, they were increasingly tempted by more autarchic conditions—predictability at the expense of opportunity.

The mechanisms for creating stability varied. Tariffs were a familiar alternative, "the natural reflex of the Republican party under pressure," as one pundit put it. Regulation of domestic markets was another: price supports for agriculture, corporatist market-sharing arrangements, and regulatory commissions, of great variety and invention. *De facto* nationalization and public enterprise were widespread: coal mining in Great Britain, a spread of companies in Italy, TVA in the United States. Devaluation of the currency won support everywhere.

Deficit spending arrived in this context as one option among many. It was understood that way by contemporaries—devaluation, tariffs, or pump priming through deficits were simply different ways of mobilizing domestic demand when foreign ones disintegrated. Thus, it is important that demand stimulus entered the public discourse of policy debates as an aspect of economic nationalism. Initially, the support base for demand stimulus came from the noninternationally minded: labor facing high unemployment, farmers overwhelmed by international overproduction, and a variety of business groups. In earlier times, basic industries like steel and textiles had been leaders in protectionism and deeply antagonistic toward labor movements and labor demands. Now, under the press of the Depression, these historic enemies converged in support of breaks with orthodoxy. In various places, demand stimulus was one of those breaks.

These alliances, involving labor, agriculture, and some business allies, were by no means uniform in their political expression. Indeed, the opposite is the case. The political formulas—their ideological framework, organization, coherence, and degree of explicit bargaining—varied considerably. In Sweden, bargaining was the most explicit, direct, and visible (the Saltsjobaden accords of 1938). In the United States, the alignment comprised similar groups in a constitutionalist democratic framework of social democratic values, but it was not formal and not even explicitly social democratic. In Germany, the linkage was authoritarian and imposed. Labor organizations were destroyed, along with opposition parties. All organizations were controlled by the Nazi party. Policies promoting employment, social services, market stabilization, and the like were imposed on various groups, without much representation by their leaders. What happened cannot be seen as what business leaders may have done on their own—they were too divided and orthodox for that. Rather, the outcome was the result of a political process in which a diversity of constituencies allowed the Nazis to break with economic conventionalism. The formula that emerged in Germany was perverse and horrifying, but the link between political and economic experimentation can be found there as in other places. In Germany more than anywhere the linkage between demand management and economic nationalism was clearest. No government sought more autarchy, and none went so far with demand management experiments in the early 1930s. But in other countries lacking the perversity of fascism, the nationalist component of early interest in Keynesianism can also be detected: the first years of the New Deal and the debates in France and Britain in the first half of the decade.

After a few years of continued experimentation and change, however, Keynesianism shook loose this linkage with economic nationalism to become a pillar of internationalism. In the 1930s, this process could only happen where constitutionalist political forms continued to allow political movement. In Sweden, the United States, and elsewhere, the supporters of demand management switched sides as the international economy revived. Internationalist industries moved to restore the conditions favorable to trade and export. They sought to repair the international monetary system and reciprocal trade agreements. In seeking these moves, they needed allies and were willing to turn to agriculture and labor to find them. They learned to accept some of the demands of these groups, and in that respect were able to do better than their domestically oriented brethren.

Here some important differences among industries proved relevant. Steel, textiles, and other older sectors had the disadvantages of considerable overcapacity around the world, nondynamic technology, and labor market conditions which put them in constant conflict with trade unions. The internationalist high-technology industries were newer, with lower wage bills, less standardized labor, and more interest in labor-purchasing power. The latter found it easier to explore alliances with other social categories.

An older pattern of relationships was rediscovered, linking "progressive" industrial sectors to labor and farm allies. The older coalitions revived in new forms—the anti-Corn Law, free trading, constitutionalist movements found in international Keynesianism a new formula for political success. Sweden provided the most developed version of the model before the war: business–farmer-labor understandings were based on full employment, subsidies for agriculture, demand management, labor market interventions, free trade, and private enterprise. Other countries worked out policies and political formulas after the war.

Economic Ideology

In exploring political support for economic experimentation we have looked so far at the economic aspects of group support—what types of groups appear to have wanted which policies. This line of reasoning emphasizes demographic or "objective" features of policy support. A different approach looks at the realm of ideology. It assumes that "objective" situations are often unclear. Within groups there may be reasonable disagreement over which policy best suits a given situation. Where reality permits varying interpretations, ideology is extremely important. Ideology can be seen as a cognitive map, a way of economizing in the face of excess or imperfect information, a way of bringing some order and sense out of the jumble of possible viewpoints and understandings of reality.

In this regard, countries, leaders, and groups approached the confusing and disrupting reality of the 1930s rather differently. Experimenters and traditionalists appeared as different types everywhere, cutting across ideology and party. Wigforss in Sweden and Roosevelt were experimenters. They looked for economic ideas that suited political conditions—not totally, but with a high degree of pragmatism. Hilferding and Snowden, despite their socialist/Social Democratic party affiliations and roles as ideological spokesmen, by contrast held firm to traditional views of how capitalist economies worked. These views corresponded to that of many neoclassical bankers and industrialists, into which demand management and other deviations from orthodoxy did not fit. Woytinsky and Bevin, the pragmatists in the two labor parties, lost out.

Similar disagreements can be found everywhere. Hitler was more pragmatic (opportunistic) in his policy outlook than other figures in his country, on all sides of the spectrum. It is not easy to find sociological patterns to the pragmatism/traditional division. But it is clearly important. Pragmatic leaders were able to construct innovative political coalitions in part because their economic pragmatism gave them a better definition of coalitional opportunities. Classical policies defined friends and enemies rather starkly in class lines, the mirror of orthodox Marxism. Demand management, along with protectionism, defines political groups and their relationships rather differently. Political innovation as well as economic innovation was thus influenced by ideological flexibility and by rigidity.

Institutions

Political outcomes, economic or other, are affected by institutional mechanisms of decision making. An understanding of societal actors—both their economic situation and their ideological outlook—provides crucial information about the actors who work through the political system. But the mode of aggregating those interests—the rules, procedures, and bureaucracies—can have a considerable effect on the policy outcome.[13]

Recent discussions of institutions in social science literature have focused on "capacity"—the organization of rules and administrative skills needed to carry out a particular policy. This can be an important explanatory variable. Its importance depends on the type of policy to be pursued. Protectionism without the ability to enforce tariffs is useless. Industrial policy may require the ability to intervene in the life of firms and industries, an ability which the United States and Great Britain lack, while Germany, Japan, and France have it in abundance.

Demand stimulus, interestingly, does not require a very high capacity for intervention. Rather, it may require a high capacity for analysis. Pump priming supposes rather good information on the effects of a given level of pressure. That takes considerable information and a high level of analytic capacity. But it does not require ample capability of policing, enforcement, supervision, and administration, at least compared to industrial policy, nationalization, or even tariffs. Because demand stimulus requires a relatively low level of intervention, it may well have been easier to introduce without the kind of political controversy that the development of more extensive techniques of government control has generated.

Institutional arrangements have had a powerful impact on the politics of economic policy making in a different way—via the effects of such arrangements on the distribution of power. No institutions are power neutral. Rules and procedures always help or hinder some groups over others. It is possible to show how institutions affected the policy debates about demand stimulus by tracing out the specific effects of each pattern of arrangements on politics in each country. That is impossible within space limitations here, but one or two examples can illustrate the point.

The Germany of the Weimar Republic is a particularly rich example. There were important groups in pre-Nazi Germany interested in economic experimentation through a new political coalition yet in a constitutionalist framework—something like the Swedish model. Institutional arrangements hindered the formation of that coalition and favored others: the judicial system favored the far right over the far left; so did the army and much of the bureaucracy; at a crucial

[13] Krasner, *Defending the National Interest*; Peter Evans, et al., *Bringing the State Back In*.

moment the presidency lay in the hands of anticonstitutionalist forces. Putting industry, labor, and agriculture together in a constitutionalist framework had always been difficult in Germany; institutional obstacles made things worse.

In the United States, federalism and the separation of powers both provided obstacles to change. Veto groups are aided in the U.S. system. Reform is hard and difficult to institutionalize; this is a frequently cited reason for the difficulty the New Deal coalition had in institutionalizing itself, in the ability of conservative farmers and business interests to limit the scope of change; and for the failure of industrial policy-type programs oriented toward business.

Institutional arrangements shape power relations among social actors. In this way they always affect political debates over economic policy.

The International System

The international system itself has a profound impact on the politics of economic policy choice in countries. It does so by shaping the calculations of actors within countries as well as the resources at their disposal. At certain moments the international system may even alter internal arrangements—institutional, economic, social, and ideological—through direct intervention.[14]

Several examples underscore this point. Size matters a good deal, as the Swedish case brings out. As a small country, Sweden could not possibly hope to mobilize enough domestic demand to sustain the standard of living desired. Sweden's route to prosperity required finding a niche in an intensely specialized international division of labor. Germany and the United States, with vastly larger populations and regional bloc possibilities, could attempt economic nationalism.

The effect of this difference in size operates through the calculations of domestic actors. The inwardly oriented lobbies in Sweden were simply smaller than their counterparts in other countries. In those countries, the nationalists and internationalists disagreed on the best strategy for the nation in relation to the world economy. The world did not impose certain choices on Germany, Great Britain, or the United States. Policies were choices—alternatives selected by a political process. What the international arena did was strengthen or weaken certain arguments and the resources of those advancing them.

The most spectacular example of the ability of the international system to intervene directly in international arrangements is that of postwar Germany. Allied intervention destroyed the regime of the 1930s. Through several processes—partition, institutional reform, de-Nazification, social change during the war, and

[14] Peter Gourevitch, "The Second Image Reversed," *International Organization* 32 (Autumn 1978), pp. 881–912.

economic reorganization—Germany's social structure, ideology, and institutional structure were profoundly altered. The Federal Republic had many fewer Protestant radicals, both left and right, no Junker-based officer corps, a higher percentage of Catholics organized after the war around Christian Democracy, and new experiences to undermine anticonstitutionalist promilitarist traditions.

The health or weakness of the international economy itself has a considerable impact on domestic policy and political calculations. The collapse of international trade and of domestic demand from 1929–1933 altered the calculations of all actors about the rewards of various economic policies and of political calculations about how to get there. Similar effects can be observed in the economic prosperity of the 1950s and 1960s. Good economic times helped integrate the economic and political actors into the postwar accommodation of the mixed economy. In a sense, economic disaster set the groundwork for interest in the demand-managed mixed economy, and economic prosperity helped provide it with legitimacy.

Finally, the success of the international economy has itself altered the incentive structure of economic and social groups within each country. As the international division of labor has intensified, more and more companies have become international. They make and sell goods everywhere. They depend on foreign countries for sourcing, markets, and finance. Of course, internationalization makes for competition, but it does increase integration. It has become harder and harder for many companies to be sure they would benefit from economic nationalism. Internationalism has become domestically stronger in each country. Despite its origins in economic nationalism, Keynesianism thus contributed to internationalism.

The Impact of World War II

World War II and its aftermath reopened the political economy arguments of the 1930s on, to varying degrees, new political ground. The policy debates of the postwar years continued the controversies of the prewar debate, sharply modified by the wartime experience. In a sense, the policy arguments of the 1940s sought to avoid earlier horrors: in economic terms, the horrors of vast unemployment; in political terms, the horrors of fascism, civil war, bolshevism, and intense political conflict.[15]

Power relations were altered by the conflict. In nearly all European countries, labor was greatly strengthened. The mobilization for war, the occupation and

[15] Fritz Scharpf, "Economic and Institutional Constraints of Full-Employment Strategies: Sweden, Austria, and West Germany, 1975–1982," in John Goldthorpe, ed., *Order and Conflict in Contemporary Capitalism* (Oxford: Oxford University Press, 1984), pp. 257–90.

resistance on the continent, and the discrediting of fascism all served to make labor movements key players in postwar debates. At the same time, many business elements also supported a greater degree of stability than the prewar years provided. And agriculture wanted the continuation and extension of its supports.

The policy arguments took place in a framework of constitutional government. The political balance led to a compromise, the mixed economy, which combined private control of investment and management with some degree of nationalization and support for the rights of labor, welfare, and regulation. However, the individual elements in this approach had to be integrated into an overall schema designed to secure full employment. Demand management in the framework of a regulated market economy fit the bill. Under common political conditions, the Swedish model was generalized to all cases.

CONCLUSIONS

As postwar prosperity lasted, so did the consensus around the mixed economy. Internationalism, demand management, and centrist politics reinforced each other. Then things began to unravel. The international economy in the 1970s experienced problems and shocks. Experts disagree on the balance between structural obstacles and historically specific shocks, like the OPEC oil price increases, but by the mid-1970s, problems were spreading. Increased international competition made the world look something like the 1880s: not a sharp business cycle slump as in the 1930s, but rather a crisis of productivity, cost cutting, expanding output, and new entrants into the international division of labor. Amidst prosperity came rising unemployment accompanied by cycles of inflation and deflation.[16]

Under those pressures, the postwar accommodation started to unravel. Agriculture found its demands thoroughly integrated into the political system. Indeed, as the agricultural population shrank, agriculture went from being a definer of political cleavages to being an interest group. As this happened, its political influence grew rather than diminished. Agriculture could be wooed. Everyone became willing to pay the price in order to get support. Agriculture became a key

[16] George Ross, Andrew Martin, Peter Gourevitch, and Peter Lange, eds., *Unions Change and Crisis* and *Unions and Economic Crisis* (London: Allen & Unwin, 1982, 1984); Peter A. Hall, *Governing the Economy* (New York: Oxford University Press, 1986); Peter Katzenstein, *Small States in World Markets* (Ithaca: Cornell University Press, 1985); John Zysman, *Government, Markets and Growth* (Ithaca: Cornell University Press, 1983); Andrea Boltho, *The European Economy: Growth and Crisis* (Oxford: Oxford University Press, 1982); Leon Lindberg and Charles Maier, eds., *The Politics of Inflation and Economic Stagnation* (Washington: Brookings, 1984); Suzanne Berger, ed., *Organizing Interests in Western Europe* (New York: Cambridge University Press, 1981); Michael Piore and Charles Sabel, *The Second Industrial Divide* (New York: Basic Books, 1986).

swing group. That development posed problems for labor. As the international economy ran into trouble, so did the earlier "progressive" alliances. High-tech internationalist businesses found that labor costs and managerial power mattered to them. They became skeptical of wage costs and social service-generated taxes. In short, labor was losing allies.

In terms of ideology, important changes had also followed from the successes of Keynesianism and the welfare state. In the 1930s, the state had been seen as an ally of the propertied elites. Capturing it meant putting it to work for the poor and dispossessed. By the 1970s, the state seemed to work for a new set of established interests. As difficulties mounted, attacking state action seemed an increasingly plausible line of reasoning. Where state inaction had once been a cause for concern, state action was now blamed for many evils.

Strained by policy disagreements and ideological quarrels over economic policy, the postwar coalitions were also weakened by other political disputes—foreign policy quarrels, social movements about ecology, gender, and migrants, and cultural developments as well. Under these pressures, the political innovations of an earlier period have seemed less workable, and the political foundations for demand management have eroded. Political and economic divergences have grown. Older arguments have resurfaced, in somewhat different form and language to be sure but nonetheless with real force. The amplitude of debate has widened. Thatcher and Reagan exemplify the revival of neoclassical arguments that has occurred everywhere. The authority of unions, the social services of the welfare state, market-stabilizing arrangements—all seemed more secure twenty years ago than they do today.

On the other side of the neoclassical revival is the reemergence of neomercantilist arguments. Interest in industrial policy, in microeconomic interventions to help specific industries and companies, has grown everywhere. Countries pursue it to differing degrees and with varying distributions of benefits. Sweden and Austria use mercantilism quite differently than the United States and Great Britain. But the technique has grown, undermining the influence of nationalization, planning, protectionism, and other earlier modes of intervention.

To some degree, even demand stimulus has come back, but in a quite different language and political context. It has been used in a conservative version by Reagan, with an emphasis on military spending, and briefly attempted in a somewhat nationalist, leftist version by François Mitterrand in France. But with diffusion has come weakness, both as an economic principle (can demand stimulus be used with already massive deficits? Does it aid in sector-specific economic adjustment?) and as a political one (how does it define friends and enemies? Is it progressive or conservative?).

The conflicts around Keynesian ideas are not over, and their end points are not clear. It is premature to say that the coalitions formed in the 1930s and 1940s are over. It is not premature to say that they are in a process of mutation. What a study of these decades does show about the political origins of Keynesian ideas is precisely the importance of politics in shaping the adoption, use, and rejection of these ideas.

Here, as in any case of economic policy making, the problems of mobilizing support for policy are crucial. Politicians sitting at the center of state decision making must find support for policies from a number of actors who have varying modes of resistance or assistance at their disposal. Economic actors can impose their will at times and in certain ways. In general terms, though, they need policies from states, and thus they need politics and politicians. Political leaders are needed to construct coalitions to produce results.

Crises are times of danger, as the career of Adolf Hitler constantly reminds us. But they are also moments for hope, as Swedish social democracy suggests. The future always requires imagination. Politicians require imagination to find new ways of linking their goals to policy options. Interest group leaders need imagination to find new ways of defining friends and enemies, and the terms of trade of alliances. Social scientists require imagination to conceptualize policy options, social categories, ideologies, historical structures, and the various ways these can combine.

In a multivariate analysis, there are two poles of possible interpretation: a deterministic mode, in which large forces move sluggishly to confine and define actors; and a voluntarist mode, in which many things are possible and people make choices and shape their destiny. As metaphors both have relationship to reality. The deterministic side expresses one's pessimism. Things drift badly. The voluntarist side is optimistic. People can make things better. The heroes of this tale are those activists who thought up combinations that linked progressive political ideals with the realities of markets and power: Wigforss in Sweden, Woytinsky in Germany, Bevin and Keynes in Britain, and Roosevelt in the United States. Creativity can be demonic, as with Hitler or Stalin. But even demons have lessons to teach, and from them we can learn whether there are ways to avoid them.

5

KEYNES, KEYNESIANISM, AND STATE INTERVENTION

Donald Winch

> When my new theory has been duly assimilated and mixed with politics and feelings and passions, I can't predict what the final upshot will be in its effect on action and affairs.
>
> The task of keeping efficiency wages reasonably stable . . . is a political rather than economic problem.
>
> I do not doubt that a serious problem will arise as to how wages are to be restrained when we have a combination of collective bargaining and full employment. But I am not sure how much light the kind of analytical method you apply can throw on this essentially political problem.
>
> —JOHN MAYNARD KEYNES

THE ABOVE statements provide a convenient starting point for some reflections on the connections, contingent or otherwise, between Keynesian economic management and state structures and capacities. There may also be some merit in being reminded at the outset of something that all too easily gets forgotten later, namely that what we now regard as Keynesianism, with or without a qualifying adjective of some kind, and Keynes' own views are not necessarily the same thing. For whereas the meanings of the various types of Keynesianism are subject to variation and multiplication according to empirical or ideological need, what Keynes himself was maintaining at any given time ought to be capable of being established within fairly strict limits. Indeed, much of what follows is based on the assumption that there is still something to be said for an approach which begins by taking serious account of Keynes' views on the political and administrative implications of what he was advocating, even though many of his comments on these subjects were often parochially British in character and the expe-

I am grateful to former collaborators, Susan Howson and Donald Moggridge, as well as to Peter Clarke for helpful comments on an earlier version of this chapter. But my chief debt is to Peter Hall, who has gone well beyond the call of normal editorial duty to suggest more ways of strengthening and clarifying the underlying argument than I have been able to adopt.

rience of operating Keynesian-style policies in different national settings has moved matters on considerably since his death in 1946.

The first of Keynes' statements cited above comes from a well-known and immodest letter written to Bernard Shaw in 1935 proclaiming the revolutionary character of the work that he was in the process of finishing.[1] With "institutions and state capacity" substituted for "feelings and passions," it could perhaps serve as a fitting epigraph for this volume. The boast certainly reminds us that Keynes was well aware of the nontechnocratic dimension of the intellectual revolution we associate with his name. The second and third quotations belong to 1943 and 1944, respectively, and they are sometimes linked together as evidence that Keynes was acutely conscious of the problem that has dogged postwar economic policy making in Britain—the problem of restraining wage increases which are in excess of productivity improvements.[2] These two statements can be used, therefore, to answer charges that Keynes was unaware of, or indifferent to, likely problems of controlling inflation under full employment conditions. It is also clear that they can be made to serve a more ironic purpose: it was precisely the failure to find a solution to this "essentially political problem" that was one of the main reasons for the collapse of the Keynesian consensus in Britain in the 1970s.

During the Second World War Keynes was partly harking back to interwar debates centering on the gold standard and reiterating the position which he had upheld since 1925, namely, that wage policy was a domestic political issue which should not be subject to determination by external pressures imposed by the international monetary system. He was also reacting to existing full employment conditions which created particular difficulties on the wage front for nonauthoritarian capitalist regimes. During the war these difficulties had been mitigated by a measure of trade union incorporation and an extensive system of physical and other controls. The postwar "political" problem to which he was addressing himself, therefore, was still broadly that expressed in the "Concluding Notes on the Social Philosophy to Which the General Theory Might Lead," namely, how to reconcile full employment with control of inflation by means that were "domestic" yet did not infringe on "efficiency and freedom."[3] Keynes' last comments on this problem reveal no loss of faith in intellectual methods ("insufficiency of cleverness, not of goodness, is the main trouble"), but at the same time

[1] John Maynard Keynes, in D. Moggridge, E. Johnson, and E.A.G. Robinson, eds., *The Collected Writings of John Maynard Keynes* (London: Macmillan, 1971–), 13: 492–93 (hereafter JMK); and for a similar statement belonging to the same year, 21: 348.

[2] The first quotation can be found in JMK, 26: 38, and the second is taken from a letter to a contributor to the *Economic Journal* dated April 1944, which is cited in D. E. Moggridge, *Keynes* (London: Macmillan, 1980), p. 30.

[3] See JMK, 7: 381.

no claim to have found the answer ("one is also, simply because one knows no solution, inclined to turn a blind eye to the wages problem in a full employment economy").[4]

Keynesianism and State Intervention

These introductory remarks can be read as a reminder that, especially for historical purposes, Keynesian techniques of macroeconomic management should be clearly distinguished from other types of economic planning, not least because they were conceived by their chief architect as alternatives to more *dirigiste* forms of state intervention. While there is nothing sacrosanct about the precise patent taken out by Keynes, any inquiry into the policy relevance of his ideas which fails to distinguish between them and the far more heterogeneous factors that underlie the expansion in the scope and size of the public sector during the twentieth century is likely to begin off-course. This extends to welfare state policies, the case for which in Britain, of course, predates anything associated with Keynesianism by three or four decades. There are subtle interconnections of an economic and political nature between Keynes' macroeconomic aims and the extension of the welfare state, especially with regard to automatic stabilization through unemployment and other social security benefits. There are also more historically contingent connections which can be documented in the British case by reference to the collaboration between Keynes and Beveridge during the Second World War.[5] And there is little doubt that the two dimensions of state responsibility have become more closely intertwined since Keynes' death as a result of postwar "quasi-corporatist" developments. Nevertheless, it is still worth preserving some distance between Keynes' ideas on economic management, its aims and instrumentalities, and other meliorist or reformist arguments which might include the creation or extension of a centrally funded welfare state. When commentators speak of "social Keynesianism" or of "the Keynesian full-employment welfare state," there is no difficulty in establishing what they mean; but the connections with Keynes can no more readily be taken for granted than the opposite, namely, treating him as the father of what is often referred to, in disparaging tones, as "commercial," "corporate," or "bastard" Keynesianism.[6]

[4] JMK, 27: 384–85.

[5] See JMK, 27: chap. 4; J. Harris, *William Beveridge: A Biography* (Oxford: Clarendon Press, 1977); P. Addison, *The Road to 1945: British Politics and the Second World War* (London: Jonathan Cape, 1975); and T. Cutler, et al., *Keynes, Beveridge and Beyond* (London: Routledge & Kegan Paul, 1987).

[6] "Commercial" Keynesianism is attributed to R. Lekachman, *The Age of Keynes* (New York: McGraw-Hill, 1966) and is generally used to describe U.S. forms of Keynesianism based on nondis-

There has always been a brand of Keynesianism, best illustrated at an early stage in the United States by the upholders, during the 1930s and beyond, of the Hansen thesis of "secular stagnation," which equates Keynesianism with a permanent increase in the state's responsibilities in all spheres, including, of course, the provision of welfare as a public good. Propitious though such attitudes might seem for the development of a U.S. version of "social Keynesianism," there can be no doubt about Keynes' antipathy to the antibusiness sentiment which much of this aspect of New Deal thinking entailed.[7] Nor is it difficult to demonstrate Keynes' consistency in distinguishing his position from that of advocates of detailed economic planning. It is implicit, for example, in his warning to Roosevelt not to confuse recovery measures with reformist aims. It is also manifest in his scepticism toward the "restrictionist" philosophy underlying the National Recovery Administration's codes; and in his relative indifference to nationalization, rationalization, and the planning movement in Britain during the 1930s, with its underlying corporatist assumptions.[8] In other words, provisionally at least, there is a traditional distinction between macroeconomic management in the Keynesian manner, designed to exercise general control over the economic environment, and more detailed forms of intervention designed to modify economic ownership and control, influence the allocation of economic activities and redistribute benefits, which often extend well beyond anything envisaged by Keynes. Without a reasonably firm benchmark of this kind, it is difficult to separate essential features of Keynesian economic management from more contingent connections and later accretions.

Keynesianism and State Capacity

The limited ends sought by Keynes were also reflected in his attitude toward political and administrative means, which might be described as a minimalist or

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cretionary fiscal policies. "Bastard" Keynesianism is a term popular among left-Keynesians, and usually connotes forms of thinking within the economics profession which have robbed Keynes of his radical message. The meaning attached to "corporate" Keynesianism can be gauged from Geoffrey Barraclough's association of this with those economists who are engaged in "reassembling the Keynesian approach to demand management to suit the needs of the well-organized interests which employed them"; see R. Skidelsky, ed., *The End of the Keynesian Era* (London: Macmillan, 1977), p. 111.

[7] See, for example, Keynes' letter to Roosevelt in 1938 in JMK, 21: 438.

[8] See JMK, 21: chap. 4; and D. Winch, *Economics and Policy: A Historical Study* (London: Fontana, 1972), chap. 10–11. Keynes' support for rationalization schemes during the 1920s was contingent on the existence of the gold standard. For an attempt to disentangle Keynes from later associations of a similar kind, see A. Cairncross, "Keynes and the Planned Economy" in A. P. Thirlwall, ed., *Keynes and Laissez-faire* (London: Macmillan, 1978).

purely technocratic view of state capacity. As the leading sales representative for his own ideas during the 1930s, and especially when operating in international markets, Keynes frequently suggested that one of the main virtues of his product was its compatibility with a broad range of constitutional arrangements and politicoeconomic cultures. The most controversial instance of this was his preface to the German translation of *The General Theory*, where he stated that his theory of output as a whole was "much more easily adapted to the conditions of the totalitarian state than is the theory of the production and distribution of a given output under conditions of free competition and a large measure of laissez-faire."[9] Technocratic claims were also made by the Keynesian economists who wrote the United Nations report on *National and International Measures for Full Employment* in 1949: "The implementation of a full-employment policy along the lines of these recommendations does not require any alteration in the political system and institutions of any country" (*Report*, par. 178).

Minimizing the required constitutional adaptations went hand in hand with the separate claim that Keynesian aims and methods were also apolitical in the partisan sense. Their presentation as such undoubtedly mirrors some of Keynes' more optimistic perceptions of the role of scientific expertise in policy matters. Here is a typical example drawn from a contribution he made in 1929 to the official discussions which led to the creation of the Economic Advisory Council attached to the prime minister's office:

> [the Council] would make a transition in our conception of the function and purpose of the State, and a first measure towards the deliberate and purposive guidance of the evolution of our economic life. It would be a recognition of the enormous part to be played in this by the scientific spirit as distinct from the sterility of the purely party attitude, which is never more out of place than in relation to complex matters of fact and interpretation involving technical difficulty. It would mean the beginning of ways of doing and thinking about political problems which are probably necessary for the efficient working of modern democracy. For it would be an essay in the art of combining representative institutions and the voice of public opinion with the utilisation by Governments of the best technical advice in spheres where such advice can never, and should not have, the last word or the power, but must be a necessary ingredient in the decisions of those entrusted with the last word and with power.[10]

In the case of Britain one could argue that the required changes in the state's capacity to adopt and implement Keynesian policies were in fact minimal. Only

[9] JMK, 7: xxvi.

[10] See S. K. Howson and D. Winch, *The Economic Advisory Council 1930–39: Economic Advice During Depression and Recovery* (Cambridge: Cambridge University Press, 1977), p. 21.

a palace revolution was required, where the palace in question was represented by one department of state, the Treasury. It entailed the collection of official statistics relating to national income and its components in the form suggested by Keynes' theory; and the establishment of new organs of economic intelligence, appraisal, and advice operating in close conjunction with those civil servants with day-to-day responsibility for preparing the Chancellor of the Exchequer's annual budget and monitoring the results of economic policy.[11] By virtue of its position at the apex of the civil service the Treasury already exercised some control over other spending departments, which left only coordination with the Bank of England over debt management, exchange-rate policy, and interest rates as the remaining condition for implementing Keynesian-style policies.[12] A unitary political system in which Parliament was dominated by an executive commanding strong party discipline completes the minimalist picture.

That such a system corresponded with Keynes' own preferences and understanding can also be gleaned from his incidental observations on the U.S. alternative. He was struck by the number and quality of the economists he found occupying key roles in various branches of the administration in 1941.[13] When negotiating the final stages of Lend Lease in 1944–1946, however, he commented on the disadvantages of a system in which civil servants operated in a public goldfish bowl, unprotected by the doctrine of ministerial responsibility, and in which, as a result of the division of powers and the existence of multiple, competing agencies, it was difficult to establish what national policy was on any given issue—a worry that was echoed by U.S. supporters of the 1946 Employment Act.[14]

[11] It should be noted, however, that the revolution in Britain has technocratic origins which began with the Committee on Economic Information in the 1930s, a body attached to the prime minister's office, followed by Josiah Stamp's Surveys of War Plans, and finally by the economic section of the cabinet office. The attachment of the economic section to the treasury did not take place until 1947; see Howson and Winch, *Economic Advisory Council*, 107–9, 157–58.

[12] The blandness of this statement should not be taken as an indication that the diffusion of Keynesianism in Britain can be examined without significant reference to the Bank of England. For studies of the monetary dimension, see D. E. Moggridge, *British Monetary Policy, 1924–31: The Norman Conquest of $4.86* (Cambridge: Cambridge University Press, 1972); D. E. Moggridge and S. Howson, "Keynes on Monetary Policy, 1910–46," *Oxford Economic Papers* 26, 2 (1974), pp. 234–42; S. K. Howson, *Domestic Monetary Management in Britain, 1919–38* (Cambridge: Cambridge University Press, 1975); and R. S. Sayers, *The Bank of England, 1891–1944* (Cambridge: Cambridge University Press, 1976). Commenting on the portrait of the minimalist position given in this paragraph, Donald Moggridge has also pointed out that it underestimates the extent of interdepartmental collaboration required in the collection of data and the implementation of policies. What he aptly describes as a "treasury-fixated" view, however, is one for which Keynes must accept some responsibility.

[13] JMK, 23: chap. 5.

[14] See, for example, JMK, 24: 208-9; and for U.S. worries on this score, S. K. Bailey, *Congress*

Keynes had played a major role as advocate for, and participant in, the improvements in economic advice and intelligence which were initiated in Britain during the 1930s; and these early initiatives provided the foundation for the system employed during the Second World War.[15] The 1944 White Paper on Employment Policy, therefore, might be said merely to have consolidated a position already achieved. It now seems significant that when a committee on the machinery of government reviewed the position of economists in 1942, Keynes and other economists with wartime experience were, for the most part, content to endorse existing arrangements; they gave no support to an ambitious and potentially more *dirigiste* scheme for employing economists in government propounded by Beveridge in his evidence to the committee.[16] Acceptance of responsibilities for economic management, it would seem, entailed nowhere near the extent of change in both machinery and personnel required by the creation of the Victorian administrative state, which in its turn became the basis for further changes when the welfare responsibilities of the state were expanded before and after the First World War.[17]

Bureaucratic Resistance to Keynesianism

At this point, however, any student of the interwar record in Britain will be struck by the paradox contained in the minimalist view of state capacity given so far. The apparent ease with which the capacity to implement Keynesian economic management was established during and after the war has to be squared with the abundant evidence of political and bureaucratic resistance to the formulation and pursuit of Keynes-inspired policy initiatives during the interwar period—where, once again, a simple contrast between economic "activism" by the state and

Makes a Law: The Story Behind the Employment Act of 1946 (New York: Columbia University Press, 1950).

[15] See R. Stone, "The Use and Development of National Income and Expenditure Estimates," in D. N. Chester, ed., *Lessons of the British War Economy* (Cambridge: Cambridge University Press, 1951); D. N. Chester, "The Central Machinery for Economic Policy,"; in *Lessons of the British War Economy* (Cambridge: Cambridge University Press, 1951); R. S. Sayers, *Financial Policy, 1939–45* (London: HMSO, 1956); and Howson and Winch, *Economic Advisory Council*, pp. 151–52, 164.

[16] On this episode, see A. Booth and A. W. Coats, "Some War-time Observations on the Role of Economists in Government," *Oxford Economic Papers* 32 (1980), pp. 177–99.

[17] For bibliographic information on this, see G. Sugherland, ed., *Studies in the Growth of Nineteenth-Century Government* (London: Routledge, 1972); V. Cromwell, ed., *Revolution or Evolution: British Government in the Nineteenth Century* (London: Longman, 1977); J. R. Hay, *The Origins of Liberal Welfare Reforms, 1906–1914* (London: Macmillan, 1975); and R. Davidson and R. Lowe, "Bureaucracy and Innovation in British Welfare Policy, 1870–1945," in W. J. Mommsen, ed., *The Emergence of the Welfare State in Britain and Germany, 1850–1950* (London: Croom Helm, 1981), pp. 264–77.

laissez-faire will not help, especially for the period after 1931. After all, while British attachment to budgetary orthodoxy was perhaps more public, even more persistent than elsewhere in the 1930s, that decade also saw the abandonment of free trade along with the gold standard, and the inauguration of interventionist policies with regard to "special areas" in matters of industrial organization. The Conservative governments of the period deserve a good part of the bold judgment passed on them by Samuel Beer: "In their reassertion of state power over the operation of the economic system as a whole, they not only broke with fundamentals of British policy in the previous hundred years, but also created many patterns of government action which, in spite of important modifications, have been followed since that time."[18] Moreover, although Keynes sought and obtained political support from those who might be loosely described as center-progressives in each of the three main parties, support for budgetary orthodoxy, and hence suspicion of Keynes' views, was also an all-party matter. The National Government formed under Ramsay MacDonald may not have fully earned its adjective, but it was initially based on a coalition drawn from all three parties, and its most impressive electoral result was achieved in 1931 by going to the country on a platform which had budgetary orthodoxy at its heart.

Bureaucratic resistance to Keynesian aims and methods was more articulate and probably more significant. It was partly based on opposition to the employment of outside experts within government, especially when such experts might duplicate or interfere with the work of those with clear-cut responsibilities and everyday administrative duties.[19] Questions of caste or *esprit de corps* that have frequently been raised when dealing with the relative imperviousness of the British civil service to "imported ideas" of a nonpragmatic variety could also be relevant here.[20] But the more important, definitely better-documented evidence of resistance to Keynesian ideas centers on the doctrine, attitude, or set of rules of thumb known as the "Treasury view," against which much of Keynes' intellectual and polemical effort was directed from 1929 onwards. In addition to his many attempts to refute the economic theory behind this view, Keynes left us

[18] See S. H. Beer, *Modern British Politics: A Study of Parties and Pressure Groups*, 2d ed. (London: Faber & Faber, 1965), p. 277.

[19] See Howson and Winch, *Economic Advisory Council*, p. 22. A separate but related set of issues surrounds official support for the collection of statistics, including national income. On this see Stone, "Use and Development," and "Keynes, Political Arithmetic and Econometrics," Seventh Keynes Lecture, in *Proceedings of the British Academy* 64 (1978), pp. 55–92; D. Patinkin, "Keynes and Econometrics: On the Interaction between the Macroeconomic Revolutions of the Inter-War period," *Econometrica* 44 (6), (1976), pp. 1091–1123; and L. Cuyvers, "Keynes' Collaboration with Erwin Rothbarth: A Contribution to the History of British National Accounting," *Economic Journal* 93, (1983), pp. 629–36.

[20] See, for example, J. P. Neggl, "The State as a Conceptual Variable," *World Politics* 20 (1968), pp. 559–92.

with a powerful diagnosis of what he took to be the civil service mentality accompanying it:

> the present heads of our Civil Service were brought up in, and for the most part still adhere to, the *laissez-faire* tradition. For constructive planning the civil servants are, of course, much more important than Ministers; little that is worth doing can be done without their assistance and good will. There has been nothing finer in its way than our nineteenth-century school of Treasury officials. Nothing better has ever been devised, if our object is to limit the functions of government to the least possible and to make sure that expenditure, whether on social or economic or military or general administrative purposes, is the smallest and most economical that public opinion will put up with. But if that is not our object, then nothing can be worse. The Civil Service is ruled today by the Treasury school, trained by tradition and experience and native skill to every form of intelligent obstruction. And there is another reason for the heads of the Service being what they are. We have experienced in the twelve years since the War two occasions of terrific retrenchment and axing of constructive schemes. This has not only been a crushing discouragement for all who are capable of constructive projects, but it has inevitably led to the survival of those who are particularly fit for retrenchment and retreat, and who are, therefore, unfit for energetic expansion. Great as is my admiration for many of the qualities of our Civil Service, I am afraid that they are becoming a heavy handicap in our struggle with the totalitarian states and in making ourselves safe from them. They cramp our energy, and spoil or discard our ideas.[21]

Coming from a consistent critic of orthodox "sit-tight" solutions, this statement might seem to contain little out of the ordinary, apart from confirming Keynes' "elitist" perspective on government. But when its date (1939) is taken into account, it becomes more interesting. For by that time Keynes had spent nearly a decade in close contact with Treasury officials as a member of the Committee on Economic Information; and there is some evidence to suggest that he had succeeded in shifting the position of one or two senior officials toward his point of view.[22] Moreover, Keynes' pessimistic conclusion was quickly proved wrong by experience in running the British war economy, and more especially by the successful introduction of the first Keynesian-style budget in 1941, which

[21] JMK, 21: 496–97. A similar diagnosis belonging to the same period can be found on pp. 571–72, but is expressed more moderately: "My belief is that the Treasury, though a bit scared of up-to-date methods, have no settled convictions against them. . . . But the trouble is that they have no really strong convictions in favour of them, with the result that their action will be half-hearted. And a half-hearted policy may have the disastrous result, not only of failing, but of bringing discredit on a policy which would have been perfectly successful if carried through wholeheartedly."

[22] See Howson and Winch, *Economic Advisory Council*, chap. 5.

made full use of inflationary-gap analysis supported by the relevant national income estimates.[23] Nevertheless, the statement is fairly accurate as a broad description of the Treasury mentality in the interwar period, and it contains some explanatory clues which have been followed up in the recent revisionist literature on the "Treasury view" considered less as an economic doctrine and more as a rationale for coping with the political and administrative difficulties faced by civil servants in implementing active spending programs.[24]

A proper treatment of this literature would entail a comprehensive survey of the problems of the British economy after 1918. As Keynes himself was fully aware, Britain's role as an international financial center constituted a major constraint on domestic action under the gold standard, especially when this became entangled with questions involving the postwar burden on the budget of debt-servicing obligations and rising unemployment expenditure. It also helps to explain the Treasury emphasis on self-liquidating public investment proposals, and the consequent belief that few projects of this type could be initiated rapidly. Keynes' hints concerning the effect of retrenchment campaigns (1921–1922 and 1930–1932) can be supplemented by Treasury fears about forms of expenditure that might become open-ended or self-perpetuating, thereby making their traditional bureaucratic role in controlling expenditure more difficult to fulfill. This was consonant with their unwillingness to expand central government initiatives at the expense of local authority autonomy and at the risk of bringing charges of bureaucratic imperialism down on their heads. A kind of anti-Parkinsonian law was at work, and it was buttressed by an interpretation of orthodox monetary policy which emphasized its "knave-proof" or apolitical qualities, and a "structural" or supply-side emphasis on cost reduction and the importance of not competing with the "normal channels of trade" (the private sector). In this expanded form it becomes easier to understand the persistence of the "Treasury view," and why Keynes was correct in his assessment that it would be "politically impossible for a capitalist democracy to organise expenditure on the scale necessary to make the grand experiment which would prove my case—except in war conditions."[25]

[23] See Sayers, *Bank of England*; and Stone, "Use and Development."

[24] See G. C. Peden, "Keynes, the Treasury and Unemployment in the Later Nineteen-Thirties," *Oxford Economic Papers* 32 (1980), pp. 1–18; "Sir Richard Hopkins and the 'Keynesian Revolution' in Employment Policy, 1929–1945," *Economic History Review* 36 (1983), pp. 167–81; "The 'Treasury View' on Public Works and Employment in the Interwar Period," *Economic History Review* 37, 2 (1984), pp. 167–81; R. Middleton, "The Treasury in the 1930s: Political and Administrative Constraints to Acceptance of the 'New' Economics," *Oxford Economic Papers* 34 (1982), pp. 49–77; "The Treasury and Public Investment: A Perspective on Interwar Economic Management," *Public Administration* 67 (1983), pp. 351–70; *Towards the Managed Economy: Keynes, the Treasury and the Fiscal Policy Debate of the 1930s* (London: Methuen, 1985); and A. Booth and M. Pack, *Employment, Capital and Economic Policy: Great Britain, 1918–1939* (Oxford: Blackwell, 1985).

[25] JMK, 22: 149. Structural diagnoses of the persistence of economic orthodoxy in Britain during

Those earlier historians, myself included, who were primarily concerned with the relationship of economic argument to policy may have been guilty of over-identifying with Keynes' way of seeing his official opponents as suffering from intellectual muddle and short-sightedness, bearing in mind one of his descriptions of the "Treasury view" as "the natural result of standing half-way between common sense and sound theory."[26] We were also influenced, no doubt, by writing during what can now be seen as the optimistic high summer of the Keynesian consensus, the late 1960s and early 1970s. Our successors have responded to a very different kind of present reality which includes modern monetarism and the "new classical" macroeconomics. Seen from this perspective, the Keynesian and Treasury positions can be made to appear closer to one another than they really were, particularly if one goes back to the earliest versions of the Treasury position. The recent discovery of other official papers by senior civil servants advising the Chancellor of the Exchequer during the election of 1929, when the "Treasury view" was given its most extensive public airing, would certainly appear to confirm the earlier "doctrinal" interpretations of this attitude and episode, namely, that increased public expenditure was held to be incapable of raising employment levels because it was either inflationary or entailed diversion of funds from private investment.[27]

Moreover, some of the revisionist literature runs the historiographic risk described by the phrase, *tout comprendre, c'est tout pardonner*, a form of overdetermination that is characteristic of some of the more all-encompassing treatments of the "Treasury view" which make it impossible to conceive of *any* choices based on alternative sources of information or forms of knowledge being adopted. If the earlier pro-Keynesian historiography was marred by exaggerated voluntarism and intellectualism, the revisionist literature frequently suggests an excessively passive, even deterministic view of policy making. Although there is room for legitimate difference of opinion as to when the changes in Treasury thinking took place, and how far this had gone by 1939 or 1944 or even 1947, the archival material clearly reveals that the presence of Keynes and other economists in government significantly shifted the nature of Treasury discussions and priorities in Keynes' direction—though perhaps falling short of what is implied in "conversion."

A further feature of some of the revisionist literature on the Treasury view in the 1930s is its narrow focus on unemployment and public works. This restricts

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the interwar period can be found in P. Hall, *Governing the Economy: The Politics of State Intervention in Britain and France* (Oxford: Blackwell, 1986), and Bradford Lee's contributions to this volume.

[26] JMK, 20: 130.

[27] This statement is based on a treasury file (T 172/2095) entitled "Cure for Unemployment Memoranda of 1928-9" which has only become available in the last year or so. I am grateful to Dr. Peter Clarke for drawing it to my attention and for sending me copies of its contents.

the interpretation of Keynes' position by identifying it with fiscal policy alone at the expense of his general contribution to the case for self-conscious economic management—a case which he began to mount in the mid-1920s with special reference to monetary policy, long before the onset of worldwide depression. This narrowing of attention could also account for such perverse conclusions as the following, namely, that while Keynesianism "had clearly become the dominant discourse of economic policy-making," there has never actually been a Keynesian revolution in British economic policy.[28]

The Anglo-Swedish Dimension

Any comparative perspective on interwar policy and experience which takes in Britain, the United States, and Sweden usually confirms the peculiarity and strength of Britain's attachment to orthodox budgeting. The extensive literature belonging to the 1930s and testifying to the attempt to learn from others' experience now has its modern equivalents. The fact that in Britain and Sweden parties committed to socialism held or shared power, and did so within comparable parliamentary arrangements and under what can be treated as comparable economic conditions—the British Labour government in 1929–1931 and the Swedish Social Democrats from 1932 onward—adds an intriguing dimension to the contrasting fortunes of the two parties and political systems. Anglo-Swedish comparisons certainly feature strongly in recent work by Peter Gourevitch and by Margaret Weir and Theda Skocpol, who have made use of the extensive secondary literature on the background to the Swedish experiment in loan-financed contracyclical public works to mount comparative exercises capable of illustrating their respective theoretical positions.

In both cases some fairly strong counterfactual conclusions are deduced. Thus Gourevitch concludes that if the British Labour government had adopted demand-stimulus policies by entering into an alliance with the Liberal party, "British politics would have looked more like the Swedish variety, dominated by labor for a couple of generations."[29] Weir and Skocpol, less interested in coalitions than in state structures and "pre-existing legacies of public policies" as explanatory variables, adopt a similar starting point by maintaining that as far as its

[28] See J. Tomlinson, "Why Was There Never a 'Keynesian Revolution' in Economic Policy?," *Economy and Society* 10 (1981), pp. 73–87; and "A 'Keynesian Revolution' in Economic Policy-Making?," *Economic History Review* 37 (1984), pp. 258–62. For comment, see A. Booth, "Defining a 'Keynesian Revolution'," *Economic History Review* 37 (1984), pp. 263–67.

[29] P. Gourevitch, "Breaking with Orthodoxy: The Politics of Economic Policy Responses to the Depression of the 1930's," *International Organisation* 10, 38 (1984), pp. 95–129.

parliamentary situation was concerned, "the British Labour Party enjoyed *greater* maneuvering room for launching a deficit-spending economic recovery strategy immediately after it came to power in 1929."[30] Addressing themselves to the obvious lack of synchronization involved in the comparison, they also maintain that the British Labour government could have acquired the same degree of freedom to carry out domestic reflationary policies as the Swedish Social Democrats possessed after the worldwide collapse of the gold standard in 1931—if it had been prepared to abandon the gold standard as an act of policy. Since neither political nor economic circumstances are regarded as having posed insuperable barriers to the acceptance and implementation of Keynesian-style policies, the different policies actually pursued in the two countries can be attributed to differing state capacities and policy traditions.

While agreeing with Weir and Skocpol that political choices should not be reduced "to the dictates of economic circumstances," I would argue that these analyses drastically underestimate the cross-pressures and problems facing the British Labour government when it took power in 1929 and later had to deal with the 1931 crisis.[31] They also overestimate the political and intellectual support that could have been marshalled in favor of expansionist measures and devaluation at the precise moments when choices were required.[32] It follows from this that the question of timing—the crucial difference between a Swedish government that came to power *after* the collapse of the gold standard and a British government that was destroyed as a result of events leading up to that collapse—cannot be disposed of as easily as they suggest. Economic circumstances may not have had a determining role, but the order in which the relevant economic events occurred, and the way in which their significance could be assessed by those capable of making decisions, matters more to the process of international diffusion of ideas than has been suggested in these accounts.

Once more, the understanding of a major participant is of value here and could modify the judgment passed on British failures. The memoirs of Ernst Wigforss,

[30] M. Weir and T. Skocpol, "State Structures and the Possibilities for 'Keynesian' Responses to the Great Depression in Sweden, Britain, and the United States," in P. B. Evans, D. Rueschemeyer and T. Skocpol, eds., *Bringing the State Back In* (Cambridge: Cambridge University Press, 1985), pp. 113–14.

[31] One of the reasons for this could be their reliance on R. Skidelsky, *Politicians and the Slump: The Labour Government of 1929–1932* (London: Macmillan, 1967), rather than a later study of the policies of the second Labour government which makes full use of public record office material; see W. H. Janeway, "The Economic Policy of the Second Labour Government 1929–1931" (Ph.D. diss., Cambridge University, 1971).

[32] For example, Weir and Skocpol ("State Structures," p. 120) state that "some voices of all persuasions" were advocating departure from the gold standard. However, it is hard to think of more than three advocates of this policy—and this does not include Keynes, who only accepted departure when it was inevitable.

the finance minister and chief intellectual architect of the Swedish Social Democrats' expansionist program, provide a fascinating source, not simply for lines of influence and those issues of theoretical priority which have interested historians of economic thought, but for explicit contemporary hypotheses on the very questions which are at stake here. Wigforss was more sympathetic to the problems faced by Ramsay MacDonald and the British Labour government than subsequent historians, including Weir and Skocpol, have been:

> The Swedish Social Democrats were favoured by fate when they were given an opportunity to take hold of the situation when the crisis had reached rock bottom and the forces of revival were once again beginning to make themselves felt. Our own contributions to that situation, in spite of their relatively modest scope, were effective support for the upsurge. Who knows if we should have dared or been able to intervene with any hope of success if we, like the English, had taken power just before the economic situation crashed from the heights into world-wide crisis.[33]

The Swedish Social Democrats were also in a position to learn from the way in which the MacDonald government was first forced by events to concede its incapacity to carry out its electoral promises and later split by disagreements over whether to adopt orthodox remedies. Wigforss reports that within the Swedish party there was understanding if not sympathy for the way in which MacDonald and Snowden had been forced to adopt "responsible" policies. But his conclusion was that the episode chiefly served as a "sharp warning signal," awakening "slumbering socialistic instincts" and leading to a revival of interest in policies of socialization and state control of industry.[34] The realization that such policies might not be effective in dealing with unemployment and would probably not attract general public support during the election of 1932 was part of the process by which the Swedish party assimilated the lessons of the MacDonald government and settled on the budgetary measures for which they are now regarded as pioneers. The Swedish Social Democrats could learn some lessons from British experience precisely because it was the fate of a *socialist* government that was settled in 1931. Like any other single variable, the lesson may not have had a determining influence, but its availability to one party rather than the other needs to be added to the other important evidence surrounding the more propitious circumstances enjoyed by the Swedish Social Democrats in 1932 when compared with those faced by their British counterparts in 1929–1931.

An important part of Weir and Skocpol's argument turns on the contrast be-

[33] E. Wigforss, *Minnen* (Stockholm, 1950–1954), 3: 62. My translations here and elsewhere.
[34] Wigforss, *Minnen*, 2: 362–63.

tween the respective policy legacies of the two countries: British debate became focused on the conditions under which unemployment insurance operated, while Swedish socialists, having failed to obtain parliamentary support for an equivalent system of unemployment insurance, focused their attention on public works as an alternative which the Swedish state was well equipped to implement. This was to prove, they maintain, "a better bridge towards proto-Keynesian macroeconomic strategies than did prior struggles over the terms on which individuals would receive unemployment benefits."[35]

Wigforss, once more, offers some interesting reflections on these differences between Britain and Sweden, though it is noticeable that when writing in the interwar period he thought of the contrast as one entailing an "advanced" country like Britain, where unemployment insurance enjoyed all-party support, and a "backward" country like Sweden, which had to content itself with a debate confined to the terms on which relief work could be made available to the unemployed. As Karl-Gustav Landgren was the first to stress in his reinterpretation of the political and intellectual career of the "new economics" in Sweden, Wigforss arrived at these conclusions on the basis of extensive reading of the work of English "New Liberals" during the 1920s, including the famous "Yellow Book" and Keynes' contributions to the 1929 election literature on the feasibility of Lloyd George's public investment program.[36] Wigforss had argued in the 1920s that the boundaries between the English type of "new liberalism" and socialism were by no means fixed, and his writings on this subject helped to form the climate which led to the abandonment of the Marxist base of Swedish Social Democratic thinking at the end of that decade. But he employed a quasi-Marxian insight to record the compensating advantages Sweden enjoyed as a result of late industrialization and relative political "backwardness" when compared with Britain. There, all parties had attracted "proletarian" voters, and circumstances had been propitious for the development of a "left-inclined" form of liberalism. By contrast, in Sweden the Social Democrats provided a natural and undisputed repository for the electoral hopes and sympathies of the wage-earning classes, and for all those other forces of moderate reform that were most conducive to "progress."[37]

So far the argument seems to be more congenial to the Gourevitch approach to the problem through coalition strategies and the mobilization of social groupings. The Weir-Skocpol thesis might, however, be accommodated by saying that

[35] Weir and Skocpol, "State Structures," p. 125.

[36] See K. G. Londgren, *Den 'nya' ekonomien' i Sverige: J. M. Keynes, E. Wigforss, B. Ohlin och utvecklingen, 1927–39* (Stockholm: Almqvist & Wicksell, 1960); and D. Winch, "The Keynesian Revolution in Sweden," *Journal of Political Economy* 74, 2 (1966), pp. 168–76.

[37] Wigforss, *Minnen*, 2: 266–68.

state capacity and policy inheritance have a part to play in the choice between policies that are otherwise of similar attractiveness to the members of a coalition. Like most of their English confrères during the 1920s, the Swedish Social Democrats demanded "work or maintenance"; they believed that relief works and unemployment insurance were feasible short-run expedients that could be achieved under capitalism, prior to the more thoroughgoing socialist transformation of the future. Of these two, unemployment insurance was the "superior" remedy, but since the parliamentary route toward this was blocked in Sweden, the Social Democrats built, whether consciously or unconsciously, on the "work" alternative, which also entailed expanding on the proven capacity of the Swedish state in organizing public works. By this means one appears to reach the same conclusion as Weir and Skocpol: "Both parties [British and Swedish] simply reacted to the existing means their national states had for coping with unemployment and its human effects," though a good deal depends on whether the Swedish state was indeed better equipped to implement public works (or better-disposed in some sense), and on whether this capacity can legitimately be regarded as the actual "bridge" that was used in getting toward the policies accepted and actually adopted by the Swedish Social Democratic government after 1932. More research is necessary to establish the validity of these points, but it does not seem likely that "simply reacted" will describe the process by which it occurred.

My own doubts can be expressed most briefly by two sets of observations, the first concerning the policy inheritance in Britain, the other relating to the nature of the actual program implemented by the Social Democrats during the thirties.

There was a respectable English lineage for public works policies which can be traced back to the minority report of the Royal Commission on the Poor Laws (1909). More important, Britain had equipped itself with a means of planning road expenditure on a contracyclical basis at much the same time, thereby becoming one of the first countries to move in this direction. Largely as a result of the Fabian credentials of the minority report, public works became part of official Labour party policy during the 1920s; and such policies were in fact employed by governments of differing complexions during this period. Far from being a novel departure then, public works policies were, if anything, overfamiliar. By 1925 the official verdict on the experience gained in this field was becoming unfavorable, chiefly because it had become difficult during a period of chronically high unemployment (widely regarded as being due to "structural" defects more or less peculiar to the British economy) to defend what were either thought to be contracyclical remedies for an acute condition, or, worse still, as clumsy mechanisms for making relief payments of a more or less degrading character.

Hence the need felt by advocates of public spending solutions in the late 1920s, such as Keynes and the Lloyd George Liberals, to distinguish their proposals from these earlier diagnoses and experiments; and the connected attempt which was made to shift attention toward national as opposed to local government appraisal, implementation, and financing of public investment projects.

On this subject Weir and Skocpol have treated Keynes' arguments for public works over the whole period, 1924 to 1932, as though they were interchangeable reactions to the same problem, employing an unchanging and uniformly cogent set of reasons.[38] It may be that the Swedish state was more effective in organizing public works policies during the same period, but the experience with such policies in Britain, and the changing nature of the intellectual rationale provided during the second half of the 1920s needs to be taken into account. It is certainly not a matter of interest to historians of economic thought alone. The Social Democrats appear to have begun by taking the familiar trade union line of attacking the payment of below-union wages to workers on public projects. The Swedish debate within the Unemployment Commission also seems to have been conducted along lines that were duplicated in Britain. Hence the significance of Landgren's research in showing that the English Liberal literature was instrumental in providing the Swedish Social Democrats with novel arguments for combatting scepticism on public works. Thus when the party adopted a public spending program in 1930, Wigforss defended its budgetary implications by means of arguments derived from Keynes' defense of Lloyd George's proposals in 1929. At this stage Keynes' arguments were designed to support a much-needed boost to an economy which had lost powers of motion. In other words, unlike the minority report proposals, his case went beyond a purely "compensatory" contracyclical program, whereby existing commitments were rephased, or ordinary and extraordinary budgets were distinguished, with the former being balanced on an annual basis and the latter being allowed to balance over the length of the cycle.[39] The architects of the Swedish policy adopted the more radical version of these ideas, but were prevented by parliamentary opposition from going beyond a contracyc-

[38] Weir and Skocpol, "State Structures," pp. 125–26 have followed R. Harrod, *The Life of John Maynard Keynes* (London: Macmillan, 1951) on this matter; but see D. Winch, *Economics and Policy: A Historical Study* (London: Fontana Books, 1972), pp. 112–18; D. Moggridge and S. K. Howson, "Keynes on Monetary Policy, 1910–46," *Oxford Economic Papers* 26, 2 (1974), pp. 234–42; and P. Clarke, "The Politics of Keynesian Economics, 1924–1931," in M. Bentley and J. Stevenson, eds., *High and Low Politics in Modern Britain* (Oxford: Clarendon Press, 1983).

[39] Failure to notice the difference between earlier minority report-style arguments and later Keynesian ones is one of the weaknesses of Steiger's [*Studien Zur Entstehung der neuen Wirtschaftslehre in Schweden: Eine Antikritik* (Berlin: Dunker and Humbolt, 1971)] attempt to dislodge features of Landgren's reinterpretation; see B. Gustafsson, "A Perennial of Doctrinal History: Keynes and the 'Stockholm School'," *Economy and History* 16 (1973), pp. 114–28.

lical budget: the crisis loan contracted in 1933, and largely spent in the following year, was repaid out of taxes, allowing a balanced overall budget to be presented in 1935. In view of the fact that unemployment remained around 10 percent, the Social Democrats could hardly fail to be aware that the "bridge" they had been forced to use left them well short of their final destination, a commitment to full employment and what Keynes was to describe as "permanent boom." A mixture of intellectual conviction, frustrated or tempered by parliamentary realities, therefore, still seems to explain the course of events better than policy inheritance.

Intervention and the Consequences of Keynes

Having rehearsed some issues that belong to an earlier phase in the adoption of Keynesian economic management, we close by considering briefly more recent experience in which the gap between macroeconomic management along Keynesian lines and more directly interventionist forms of state action seems to have narrowed. The economic logic of Keynesianism in its original guise may not have entailed the simultaneous extension of welfare policies by the state, but there may be some political implications that require, in some sense, a move in this direction. When the technocratic interpretation of state capacity associated with Keynes himself is mixed with politics, can Keynes' own minimalist position be sustained? Are not left-Keynesians (and their monetarist opponents for that matter) correct in believing that the logic of Keynesianism leads to greater intervention, such that what may have begun as macroeconomic management requires extension into microeconomic intervention to ensure success? Essentially the same observation underlies Peter Hall's recent diagnosis of the politics of British economic decline: acceptance of Butskellite, or consensual forms of Keynesianism, of minimalist and purely macro-oriented forms of economic management, initially led to income policies and modest forms of industrial policy under Wilson. Nevertheless, the continuing emphasis on demand management left Britain with what he describes as "the most arms-length industrial policy in Europe" and a consequent incapacity to achieve industrial rationalization.[40] It is not so much a case of goodness becoming more important than cleverness as of a different kind of cleverness being needed to solve the "essentially political problem."

Samuel Beer was one of the first commentators to diagnose that the managed economy and the welfare state were closely connected aspects of British eco-

[40] See Hall, *Governing the Economy*, chap. 4.

nomic policy: both entail a "new group politics" as a means of mobilizing producer and consumer groups for purposes which he classifies as advice, acquiescence, and approval.[41] This "quasi-corporatist" development can now be most readily studied by concentrating on the issue of wages or income policies. Successive postwar (pre-Thatcher) governments have attempted to enlist the participation of trade unions and employer associations to assist them in their attempts to control the inherent inflationary bias in a system of voluntary collective bargaining—a bias which has, contrary to earlier (Phillips curve-based) expectations, operated under conditions of high as well as low rates of unemployment.

There have always been those, chiefly on the left, who have maintained that Keynesianism needs to be supplemented, where not replaced, by more extensive measures of public ownership and control. The British war economy provided them with a good example of the reciprocal relationship between Keynesian monetary and fiscal policies on the one hand, and rationing and physical controls on the other. But if the control of wage increases under peacetime conditions seems to require the striking of some kind of bargain, even a "social contract" involving welfare and other legislative concessions, between the state and one of the major producer groups (as represented, say, by the TUC), then we have clearly moved a considerable distance from the minimalist, yet basically autonomous conception of state capacity outlined earlier.

The checkered history of wage policies is a crucial element in the story of economic management since 1945.[42] Keynes' interest in the problem was not confined to a few pious warnings at the end of his life. Indeed, much of his work in the interwar period can be interpreted as an attempt to deal with an asymmetric wage problem in the context of an open economy. He was also interested in wage policy directly: for example, in 1930 he was toying with what he called "insular socialism," an idea which involved stabilizing money wages by means of a bargain that entailed compensating increases in the "social wage" (social services and progressive taxation).[43] When campaigning for his plan of war finance in 1940 he made special efforts to gain the support of trade union leaders by including in his policy of deferred pay such concessions as family allowances to the low-paid, a postwar capital levy, and the stabilization of basic items in the cost-of-living index.[44]

[41] S. Beer, *Modern British Politics: A Study of Parties and Pressure Groups*, 2d ed. (London: Faber & Faber, 1969), chap. 12.

[42] See G.D.N. Worswick and P. H. Ady, *The British Economy in the Nineteen-Fifties* (Oxford: Clarendon Press, 1962); J.C.R. Dow, *The Management of the British Economy, 1945–60* (Cambridge: Cambridge University Press, 1964); and F. T. Blackaby, ed., *British Economic Policy, 1960–74: Demand Management* (Cambridge: Cambridge University Press, 1978).

[43] JMK, 20: 3–16, 359–69.

[44] JMK, 22: chap. 2.

The instrumentalities for implementing wage policy have been at the core of much of the literature dealing with the resurgence of corporatism in advanced capitalist countries since the war, where the Keynesian commitment to full employment is often treated as an essential feature of the new situation.[45] Britain's failure to achieve stable forms of bipartite or tripartite corporatism at the enterprise or economy level has frequently been the subject of unfavorable comparisons with Germany and Sweden, respectively. Thus Heclo has compared the positive contribution made by the Swedish LO to the formation of "an integrated labour-market approach" with the far less creative role played by the British TUC. Andrew Martin has dealt with more recent Swedish developments and difficulties in this field, and has done so by treating Sweden as an archetypal kind of Keynesian economy in which political equilibrium has been sustained by a wide variety of forms of state intervention. His conclusion that the process of evolution "has reached a turning point, at which it is no longer possible to maintain full employment without institutional changes that would seriously encroach on the capitalist character of [the Swedish] economy" neatly brings the subject back to Keynes' vague mention of "a somewhat comprehensive socialisation of investment" in *The General Theory*, giving it a more collectivist flavor than Keynes perhaps hoped for.[46] Half a century of almost unbroken government by the Social Democrats, with their special relationship to the blue-collar unions, encourages the use of an evolutionary analogy; and, as in the British case, one wonders how far the trend requires the persistence of a stable constellation of political parties.

The very fact that diagnoses of the failures of bi- or tripartite bargaining in Britain run along fairly predictable ideological lines is merely another indication of the disappearance of the Keynesian consensus. Thus studies such as those by Leo Panitch continue to treat the partial and short-lived successes of corporatism as evidence of the occasional willingness of trade union leaders to sacrifice the "natural" interests of their working class membership to class enemies, as represented, however indirectly, by the state.[47] Robert Currie has introduced a "cultural" dimension into his study of the activities of organized labour which turns

[45] See P. Schmitter and G. Lehmbruch, eds., *Trends Toward Corporatist Intermediation* (London: Sage, 1979); and S. Berger, ed., *Organizing Interests in Western Europe: Pluralism, Corporatism, and the Transformation of Politics* (Cambridge: Cambridge University Press, 1981).

[46] A. Martin, "Dynamics of Change in a Keynesian Economy: The Swedish Case and Its Implications," in C. Crouch, ed., *State and Economy in Contemporary Capitalism* (London: Croom Helm, 1979), p. 170.

[47] L. Panitch, *Social Democracy and Industrial Militancy: The Labour Party, the Trade Unions and Incomes Policy* (Cambridge: Cambridge University Press, 1976); and "The Development of Corporatism in Liberal Democracies," in P. C. Schmitter and G. Lehmbruch, eds., *Trends Toward Corporatist Intermediation* (London: Sage, 1979). The same perspective informs B. Jessop, "Corporatism, Parliamentarism and Social Democracy," in P. Schmitter and G. Lehmbruch, eds., *Trends Toward Corporatist Intermediation* (London: Sage, 1979).

on the dogged persistence of "utilitarian liberal-democratic individualism" within trade unions when presented with various "collectivist" solutions to the problems of industrial society which call for the sacrifice of sectional self-interest in return for responsible control or participation. Within such a culture corporatism merely becomes an alternative means of pursuing "higher sectionalism," so that while organized labour in Britain has consistently attempted to "industrialize" politics, it has assiduously resisted attempts to "politicize" industry.[48]

While Currie provides a refreshingly different perspective on the problem, his position is inconclusive, since his notion of the collective interests associated with wage policies remains vague and often little more than a patriotic appeal to the interests of Great Britain Ltd. One of the attractions of the present monetarist regime to its supporters lies in its promise of bypassing the troublesome issues involved in any wage policy: monetary weapons and targets control the inflation rate, leaving the determination of employment/unemployment to supply-side factors and the results of wage bargaining. Trade unions operating outside the public sector, where wage control is exerted via cash limits, are thrust back into the market realm of bilateral monopoly bargaining—the realm which, ironically, is most readily endorsed by the leaders of stronger unions. One can only speculate about a post-Thatcher policy regime, especially one in which the Labour party may no longer wish, or even be in a position to reinstate the TUC as a contractual partner by restoring the legal immunities and other privileges which have been eroded. It is certainly of interest to note from a historian's perspective that Keynes' relationship to the Liberal party in the three-party system of the interwar period contains some parallels with James Meade's current attempt, under Liberal-Social Democratic Alliance auspices, to find a solution to the wage problem that will bridge the gap between monetarism and the now-outdated forms of Keynesianism.[49]

[48] R. Currie, *Industrial Politics* (New York: Oxford University Press, 1979).
[49] J. E. Meade, *Wage Fixing* (London: Allen & Unwin, 1982).

6

THE MISCARRIAGE OF NECESSITY AND INVENTION: PROTO-KEYNESIANISM AND DEMOCRATIC STATES IN THE 1930S

Bradford A. Lee

SHERLOCK HOLMES WAS on to something of academic significance when he apprised Watson of how important it was that the dog had not barked during the night. In researching the past for the purposes of social science, one may find it illuminating to concentrate on what did not happen. That especially holds true for an attempt to reconstruct the translation of Keynesian ideas into the economic policy of democratic states. The puzzle in that story is why a fluent translation took so long to materialize in any full and sustained manner. The point of this essay is to examine the 1930s as an early turning point that did not turn in the long, irregular pattern of the adoption of Keynesianism.

The theoretical context in which this slice of history fits is that of "policy innovation." But that is a context without many useful texts from which to draw. Historical descriptions abound of the trajectories that particular ideas have followed from conception to agenda and then on to policy; general theoretical propositions abstracted from, or tested against, specific cases have not developed apace.[1] The most venerable theory, that which invokes the "second face" of power, has to do with what commonly does not happen by way of innovation, with how certain ideas or demands have ended up shunted aside in the early stages of the "policy cycle" either because they were at odds with some estab-

[1] Among the best of such historical descriptions are two by economists who deal with Keynesianism: Herbert Stein, *The Fiscal Revolution in America* (Chicago: University of Chicago Press, 1969); and Donald Winch, *Economics and Policy* (London: Hodder & Stoughton, 1969; rev. ed., London: Fontana, 1972). An exemplary study that adds theory to historical description is Hugh Heclo, *Modern Social Politics in Britain and Sweden* (New Haven: Yale University Press, 1974). Of the works that strive for greater theoretical effect, the most recent is Nelson Polsby, *Political Innovation in America* (New Haven: Yale University Press, 1984). More narrowly conceived but illuminating is Jack L. Walker, "Setting the Agenda in the U.S. Senate: A Theory of Problem Selection," *British Journal of Political Science* 7 (Oct. 1977), pp. 423–45. See also Peter A. Hall, "Policy Innovation and the Structure of the State: The Politics-Administration Nexus in France and Britain," *Annals of the American Academy of Political and Social Science* 466 (March 1983), pp. 43–59; and John Kingdon, *Agendas, Alternatives, and Public Policies* (Boston: Little, Brown, 1984).

lished ideological orthodoxy or ran afoul of procedural biases in policy-making institutions imparted by vested interests.[2] As critics of this theory have pointed out, in practice it is a highly problematic exercise to prove, and even more to disprove, the operation at any given juncture of the second face of power. Later we shall explore whatever ideological and institutional obstacles of this sort there may have been to the adoption of a Keynesian policy in the United States, Britain, and France in the 1930s. First, however, we must consider the reasons for supposing that such an eventuality, such an ascent of new macroeconomic ideas to the commanding heights of the policy-making heap, was in fact a real possibility in the circumstances of the time. In other words, we must convince ourselves that there is a genuine puzzle awaiting our solution.

As the point of departure, we shall take not an elaborate, well-specified theory—none exists yet that is suitable for our purposes—but instead two pieces of folk wisdom. One is the aphorism that "necessity is the mother of invention." The other is the cliché about "an idea whose time has come." Both invite our attention to the interaction of concept and circumstance as the mechanism that drives policy innovation. The first main section of this essay will address the issue of "invention," in the sense of new concepts of macroeconomic management that academic economists and others were pushing upon policy makers well in advance of the publication of *The General Theory of Employment, Interest and Money* in 1936. The basic argument in this section is that "proto-Keynesian" concepts were very much part of public discourse before the mid-1930s and that we ought to take this neglected development in intellectual history more seriously than has been the case so far. There were actually ideas waiting for their time to come.

The second section of the essay will take up the issue of "necessity," in the sense of compelling "objective" circumstances that militated in favor of an acceptance by policy makers of deficit financing in the 1930s. Even beyond the felt need to "do something" about the massive unemployment and destitution brought on by the Great Depression, political leaders found themselves caught in an extraordinary fiscal crunch, a crunch whose painful and far-reaching repercussions could most easily have been evaded by an adoption of Keynesian budgetary notions. Thus, in more than one sense, the times were seemingly propitious to the new ideas that lay in wait.

The final section of the essay leads off with a synopsis of how far U.S., Brit-

[2] Peter Bachrach and Morton S. Baratz, "Two Faces of Power," *American Political Science Review* 56 (Dec. 1962), pp. 947–52. For an attempt to apply this theory, see Matthew A. Crenson, *The Un-Politics of Air Pollution* (Baltimore: University of Maryland Press, 1971). For a critique of the theory and this application of it, see Nelson W. Polsby, "Empirical Investigation of the Mobilization of Bias in Community Power Research," *Political Studies* 27 (Dec. 1979), pp. 527–41.

ish, and French leaders did, in the event, deviate from strict fiscal "orthodoxy." That deviation, however unappreciated it remains in the conventional wisdom about the 1930s, should scarcely be surprising in light of the appearance of new concepts and the pressure of extraordinary circumstances. Still, it not only fell far short of being a "Keynesian revolution" in economic policy, but also left the policy makers in the grip of the fiscal crunch. The final section of the essay goes on to sort out, and discriminate among, various hypotheses—many of them the usual suspects—that might account for the discomfort which the leaders of democratic states felt with overt or prolonged budgetary imbalance. We conclude by teasing out of the welter of possibilities a fresh hypothesis: in the minds at least of some of the key leaders, the discomfort arose from a deep-seated concern with preserving the core of the autonomy of the modern state in the face of pressures from either strategically placed elites or numerically potent masses in democratic society.

Invention: Cranks, Scribblers, and Proto-Keynesianism

To the victors go the historical spoils. That creates problems for a historian trying to understand what really happened. In reconstructing an intellectual revolution, one must be wary of swallowing the claims of those who triumphed. They may slight the contributions of precursors, allies, or ostensible opponents. They may give a misleading picture of precisely how they won and what was at stake. And they may inflate the ultimate significance of their accomplishment.[3]

Such problems have long plagued historical interpretation of the Keynesian revolution in its theoretical and policy aspects. Many of them have their origin in what Keynes himself said, or did not say, in *The General Theory*. His attack on "the classical theory" distorted the state of the art in economics as of the 1930s. To be sure, in chapter 23, he presented a gallery of heretics, but he did not even mention the immediate precursors whose ideas came closest to those of his theory, and still less did he indicate how widely such ideas had already circulated.

If classical (or, more precisely, "neoclassical") theory still constituted the mainstream of abstract economic discourse in the first third of the twentieth century, a more empirical cross-current had surged up by the late 1920s: business-cycle theory. It did not represent an anticipation in any coherent sense of the

[3] For a suggestive discussion of one extreme case in which myths came to surround an intellectual revolution, see Frank J. Sulloway, *Freud: Biologist of the Mind* (New York: Basic, 1979), chaps. 12–13. On one set of myths that arose from the Keynesian revolution, see T. W. Hutchinson, *On Revolutions and Progress in Economic Knowledge* (Cambridge: Cambridge University Press, 1978), pp. 175–99.

Keynesian "revolution" in its theoretical aspects. But reconciling the implications of work on business cycles with the tenets of classical theory was no easy matter.[4] And it was not a difficult feat to draw inferences from the business-cycle literature that would point governments toward measures later associated with Keynes' policy ideas. In a survey in 1927 of a wide range of business-cycle theories, Wesley C. Mitchell highlighted how many of them were "ways of explaining why the people of a country sometimes cannot or will not buy at profitable prices all they produce. . . ."[5] From that point no great leap of intuition was necessary for even an intellectually sluggish policy maker to reach the conclusion that one means of countering slumps was to inject additional purchasing power into the economy.

The most widely read proponents of this new economics at the time are among the least remembered today: William T. Foster and Waddill Catchings—as U.S. amateur-economists, good specimens of what Keynes once called "cranks."[6] Two of their four books in the 1920s ran through several editions; fifty thousand copies of one edition of their *The Road to Plenty* (1928) were published. Most of their dozens of articles appeared in popular periodicals; one of those articles was distributed by the hundreds of thousands in reprint form. Their syndicated columns were carried in eighty newspapers.[7]

To get the serious attention of the economics profession, Foster and Catchings offered a prize of $5000 for the best criticism of their book *Profits* (1925) and recruited eminent economists to judge the contest.[8] But it was policy makers above all whom Foster and Catchings were eager to influence. Their most promising effort in that regard came in November 1928, at a conference of U.S. state governors, just after the election of Herbert Hoover as president. Introduced by

[4] See, for example, Simon Kuznets, "Equilibrium Economics and Business-Cycle Theory," *Quarterly Journal of Economics* 44 (May 1930), pp. 381–415; Paul T. Homan, "The Impasse in Economic Theory," *Journal of Political Economy* 35 (Dec. 1927), pp. 776–803; and the letter from Gottfried Haberler to Keynes, 3 April 1938, in Donald Moggridge, ed., *The Collected Writings of John Maynard Keynes*, vol. 29, *The General Theory and After: A Supplement* (London: Macmillan, 1979).

[5] Wesley C. Mitchell, *Business Cycles* (New York: Bureau of Economic Research, 1927), p. 35.

[6] John Maynard Keynes, *A Treatise on Money* (London: Macmillan, 1930), I: 100.

[7] A good source of information on Foster and Catchings is Joseph Dorfman, *The Economic Mind in American Civilization*, vol. 4 (New York: Viking, 1959), pp. 339–50. See also F. A. von Hayek, "The 'Paradox' of Saving," *Economica* 32 (May 1931), pp. 125–69, esp. pp. 126–28, 134, 136n. Widener Library at Harvard has a bibliography of writings by Foster, which includes work that he did jointly with Catchings.

[8] Pollak Foundation for Economic Research, *Pollak Prize Essays* (Newton, Mass.: Pollak Foundation for Economic Research, 1927), contains a description of the contest, four of the critical essays judged to be the best, and comments on the essays by Foster and Catchings. The judges included two recent presidents of the American Economics Association, one of whom was Wesley Mitchell, the preeminent professional expert on business cycles at the time.

Governor Ralph Owen Brewster of Maine, who invoked the authority of a telegram from the president-elect and who claimed to "know Mr. Hoover has given a large measure of assent" to the ideas of Foster and Catchings, Foster presented the rationale for a countercyclical economic plan that Brewster outlined in the name of Hoover. The plan involved a coordinated program of public works by the federal and state governments as soon as what passed then for "leading indicators" gave the signal to act; the goal was to regulate "the consuming power of the people" so as to maintain full employment.[9] Reporting to Hoover on the public response to the presentation, Brewster noted that "[t]he volume of friendly comment was an indication that the field had been somewhat plowed and that there was a rather widespread public sympathy with thought along these lines."[10]

If the methods by which this dynamic duo promoted ideas were ahead of their time, what about the ideas themselves? Foster and Catchings represented the pre-Keynesian culmination of the modern stream of underconsumption theory that had been loosed by A. F. Mummery and J. A. Hobson in *The Physiology of Industry* (1889) and that had developed into the most powerful current of the new wave of business-cycle studies which had become so prominent by the late 1920s. Though Keynes himself did not acknowledge their contribution, they also may have represented in some ways the proximate bridge between that wave and his work of 1936.[11]

[9] Morning session, 21 Nov. 1928, *Proceedings of the Twentieth Annual Session of the Governors' Conference* (New Orleans, 1928), pp. 65–84. Foster and Catchings had sent copies to Hoover of their two most important works, *Profits* (Boston: Houghton Mifflin, 1925) and *The Road to Plenty* (Boston: Houghton Mifflin, 1928). See the letters of acknowledgment from Hoover aides: Harold Phelps Stokes to Foster, 27 March 1926, and George Akerson to Pollak Foundation, 16 Jan. 1928, Commerce Papers, Hoover MS, Herbert Hoover Presidential Library, West Branch, Iowa. (I am grateful to George Nash for finding these documents for me.) Also, around the time of the publication of *The Road to Plenty*, Foster had a conference in Washington with Hoover and eleven other government officials about the ideas that he and Catchings had developed. See Foster's recounting of support from Hoover for those ideas at the meeting, in *Proceedings of the Twentieth Annual Session of the Governors' Conference*, p. 79. It should be noted, however, that Hoover was probably using Foster and Catchings politically at least as much as they were influencing him intellectually. As Secretary of Commerce in 1921, before they had written anything on business cycles, he had orchestrated an increase in public construction to counter the recession of 1920–1921. When Hoover moved to step up public works in late 1929 after the crash on Wall Street, Foster and Catchings were effusive in public praise of the president's countercyclical policy. For that praise, see William Trufant Foster and Waddill Catchings, "Mr. Hoover's Road to Prosperity," *Review of Reviews* 81 (Jan. 1930), pp. 50–52.

[10] Letter from Brewster to Hoover, 2 Jan. 1929, Campaign & Transition Papers, Hoover MS.

[11] My exposition of the theory developed by Foster and Catchings is based on their two books cited in note 9 above and on their two most important articles, "The Dilemma of Thrift," *Atlantic Monthly* 137 (April 1926), pp. 523–43, and "Progress and Plenty: A Way Out of the Dilemma of Thrift," *Century Magazine* 116 (July 1928), pp. 257–68. The best secondary account of their theory is Alan H. Gleason, "Foster and Catchings: A Reappraisal," *Journal of Political Economy* 67 (April 1959), pp. 156–72.

Like Keynes after them, and like other underconsumption theorists before them, Foster and Catchings attacked Say's Law, the notion that (as they restated it) "the very process of putting goods on the market—payments of wages, interest, dividends and the rest—induces a flow of money to consumers sufficient to take the goods off the market."[12] Their explanation of shortfalls of actual from potential output was that corporations did not distribute all earnings to consumers and that consumers in turn did not spend all income. Their conclusion played up the need for "a flow of money to consumers which, after providing for individual savings, would always be approximately equal to the flow of finished goods."[13]

Compare this conclusion with the core of Keynes' argument as summarized in chapter 3 of his *General Theory*: "to justify any given amount of employment there must be an amount of current investment sufficient to absorb the excess of total output over what the community chooses to consume when employment is at the given level." Full-employment equilibrium was possible only when "current investment provides an amount of demand just equal to the excess of the aggregate supply price of the output resulting from full employment over what the community will choose to spend on consumption when it is fully employed."[14] What Keynes highlighted here, and what Foster and Catchings introduced only less systematically, was the crucial role of investment. But in developing their theory, if not in summarizing it, Foster and Catchings did capture the importance of investment as an offset to the excess of aggregate supply over consumption: "as long as capital facilities are created at a sufficient rate, there need be no deficiency of consumer income. To serve that purpose, however, facilities must be increased at a constantly accelerating rate. . . ."[15] The problem in practice was that as the business cycle developed, businessmen would come to doubt that future consumer demand would grow at the pace necessary to sustain additional investment.[16] Using his concept of the marginal propensity to consume, Keynes later put the point in this way: "since when our income increases our consumption increases also, but not by so much[,] . . . it follows from this that the greater the volume of employment the greater will be the gap between the aggregate supply price . . . of the corresponding output and the sum . . . which the entrepreneurs can expect to get back out of the expenditure of consumers." In these circumstances, "the increased employment will prove

[12] Foster and Catchings, "Progress and Plenty," p. 259. For examples of their attacks on Say's Law, see *Profits*, p. 232, and *Road to Plenty*, pp. 31, 122ff.

[13] Foster and Catchings, "Dilemma of Thrift," pp. 537–41; the quotation is from p. 541. See also *Profits*, p. 364.

[14] John Maynard Keynes, *The General Theory of Employment, Interest and Money* (London, 1936; my citations are from the Harcourt Brace and World 1965 paperback edition), pp. 27–28.

[15] Foster and Catchings, *Profits*, p. 413.

[16] Foster and Catchings, "Dilemma of Thrift," p. 538.

unprofitable unless there is an increase in investment to fill the gap." But "[n]ew capital-investment can only take place in excess of current capital-disinvestment if *future* expenditure on consumption is expected to increase. Each time we secure to-day's equilibrium by increased investment we are aggravating the difficulty of securing equilibrium to-morrow."[17] Though Keynes expressed himself in more formal language than Foster and Catchings, the basic idea was the same.

If investment could not always be relied upon to offset insufficient consumer demand, what could? Foster and Catchings stressed the same compensating factor that Keynes was to put forward: government spending in excess of tax revenues.[18] In short, by the late 1920s, they had already developed the rudiments of a Keynesian theory of the determination of national income. Though their work lacked the rigor and depth, the elegantly articulated underpinnings, of *The General Theory*, they provided enough of a theoretical base to support proposals for macroeconomic management strikingly akin to later Keynesian notions. In 1928, they called for a Federal Budget Board that could bring about an increase in spending on public works when leading indicators sagged. They were very clear on the point that deficit financing of countercyclical outlays was essential.[19] They did not explicitly develop a multiplier concept, but they did appreciate that government spending would have cumulative and far-reaching repercussions.[20]

In the prehistory of the Keynesian revolution, Foster and Catchings are the most important figures upon which to focus, because they were so widely known and because they were the first to marry sophisticated theoretical formulations with proto-Keynesian policy proposals. But many other economists were bandying about similar proposals, even if they could not yet match them with their theoretical commitments as harmoniously as Foster and Catchings.* As early as 1929, in a critique of the ideas of Foster and Catchings, Friedrich von Hayek apprehended that "[t]he effect of their teaching on popular opinion is less remarkable when it is considered that proposals of a more or less inflationist tendency—less extreme, perhaps, but in substance exactly similar—are put forward

[17] Keynes, *General Theory*, pp. 29–30, 98, 105. See also the formulation in a draft that Keynes did in mid-1934: *Collected Writings*, 13: 438.

[18] See, for example, Foster and Catchings, "Progress and Plenty," pp. 260–61..

[19] Foster and Catchings laid out their policy proposals in *The Road to Plenty*, esp. pp. 101–2, 106–7, 153–62, 182–96, and, more compactly, in "Progress and Plenty."

[20] Foster and Catchings, "Better Jobs and More of Them: The Government's Part in Preventing Unemployment," *Century Magazine* 118 (July 1929): p. 281; and "The New Attack on Poverty: Mr. Hoover's Plan: What It Is and What It Is Not," *Review of Reviews* 79 (April 1929), pp. 77–78.

* Turning a famous wisecrack of Keynes to my own use, I shall designate as "scribblers" those professional economists whose advocacy of countercyclical fiscal policies in public outran their source of support in their own academic theory. According to this usage, Keynes himself was very much a scribbler prior to *The General Theory*, as we shall see presently.

to-day by economists of very high repute. They are the prevalent fashion of contemporary economics."[21]

It was in the United States that such "scribblers" were most numerous. Indeed, J. Ronnie Davis has asserted that in the early 1930s "a large majority of leading U.S. economists" favored a proto-Keynesian fiscal policy. In the absence of a comprehensive survey done at the time, it is hard to have a high degree of confidence in such an assertion, but Davis does have some suggestive evidence: in January 1931, ninety-three economists joined with fifty-eight mayors in publicly endorsing the idea of a $1-billion public works program financed by government borrowing; a year later, thirty-one economists came out in support of the campaign by publisher William Randolph Hearst for a deficit-financed program of $5 billion; and in the spring of 1932, when Senator Robert Wagner made the broadest contemporary survey of economists' opinions, he found that a great proportion of the respondents (many, though, with reservations) spoke positively about his legislative efforts on behalf of a long-term bond issue to finance public works amounting to over $1 billion. One response was especially revealing. Frank H. Knight, a thoroughgoing neoclassicist in his own theoretical work (and later a hostile critic of *The General Theory*), told Wagner that "[a]s far as I know, economists are completely agreed that the Government should spend as much and tax as little as possible at a time such as this. . . ."[22]

The opinions of professional economists in the United States, however insistently they were thrust into public discourse, lacked bureaucratic representation within the Hoover administration. More than any other U.S. president before or since, Hoover was conversant with the work of the economists of his time, but he did not recruit them, by and large, into his regular policy-making machinery. From 1933 on, economists did make their way into the government bureaucracy in considerable numbers, and among them Keynesians *avant la lettre* are not hard to find. Jacob Viner, a colleague of Knight at the University of Chicago and an energetic advocate of compensatory fiscal policy in the early 1930s (but later a critic of *The General Theory*), moved into the Treasury Department. Lauchlin Currie, who became the Assistant Director of Research and Statistics for the Federal Reserve Board in 1934, was one of several young economists who migrated

[21] Hayek, " 'Paradox' of Saving," p. 168. The original German version of this article was published as "Gibt es einem 'Widersinn des Sparens'?" in the *Zeitschrift für Nationalökonomie* 1 (Nov. 1929), pp. 287–429.

[22] J. Ronnie Davis, *The New Economics and the Old Economists* (Ames, Iowa: Iowa State University Press, 1971), p. 6, for the quotation about "a large majority," pp. 10–11 and 15–24 for the three pieces of evidence that I summarize, and p. 16 for Knight's response. William J. Barber, *From New Era to New Deal: Herbert Hoover, the Economists, and American Economic Policy, 1921–1933* (Cambridge: Cambridge University Press, 1985), pp. 151–55, refines Davis's picture of the responses to Wagner's survey.

to Washington from Harvard, where the climate created by senior economists was harsh for those with proto-Keynesian inclinations. As for nonacademic economists in the Roosevelt administration who were sensitive to the need to stimulate demand, one might note Isador Lubin from Brookings, Leon Henderson from the Russell Sage Foundation, and Alexander Sachs from Lehman Brothers. Except for Currie (who had studied in England) and Sachs (who had been in close touch with R. F. Kahn in the spring of 1933), these economists seem to have developed their ideas independently of any significant influence from Keynes. But none of them, in Roosevelt's first term, was yet in a position to have much direct influence on fiscal policy.[23]

Like Hoover, though, Roosevelt was quite aware of the arguments for stimulating demand by increasing government spending. In view of the wide circulation of such ideas by the early 1930s, it would have been remarkable if they had remained unfamiliar to any U.S. political leader. And there was one proto-Keynesian in high office before 1936 who could directly impress upon Roosevelt a sophisticated rationale for deficit spending. That was Marriner S. Eccles, whom Roosevelt had appointed as governor of the Federal Reserve Board in 1934. Eccles was a banker, not an economist, and his fiscal conceptions were derived not from Keynes, but from Foster and Catchings.[24]

It is no wonder, then, that Herbert Stein found it possible to describe the incipient "fiscal revolution" in the United States in the 1930s without giving Keynes any important role.[25] The same cannot be done for concurrent developments in Britain, for there Keynes was at center stage as the new fiscal scenario unfolded. The first act for Keynes came in 1924, when he wrote an article calling

[23] For Hoover's relationship with economists, and with social scientists more generally, see Barber, *New Era*; Guy Alchon, *The Invisible Hand of Planning: Capitalism, Social Science, and the State in the 1920s* (Princeton: Princeton University Press, 1985); and Barry Karl, "Presidential Planning and Social Science Research: Mr. Hoover's Experts," *Perspectives in American History* 3 (1969), pp. 347–409. For economists (except Sachs) in the Roosevelt administration, see Alan Sweezy, "The Keynesians and Government Policy, 1933-1939," *American Economic Review* 62 (May 1972), pp. 116–24. There is some information on Sachs in Stein, *Fiscal Revolution in America*, pp. 51–52, 474–75. A substantial part of *History of Political Economy* 10 (Winter 1978) is devoted to Currie, who in 1939 became the first professional economist to serve on the White House staff. Viner seems to have lost enthusiasm for deficit financing by late 1934. See Harold L. Ickes, *The Secret Diary of Harold L. Ickes: The First Thousand Days, 1933–1936* (New York: Simon and Schuster, 1953), p. 224.

[24] See the speeches that Eccles made and the memoranda that he sent to Roosevelt, in Official File 90, Roosevelt MS, Franklin Roosevelt Presidential Library, Hyde Park, New York. See also Marriner S. Eccles, *Beckoning Frontiers* (New York: Knopf, 1951); on p. 132, Eccles denies getting any of his ideas from Keynes. My evidence for the influence of Foster and Catchings on Eccles is Lauchlin Currie, "Comments and Observations," *History of Political Economy* 10 (Winter 1978), p. 542. Currie worked very closely with Eccles from 1934 to 1939.

[25] Stein, *Fiscal Revolution in America*, p. 131.

for the government to give "an impulse, a jolt, an acceleration" to the British economy by "promoting expenditure up to (say) £100,000,000 a year on the construction of capital works at home. . . ." He did not address the issue of how much of this expenditure should be financed by borrowing. Five years later, on the eve of the national elections of 1929, he and Hubert Henderson reached a wider audience for similar ideas in their pamphlet *Can Lloyd George Do It?* Again, the expenditure in question was on the order of £100,000,000 a year (over perhaps three years). This time, however, there was explicit acknowledgment that much of the money would be raised by borrowing.[26]

In retrospect, the most striking point about these two pieces of policy advocacy is how sparing they were of explicit reference to any theoretical base. To be sure, when the article and the pamphlet are implicated in their contemporary context, this fact is not altogether surprising. Both were written in support of initiatives by the leader of the Liberal party, David Lloyd George; they were political documents designed to induce ready assent rather than to invite sustained thought. Even so, it is remarkable that in *Can Lloyd George Do It?* Keynes went to great lengths to justify the policy proposal in terms of common sense and to scorn its opponents for resting their case on "highly abstract theories."[27] Of course, as Keynes recognized, many of the assertions in the pamphlet implied underlying theoretical propositions. Yet these were not brought to the surface—and did not necessarily form a coherent framework—though Keynes and Henderson did insist (without being specific) that they represented a consensus among economists. Even the discussion of multiplier effects was presented as "nothing fanciful or fine-spun," as simply "the A B C of economic science."[28]

All the while, from 1924 on, Keynes was working on what he presumed would be his theoretical magnum opus, *A Treatise on Money*. But when it appeared in 1930, it did little to give his ideas on fiscal policy a solid base in theory. Indeed, the treatment by Keynes of spending on public works took up only two or three paragraphs in a two-volume work of 765 pages.[29] He structured his ponderous analytical apparatus in such a way as to bring out the importance of the management of interest rates by central banks. Fiscal policy was, in this scheme, merely a second-best instrument for those countries, like Britain, which were so inte-

[26] J. M. Keynes, "Does Unemployment Need a Drastic Remedy?" *The Nation and the Athenaeum* 35 (24 May 1924), pp. 235–36; and J. M. Keynes and H. D. Henderson, *Can Lloyd George Do It?* (London: Macmillan, 1929).

[27] Keynes and Henderson, *Can Lloyd George Do It?*, p. 10.

[28] Ibid., p. 24. On p. 36, there was a foreshadowing of the main theoretical idea of Keynes' *Treatise* (1930). There was also a glimmer of theory in the discussion on p. 41 of the impact of deficit spending on interest rates.

[29] Keynes, *Treatise*, 2: 376–77, where there are two paragraphs on public works. A paragraph on pp. 186–87 also seems to refer, rather obliquely, to public works.

grated into the international economy and so constrained by their foreign balance under the gold standard that they could not risk triggering a capital outflow by an expansionary monetary policy. On a superficial level, there was an implicit theoretical justification in the *Treatise* even for such a second-best instrument: anything that boosted investment relative to savings (in Keynes' peculiar sense of the concept) would tend to stimulate the economy. But at a deeper level, the theory behind public works remained obscure.[30] When R. F. Kahn tried to fit his multiplier analysis into the framework of the *Treatise*, the results were not very edifying.[31]

Thus, by 1930, Keynes had already for six years been advocating a program of government spending to bring about full employment in Britain, but unlike Foster and Catchings he still did not have, and evidently did not yet even see the need for, a theory designed primarily to underpin such a policy. Then, from the early 1930s, a confluence of his sensitivity to the limitations of the *Treatise* (heightened for him by critical reactions from other economists) and of new circumstances arising from the Great Depression finally brought about a shift in his theoretical priorities.[32] If one searches for early published hints of the new notions that were to be fully exposed in *The General Theory* in 1936, one can find some in his *Means for Prosperity*, which appeared originally in articles in the *Times* and in the *New Statesman and Nation* in 1933 as part of an extensive campaign in the press for an expansionary fiscal policy.[33] Still, what stood before those hints in that tract was an appeal to common sense—just as in the pamphlet of 1929.[34]

By 1936, the hope that Keynes had invested in the power of common sense had been replaced by faith in the impact of abstract theory. No doubt frustrated by his lack of influence on policy as a "scribbler," he convinced himself that the problem lay in the absence of a theoretical consensus among economists. In the preface of his *General Theory*, he declared that "it is my fellow economists, not the general public, whom I must first convince"; he had "to bring to an issue the

[30] See the discussion in Don Patinkin, *Anticipations of the General Theory? And Other Essays on Keynes* (Chicago: University of Chicago Press, 1982), pp. 207–8.

[31] R. F. Kahn, "The Relation of Home Investment to Unemployment," *Economic Journal* 41 (June 1931), pp. 173–98, esp. pp. 180–82.

[32] See D. E. Moggridge and Susan Howson, "Keynes on Monetary Policy, 1910–1946," *Oxford Economic Papers* 26 (July 1974): 226–247; Susan Howson and Donald Winch, *The Economic Advisory Council 1930–1939* (Cambridge: Cambridge University Press, 1977), *passim*; Don Patinkin, *Keynes' Monetary Thought* (Durham, N.C.: Duke University Press, 1976) and *Anticipations*; and Don Patinkin and J. Clark Leith, eds., *Keynes, Cambridge and the General Theory* (London: Macmillan, 1977), especially the comments by Winch on p. 120.

[33] J. M. Keynes, *The Means to Prosperity* (New York: Harcourt Brace, 1933). There is a brief description of the press campaign in Winch, *Economics and Policy*, p. 217.

[34] Keynes, *Means to Prosperity*, pp. 4–5.

deep divergences of opinion between fellow economists which have for the time being almost destroyed the practical influence of economic theory, and will, until they are resolved, continue to do so.''[35] Thus, there was little said explicitly about policy in the book—though Keynes' underlying purpose was finally to provide a comprehensive theoretical rationale for the deficit spending that he had long advocated in vain.

Many readers have come away from *The General Theory* with the impression that virtually all of Keynes' peers in the economics profession in Britain were devotees of ''the classical theory'' and that their policy preferences flowed in a direct and orthodox manner from their theoretical commitments. In private correspondence, however, Keynes was willing to grant that some of his most eminent peers, notably Ralph Hawtrey and Dennis Robertson, were not classical theorists.[36] And an alert reader of *The General Theory* could infer from a footnote in chapter 2 that most British economists in the 1930s did not advocate policy measures that were consistent with classical theory.[37] In fact, T. W. Hutchinson later wrote that ''[i]n the early 1930s it seems that a considerable majority of university economists—and, in Britain, *very* few of any other kind then existed—broadly agreed on policies against unemployment.''[38]

As with Davis's claim about the opinions of U.S. economists, we are not in a position to confirm such a conjecture. But in the British case, there is supporting evidence similar to that for the U.S. scene: in July 1932, forty-one academic economists (according to Hutchinson, ''a considerable percentage of the total in those days'') signed a letter calling for tax cuts and government spending financed by borrowing; and in March 1933, thirty-seven economists from a variety of universities signed a further letter along the same lines.[39] We have already seen, moreover, that Keynes himself in 1929 had said that the ideas in *Can Lloyd*

[35] Keynes, *General Theory*, pp. v–vi.

[36] See the letters from Keynes to Hawtrey, 15 April 1936, and to Haberler, 3 April 1938, in *Collected Writings*, 14: 23; 29: 270. T. W. Hutchinson, in one of his essays in *On Revolutions and Progress in Economic Knowledge*, has argued (p. 172) that ''for some decades before *The General Theory* the adjective 'classical' had ceased to be applicable, in any very significant sense, to a majority of leading economists.''

[37] Keynes, *General Theory*, p. 20n. The footnote reads: ''It is the distinction of Prof. Robbins that he, almost alone, continues to maintain a consistent scheme of thought, his practical recommendations belonging to the same system as his theory.'' Actually, Lionel Robbins was one of a group of economists at the London School of Economics that, even more than senior economists at Harvard in the U.S. case, formed an academic center of resistance to proto-Keynesian ideas in Britain. On the LSE in this period, see Winch, *Economics and Policy*, pp. 158–60, 199–207.

[38] Hutchinson, *On Revolutions*, p. 165. See also Hutchinson, *A Review of Economic Doctrines 1870–1929* (Oxford: Oxford, 1953), p. 422, where he concludes that even as of 1929, ''[a] majority of economists in Britain supported the general case for public works to combat unemployment. . . .''

[39] Hutchinson, *On Revolutions*, p. 186.

George Do It? represented the consensus of expert opinion. Even A. C. Pigou, the *bête noire* of *The General Theory*, was a consistent, if sometimes cautious, advocate of large-scale public works. So was Robertson, who stood out with Keynes and Pigou in the first rank of British economists in the interwar years.[40] It is also worth noting that in Britain, prominent economists secured an institutional foothold within the government in 1930, well before that happened in the United States. The foothold was the Economic Advisory Council, and one of the early reports produced in 1930 by the economists (including Keynes and Pigou) associated with it made the case for public works, albeit in a constricted form.[41]

Thus, in Britain and the United States, there was an efflorescence of proto-Keynesian notions among economists before 1936. In France, the situation was different. Indeed, there was not much of a distinct economics profession; French economists tended to be mixed into that academic *macédoine*, the law faculty.[42] In any case, politicians in France showed less disposition than their counterparts in Britain and the United States to heed professional economists. Those economists who did work for the Ministry of Finance, such as the young Jacques Rueff, or had close connections to it, notably Charles Rist, were impeccably orthodox.[43] There were French "cranks" of an unorthodox sort. The most widely known, at least among Radicals, the pivotal political grouping, was Jacques Duboin; farther to the left, the Marxist Lucien Laurat may have made an impression on some Socialists. Though both in their different (and not very sophisticated) ways were underconsumption theorists, neither seems to have developed an interest in proto-Keynesian fiscal ideas.[44]

[40] On Pigou, ibid., pp. 162, 165–66, 175–99 *passim*; and Howson and Winch, *Economic Advisory Council*, pp. 63, 66. On Robertson, see T. W. Hutchinson, *Economics and Economic Policy in Britain, 1946–1966* (London, 1968), pp. 23–24; Winch, *Economics and Policy*, pp. 170, 215; and D. H. Robertson, "The Monetary Doctrines of Messrs. Foster and Catchings," *Quarterly Journal of Economics* 43 (May 1929), pp. 476–77.

[41] For a detailed study, see Howson and Winch, *Economic Advisory Council*, which reprints on pp. 180–243 the report to which I refer.

[42] See G. Pirou, "L'enseignement économique en France: les Facultés de droit," in Charles Rist et al., *L'enseignement économique en France et à l'étranger* (Paris: Librairie du Receuil Sirey, 1937), pp. 1–21.

[43] On Rueff in this period, see his memoirs *Combats pour l'ordre financier* (Paris: Plon, 1972). For a sense of Rist's theoretical orientation, see his *History of Monetary and Credit Theory* (New York: Augustus M. Kelley, 1966).

[44] Some of the writings in the 1930s of both Duboin and Laurat are difficult to track down today. I have found Duboin's *La grande relève des hommes par la machine* (Paris: Les Editions Nouvelles, 1932), *La grande révolution qui vient*, 2d ed. (Paris: Editions Fustier, 1936), and *Kou L'Ahuri*, 2d ed. (Paris: Editions Fustier, 1936); and Laurat's *L'accumulation du capital d'après Rosa Luxembourg* (Paris: Rivière, 1930), *Economie dirigée et socialisation* (Paris: L'Eglantine, 1934), and *Cinq Années de crise mondiale* (Paris: L'Eglantine, 1934). For summaries of their ideas, see Tihomir J. Markovitch, *Les théories modernes de la sous-consommation en matière de crises périodiques de surpro-*

Nonetheless, there were elements of the French situation that left the way open to a proto-Keynesian policy for any government so inclined. One such element was a long (if somewhat checkered) tradition of countercyclical public works in France.[45] Even more important was the fact that, for all the commitment in principle to balanced budgets after the financial crisis of the mid-1920s, French budgetary procedures were flexible in practice. There was much less of a tendency in France than in Britain or the United States to look askance at the transfer of costly programs from the formal budget to extrabudgetary accounts financed by borrowing.[46] And as one reads the press and parliamentary debates in the 1930s, one finds considerable awareness—not just among those to the left of center—that government outlays could stimulate demand. Indeed, in France at the turn of 1932–1933 there was a campaign in the press for a deliberate policy of deficit spending, much as there was in the British press shortly afterward.[47]

In none of the three major democracies, then, was a Keynesian policy *avant la lettre* out of the question simply because its potentially beneficial effects had escaped widespread notice. But given that prior to 1936 only the work of Foster and Catchings contained a substantial appeal to theory, and that even the sophistication of their theory was belied by the informality of its presentation, we need to ponder the premise of *The General Theory* that before a revolution in fiscal policy could occur, there had to be an elaborate theoretical rationale for compensatory deficit financing. Keynes postulated that economic ideas were more potent than vested interests. His provisos were that the degree of potency depended upon the development of a theoretical consensus among economists; and that such a consensus could only emerge from "a highly abstract argument" about "difficult questions of theory." In ordinary circumstances, he suggested, the process of moving from theory to practice would involve a generational lag, but in the 1930s the public, which could eavesdrop on the debate among economists, was unusually receptive to fundamental diagnoses and new remedies; hence less time

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duction (Paris: Librairie des Sciences Politiques et Sociales, 1937). For a generous estimate of Duboin's influence on radicals and of Laurat's on socialists, see Julian Jackson, *The Politics of Depression in France 1932–1936* (Cambridge: Cambridge University Press, 1985), pp. 16, 38, 48, 152.

45 Pierre Saly, *La politique des grands travaux en France, 1929–1939* (New York: Arno Press, 1977), has recently reminded us of that tradition.

46 The best way to appreciate the full extent of the flexibility of French budgetary practice is to look at the "off-budget" accounts of the Ministry of Finance from 1930 on: F30/2340–2346, archives of the Ministère des Finances, Paris.

47 The article that attracted the most attention in this campaign was in the *Petit Journal*, 2 January 1933. On the "*vive sensation*" that this article created, see *Notre Temps*, 8 January 1933. For clippings from the press in this period, see the papers of the French premier at the time, Joseph Paul Boncour: 424AP19, Archives Nationales, Paris.

than usual might be required for his new ideas to displace old modes of thought from the minds of political leaders.[48]

If it is puzzling that Keynesian ideas took so long to be translated into policy, it is also striking how quickly *The General Theory* gained a large and devoted following among economists. Well before there was firm empirical support for Keynes' key propositions, many of his professional colleagues had been seduced by the *esprit de système* of the book, by the manner in which he combined the concepts of marginal propensity to consume, liquidity preference, and marginal efficiency of capital. They could soon distill the theory into the IS-LL (later IS-LM) curves of John Hicks or transform it into the simultaneous equations of econometric models. But the abstract features of the theory that made it so attractive to economists made it bewildering to policy makers. As J. K. Galbraith said of laymen trying to understand Keynes' book: "Though comfortably aware of their own intelligence, they will be unable to read it."[49]

No doubt, as more and more economists joined the Keynesian camp, more and more policy makers took notice. But the promised land of consensus was never reached; there were always discordant "expert" voices within earshot of political leaders. That meant Keynesians had to persuade or tutor those leaders. And tutoring even liberal policy makers was not easy, as Keynes himself discovered from his meeting with Roosevelt in 1934. Virtually all political leaders then and later had a low tolerance for abstract theory. In dealing with them, Keynesians had to reduce their theory to simple terms—terms similar to those of *The Means to Prosperity* in 1933 or, indeed, of Foster and Catchings in the 1920s.

If my estimate of the process of persuasion is correct, then *The General Theory*, even reinforced by the bulk of opinion in the economics profession, was far from being a sufficient source of the ultimate revolution in fiscal policy. And though it certainly helped the cause, such an elaborate theory was not necessary either. After all, German and Japanese governments committed themselves deliberately to deficit spending in the 1930s without any sophisticated conceptual basis for doing so. At the same time, U.S., British, and French governments adopted new economic policies, notably measures involving the restriction of supply, without bothering much about a theoretical rationale. Extending one's historical perspective back past the 1930s, one can see that the impact of economic theories on economic policies has long tended to be fragmentary, with all but certain bits and pieces, certain catch phrases, typically being screened out or disfigured by

[48] Keynes, *General Theory*, pp. v–viii, 383–84.

[49] John Kenneth Galbraith, "How Keynes Came to America," in Milo Keynes, ed., *Essays on John Maynard Keynes* (Cambridge: Cambridge University Press, 1975), p. 132.

ideology.[50] And looking at the influence of a broad range of social scientific theories on government policy since the 1930s, one can find little correlation between profundity and potency.[51]

Still, as a working hypothesis, one might suppose that some modicum of conceptual gloss (or, alternatively, some veneer of empirical verisimilitude) made an idea more attractive to policy makers in the 1930s than it would otherwise have been. One might further hypothesize that just how substantial the modicum had to be depended on circumstances: the more compelling the relevant circumstances were, the less the fate of the idea in the policy arena would turn on the degree of hard thought behind it. With this plausible relationship between invention and necessity in mind, it is time to examine the two most important sets of "objective" circumstances that weighed upon U.S., British, and French policy makers in the 1930s.

Necessity: Economic Depression and Fiscal Crisis

The weight of a crushing economic collapse was the most immediately obtrusive burden on political leaders in Washington, London, and Paris. In the early 1930s, the thud was most resounding in the United States, where the Federal Reserve index of industrial production had fallen by the spring of 1932 to little more than half of its average level in 1928 and where (as we can now calculate) nominal GNP declined by over 12 percent from 1929 to 1930, over 16 percent from 1930 to 1931, and over 23 percent from 1931 to 1932. Not until 1937 did real GNP nearly recover to its annual peak in 1929, but a severe recession from May 1937 to June 1938 brought a sharper rate of decline in industrial production than even in the initial crash. Estimates of the rate of unemployment in the United States over the course of the 1930s vary widely, but it seems that on average well over one-fifth of the civilian labor force (and well over one-third of the nonfarm labor force) was unemployed by 1932 and 1933, and that the rate did not go below 10 percent on a sustained basis until 1941.[52]

[50] Alexander Gerschenkron, "History of Economic Doctrines and Economic History," *American Economic Review* 59 (May 1969), pp. 1–17.

[51] James Q. Wilson, " 'Policy Intellectuals' and Public Policy," *Public Interest* 64 (Summer 1981), pp. 31–46.

[52] The Federal Reserve index of industrial production, originally published in the *Federal Reserve Bulletin* (monthly), is reprinted in Alfred Sauvy, *Histoire économique de la France entre les deux guerres* (Paris: Fayard, 1967) 2: 537. For GNP statistics, see U.S. Department of Commerce, *Historical Statistics of the United States* (Washington, D.C.: G.P.O., 1975), series F47-70, p. 229; and John W. Kendrick, *Productivity Trends in the United States* (Princeton: Princeton University Press,

The drop of the British economy was less severe—real GNP fell by only 5.5 percent from 1929 to 1932, as compared with a corresponding figure of 26.8 percent in the United States—but it came on top of the leaden performance of the 1920s. In that decade, the average rate of unemployment was never below 7 percent in any year; from 1929 to 1932, it rose from 7.3 percent to 15.6 percent. Despite an early and steady economic recovery from the second half of 1932, the unemployment rate did not go below 10 percent on an annual basis until 1936 and below 7 percent until 1939.[53]

At first, it seemed that France would suffer less than the United States and Britain. French industrial production did not begin to fall off until the second half of 1930. Though real GDP in 1931 was 7 percent lower than it had been in 1929, and industrial production declined over 21 percent from the second quarter of 1931 to the second quarter of 1932, there was a period of recovery from June 1932 to June 1933. But in the next two years, while other major industrial economies were on an upswing, the French economy fell back again. Even as late as 1938, real GDP remained below what it had been in 1930. Only in the second quarter of 1939 did industrial production surpass its level of the second quarter of 1931. French unemployment statistics for the 1930s are notoriously unreliable, but one can get some idea of conditions in the labor market by noting that the employed work force in the first half of 1935 was more than 27 percent below its average size in 1930.[54]

As this economic catastrophe developed, political leaders in the United States, Britain, and France were not inclined to sit idly by and wait for some automatic equilibrating mechanism to come into operation. On the contrary, those who took office in all three countries in 1929 exuded unprecedented confidence in their ability to manage their economies. André Tardieu, the dynamic center-right politician who became the French premier in November 1929, grandiloquently proclaimed "*une politique de la prosperité*" whose central element was to be a program of public works.[55] Herbert Hoover was quick to project an image of macroeconomic activism. And the British Labour party rode into power in mid-

1961), table A-IIa, pp. 294–95. On unemployment, see Gene Smiley, "Recent Unemployment Estimates for the 1920s and 1930s," *Journal of Economic History* 43 (June 1983): 487–93.

[53] C. H. Feinstein, *National Income; Expenditure and Output of the United Kingdom 1855–1965* (Cambridge: Cambridge University Press, 1972), table 5, T16 (for GNP), and table 58, T128 (for unemployment). Feinstein's estimates of the unemployment rate, which refer to the total labor force, are lower than the official figures at the time, which covered only insured workers.

[54] Sauvy, *Histoire économique*, 2: 528 (for industrial production) and 2: 544 (for the employed work force); and J. J. Carré et al., *French Economic Growth* (Stanford: Stanford University Press, 1975), p. 24 (for GDP).

[55] *Journal Officiel: Débats parlementaires: Chambre des Députés*, 7 Nov. 1929, pp. 2999–3001.

1929 on a wave of hope swelled by its attacks on the "placid assumption"—as its party program put it—that "the recurrence of involuntary idleness is still to be regarded, like tempests and earthquakes, as an act of God."[56]

Whatever private doubts on this score that political leaders may have had, they discovered that their electorates took them at their public word. Every administration or governing majority that presided ineffectually over any sustained part of the economic downswing in Britain, France, or the United States suffered a stunning defeat in the next election. Conversely, the National government and the Roosevelt administration reaped electoral rewards after presiding over economic upswings. No sensitive leader could fail to realize that he would not sleep well until voters ate better.[57]

Thus, there was a great political premium on "doing something," just as there were proto-Keynesians aplenty who sought to press their idea of a fiscal fix into the heads of politicians. But proto-Keynesians were not alone in catching the ears of politicians. Every group and every gadfly had a nostrum, or (as Keynes termed it) a "device."[58] In some cases, the ideas had a heavy political weight behind them. In other cases, those who peddled the nostrums could support them with what purported to be empirical evidence—as, for example, the agricultural economist George Warren did by showing to Roosevelt his charts putatively correlating gold prices and commodity prices. In still other cases, the ideas had that theoretical gloss for which we looked in the proto-Keynesians. Some policy entrepreneurs—Keynes among them—had a whole array of ideas, emphasizing one and then another according to the occasion or circumstances.[59]

Putting oneself in the place of a politician bombarded by ideas from all angles is a salutary intellectual exercise. Social scientists rarely need to be reminded that choices are made within political and structural constraints. More often they need to be reminded that choices are made in conditions of intellectual uncertainty. That uncertainty cut two ways. On the one side, it prompted political leaders to give more thought to new fiscal ideas than they might otherwise have done; in the extraordinarily baffling circumstances of the 1930s, even the most narrow-

[56] Labour Party, *Labour and the Nation* (London: The Labour Party, 1928), p. 22.

[57] For a collection of voting results, see Thomas T. Mackie and Richard Rose, *International Almanac of Electoral History* (New York: Free Press, 1974).

[58] Keynes used the term in *The Means to Prosperity*, p. 4. For discussions of the proliferation of economic plans in French public discourse by the mid-1930s, see Richard F. Kuisel, *Capitalism and the State in Modern France* (Cambridge: Cambridge University Press, 1981), pp. 98ff; and Jackson, *Politics*, chap. 7.

[59] For Keynes' twists and turns on one issue, see Barry Eichengreen, "Keynes and Protection," *Journal of Economic History* 44 (June 1984), pp. 363–73. For the variety of proposals floated by another eminent economist, see William R. Allen, "Irving Fisher, F.D.R., and the Great Depression," *History of Political Economy* 9 (Winter 1977), pp. 560–87.

minded politicians had to ponder the imponderable. On the other side, it meant even the more open-minded of them were hopelessly confused about whether those ideas offered the most straightforward path out of the Great Depression.

There was another set of objective circumstances that bore insistently on the issue of whether or not to accept deficit financing. Governments that clung to budgetary orthodoxy sooner or later ended up in an excruciating fiscal crunch—a crunch brought on not only by the economic slump but also by the international tension arising from German and Japanese foreign policy.[60] French, British, and U.S. leaders had to deal with extraordinary pressures for expenditure to aid depressed industry and agriculture, to alleviate misery and unemployment with welfare payments and public works, to develop armies that could withstand the rising military power of Nazi Germany, to build up navies that could counter a restless Japan halfway around the world, and to put together a new military arm, air forces. It was hard to do all that and still avoid big budget deficits, especially since the French, British, and U.S. economies were too depressed to yield much, if any, new revenue from tax increases.

The easy way out of this fiscal crunch would have been for policy makers to resign themselves to protracted budgetary imbalance, to give in to the manifold pressures for expenditure and hope that deficits would—as Keynes and other scribblers promised—cure the Depression in the bargain. As we shall see, it did at first seem that there might be a new departure in fiscal policy. But then budgetary orthodoxy made a vigorous comeback from mid-1931 in London, late 1931 in Washington, and early 1932 in Paris. Under the National government in Britain, that orthodoxy reigned until the late 1930s. In France, a long series of governments tried, after a fashion, to pursue a balanced budget until mid-1936 and then again, in some measure, from mid-1937 to the spring of 1938. In the United States, Roosevelt interrupted the budget-balancing drive from the spring of 1933 to early 1936, but even he made a serious effort to eliminate the deficit in 1936 and 1937. For some time after budgetary balance became the overriding priority of British, French, and U.S. leaders, it was expenditure for social and economic purposes that gave way the most. But ultimately, as the Germans, the Japanese, and the Italians grew ever more menacing, it was pressure to spend on defense that had to be restrained if budgetary orthodoxy were to be safeguarded.

There was much at stake in this process of sorting out priorities. Try though they might, policy makers could not successfully muddle through with incremen-

[60] My discussion of the "fiscal crunch" is drawn from my manuscript in preparation on "The Consequence of Choice: Priorities of State in Britain, France, and the United States, 1929–1941," 3 vols. I presented a synopsis of my preliminary findings in "Budget-Balancing in an Historical Perspective: National Priorities in Britain, France, and the United States, 1929–1941," a paper for a colloquium at the Wilson Center, Washington, D.C., June 1981.

tal adjustments at the margin of particular items of revenue or expenditure; the incrementalism later formalized academically by Charles Lindblom and Aaron Wildavsky was out of its depth in the 1930s. Basic strategic axioms and important foreign interests, popular goals and established programs of domestic policy, or deeply rooted principles of fiscal rectitude had to be substantially eroded or even abandoned.

Consider some of the trade-offs that governments made for the sake of balancing budgets.[61] The National government, upon taking power in 1931, pushed through a combination of increases in taxes and reductions in expenditure that amounted to a major fiscal swing of over 3 percent of British GNP. In addition to cutting rates of unemployment benefit by 10 percent, the new government imposed a strict means test on the so-called "transitional" payments made to the large number of jobless workers who had exhausted their covenanted benefits. In the British working class, nothing had been despised so much for so long as a means test of this sort. When local authorities, under pressure from their communities, began to shy away from administering the means test, Neville Chamberlain, the Chancellor of the Exchequer, moved to ensure that outlays on the dole would never again reach budget-busting levels, as they had by 1931. Erasing an administrative distinction between the unemployed and the unemployable that his own father had introduced nearly fifty years before, he worked out a new arrangement in which the longer-term jobless were lumped together with many paupers who had been under the Poor Law. And hoping to save money in the short run as well, he resisted pressure from the Ministry of Labour to adjust the new scales of relief so that the longer-term jobless would not receive less than before. Implemented at the turn of 1934–1935, the new dispensation touched off the most massive protests of the 1930s in Britain.

The government backed away from the new scales of relief, and indeed lost the political will to hold down domestic expenditure of other kinds—apart, that is, from Lloyd George's proposals for a large program of public works. Chamberlain now concentrated his fire on the mounting pressures for rearmament. Already in 1934, in an effort to undercut the case for a major naval build-up, he had tried (and failed) to reach a rapprochement with Japan. In 1937, when the outlays for arms reached the point where they had to be financed by borrowing and when they seemed to be gaining a momentum that the Treasury could not control, Chamberlain moved to impose a ceiling on defense expenditure for the next five years. At the level set for that ceiling in early 1938, the army could no longer hope to send a well-equipped force to the Continent in the event of war, the navy could no longer expect to build up a fleet sufficient to counter Japan, and the air force could no longer work toward parity in bombers with Germany. Drawing

[61] Ibid.

the logical diplomatic conclusions from those self-imposed limits on British military power, Chamberlain as prime minister from June 1937 sought to reduce the number of adversaries that menaced Britain. The goal of his approaches to Hitler was not simply to avert war, but also to end the arms race and, with it, the pressure on the British budget.

In the United States, the trade-offs made for the sake of budgetary orthodoxy were also significant, if not as dramatic. In late 1931, with the next presidential election less than a year away, Hoover proposed the largest tax increase (in relative terms) of peacetime U.S. history and pushed for reductions in expenditures, not least on the public works that had been central to his economic policy during the previous two years. He also sought to cut government aid to agriculture, at a time when farmers were already very restive politically. The aim of this seemingly suicidal fiscal package was to balance the budget (excluding debt redemption) for the fiscal year ending in mid-1933.

Until Hoover executed this about-face, he had appeared quite willing to go along with a rising deficit. A similar trajectory, albeit with a larger sweep, characterized the fiscal policy of Roosevelt before 1938. From 1933 to 1935, he was content to run a big deficit. Then, in 1936 and 1937, he turned sharply toward budgetary balance. Though unemployment remained very high, he reined in the spending and lending agencies of the New Deal. His budget-balancing drive also led him to hold back on rearmament, including that of the U.S. navy, even though Japan had just abrogated the naval arms limitation treaties of 1921 and 1930. The consequences of Roosevelt's delay in the realm of defense were to haunt him in 1941, when it turned out that the United States did not yet have either sufficient naval forces-in-being to sustain his strategy of deterrence in the Pacific or enough capacity in tank and aircraft factories to carry out his "arsenal of democracy" policy in Europe.

In France, the ultimate consequence of attempts to balance the budget was not merely to diminish the chances of staying out of war in the first place, but to undermine the prospects of staving off defeat when the war came. French budget-cutting began in earnest in mid-1932, and from the outset neither defense nor domestic spending was spared. Data in the Finance Ministry archives indicate that by 1934 outlays for public works and various social programs financed outside of the ordinary budget had dropped to one-quarter of their level two years before.[62] Though off-budget spending began to rise again in the mid-1930s, expenditures in the ordinary budget underwent the unkindest cuts of all at the hands of Pierre Laval in 1935. His efforts backfired in the sense that their political upshot was to galvanize further mass support for the emerging Popular Front

[62] See the table given to the Cabinet du Ministre des Finances, 20 May 1937, no. 31 in F30/2345, Ministère des Finances.

coalition on the left. On the military front, meanwhile, the successive chunks taken out of the defense budget from 1932 to 1934 helped to turn the army into an inert shell. There was no immediate revitalization even after a French diplomatic note of April 1934 declared that because Hitler was so clearly bent on rearmament, France would have to take steps to enhance her security rather than carry on with disarmament negotiations. Not until September 1936, when the Popular Front was in power and was pursuing an expansionary fiscal policy, did the French begin seriously to rearm. This delay left France dependent on the support of potential allies; indeed, she ended up virtually surrendering her diplomatic independence to the British. And the budgetary restrictions on rearmament before 1936 left the French much more vulnerable than they might otherwise have been to the German Blitzkrieg in 1940.[63]

Of course, as French, U.S., and British leaders made choices among guns, butter, and balanced budgets in the 1930s, they could not foresee the dénouement of their decisions. But all of them sensed the risks they were running. Given the wide circulation of arguments about the importance of purchasing power, they surely had some apprehension that cuts in spending might lead to further economic contraction. (And as they could have inferred even then, all of the cuts except for those in Britain in 1931 proved to have perverse economic effects.) As politicians, they no doubt were sensitive to the possibility that such cuts might lose them votes and provoke social disorder. (And even before any of the Depression elections were held, the mutiny of the British navy at Invergorden in September 1931 over cuts in pay provided a warning.) In their role as guardians of national security, they could appreciate that, given how long weapons took to make, decisions on defense expenditure involved an implicit wager about what the international situation would be in three or four years' time. (And gambling with the likes of Hitler, Mussolini, and the Japanese military was clearly a dangerous game.) In these circumstances, it could scarcely have escaped their attention for long that the choices imposed upon them by the fiscal crunch would have been much easier, had it not been for the constraint of budgetary orthodoxy.

One Hypothesis Among Many: Budgetary Balance and State Autonomy

On our forays into the realm of concept and the realm of circumstance, we have gathered the pieces of a puzzle: why there was no proto-Keynesian revolu-

[63] Bradford A. Lee, "Strategy, Arms and the Collapse of France, 1930–1940," in Richard Langhorne, ed., *Diplomacy and Intelligence during the Second World War* (Cambridge: Cambridge University Press, 1985), pp. 43–67.

tion in the major Western democracies during the Great Depression. To the casual student of the 1930s, that may seem to be a bogus puzzle, because a fiscal revolution was, presumably, out of the question before *The General Theory* appeared in 1936. But such a presumption, such a dismissal of the whole issue, is naive. For we have found a good deal of proto-Keynesian invention. We have also found great necessity. From the intercourse of necessity and invention we might well have expected to find a new fiscal policy. Yet in the event there was no pattern of innovation on a sustained basis. A genuine puzzle needs to be solved after all.

We can heighten our sense of mystery by noting that before the series of turning points from mid-1931 to mid-1932, budgetary balance was giving way in practice. Hoover did step up government spending (and reduce taxes) in the first stage of the Depression. Meanwhile, as the economy declined, so did government revenues. By the calendar year 1931, the deficit was nearly 3 percent of national income and still going up fast. As late as the end of May 1931, the president was expressing (to his Cabinet) a willingness to let the red ink continue to flow.[64]

In France, from late 1929 to early 1932, center-right governments under Tardieu and Laval adopted a much more relaxed fiscal posture than might have been anticipated so soon after the financial trauma of the mid-1920s. Indeed, there was an explosion of expenditure in the wake of Poincaré's fiscal rectitude in 1926–1928. From 1928 to the fiscal year that ended in March 1931, spending recorded in the ordinary budget rose over 25 percent. On top of that came a further surge in spending off-budget. Finance Ministry accounts show that by the calendar year 1932 extrabudgetary outlays (excluding debt redemption) were up to an annual level equal to nearly one-fifth of expenditure in the budget proper. Though we lack precise figures, the total deficit was probably running over 5 percent of national income when the center-left Herriot government took office in June 1932. And until that point, the bulk of the deficit was due to new expenditure rather than to shortfalls of revenue.[65]

In the case of Britain, historians have paid too little attention to what the Labour government was doing by way of spending in 1929–1931 and too much attention to what its Chancellor of the Exchequer, Philip Snowden, was saying against the spending. His bark about the need for budgetary balance was worse than his bite into the growth of outlays on road building, unemployment compensation, and old age pensions. Even though the 1929–1930 budget that he inherited from the Conservatives in June 1929 was already heading for a deficit, he acqui-

[64] Diaries, 26 May 1931, Henry Stimson MS, Yale University (microfilm at Harvard).

[65] For expenditure in the ordinary budget, see Alfred Sauvy, *Histoire économique* (Paris, 1965), 7: 513. For off-budget outlays, see the table cited in n. 62 and the materials in F30/2340, Ministère des Finances.

esced in major spending proposals from his Cabinet colleagues. He did push through a big tax increase in 1930, but he shied away from a similar step in 1931 for fear that it would have a counterproductive effect on business activity. The notorious majority report of the May Committee, published on 1 August 1931, projected a deficit of £120m (including £55m for debt redemption) in the financial year 1932–1933—slightly more than 3 percent of national income in Britain at the trough of the Great Depression. Modest though that was relative to the looming U.S. and French deficits, it was enough to set off a train of events that ended with fiscal practice being brought back in line with orthodox budgetary principle in London and in Washington and Paris as well.

It may seem that our sense of mystery ought to be dispelled by the striking coincidence between the realignment of budgetary policy and the unfolding of the international financial crisis of 1931. But note that even before that crisis, no political leader in the United States and France, and only Lloyd George in Britain, had openly renounced the convention of balanced budgets in favor of a proto-Keynesian conception of deficit financing. Note also that the impress of the financial crisis did fade over time and that some deviations in practice from orthodox principle did reappear, most overtly with Franklin Roosevelt, but also, more covertly, with French governments in 1934–1935. These two points suggest that the financial crisis of 1931 by no means suffices as a solution to our puzzle.

If we are to find the way to that solution, we manifestly have to go beyond the realm of necessity and the realm of invention. We have not yet probed the minds of the policy makers, nor the political systems through which those policy makers sought to govern, nor the larger social setting in which those political systems operated. It was through this nexus that fiscal concept and objective circumstance had to interact. My puzzle-solving tactic will be to slice through this nexus and try to isolate the key point(s) at which concept and circumstance failed to connect.

Imagine a series of concentric rings, with the larger social setting on the outside, with the minds of the leading policy makers in the middle, and with the main layers of the political system in-between. The rings represent sets of actors, institutional contexts, or loci of pressures, constraints, and values; they are arrayed roughly according to their proximity to the central point of decision in a given national structure of power. By exploring each ring in turn, we can avoid the sin of omission of plausible hypotheses, and we can test for the most potent ones in the three national cases.

In the outer ring, we start with the hypothesis that there was an ethos, a collective *mentalité*, so suffused with fiscal orthodoxy that it would have been virtually unthinkable for U.S., British, and French policy makers to abandon, in an open manner and in a sustained way, the convention of budgetary balance. It is difficult to gauge mass attitudes before the appearance of "scientific" opinion polls, unless one operates on the dubious assumption that the press either faithfully reflected or decisively shaped opinion in society at large, or that political leaders thought it did.[66] An early Gallup poll, at the turn of 1935–1936, found that 70 percent of those Americans surveyed favored a balanced budget.[67] Doubtless, had similar polls been taken earlier, in France and Britain as well as in the United States, there would have been a majority in each instance against the idea of budget deficits. But it is quite doubtful that such a sentiment was intense, in fact or in the perception of politicians.

If a financial issue was salient in any of the three countries, that issue was currency devaluation in France. Opposition to devaluation of the franc was the only point on which nearly all elements of the French political community, from communists to crypto-fascists, could agree. But there was not agreement on the importance of the relationship between the state of the budget and the stability of the currency. Laval's spending cuts of 1935, linked though they were to the defense of the franc, ran into great opposition in the population at large. And it is noteworthy that several governments before 1935, right-center as well as left-center, perceived it to be politically advantageous to propose off-budget programs of public works made to look larger than they really were.

Even in Britain, where the opinions of the financial community had evidently trickled down farthest into society at large, politicians did not jump to the conclusion that an ethos of budgetary orthodoxy was deeply rooted. After all, in 1929, 1933, and 1935, there were great debates over proposals for fiscal innovation, and in each case the government in power was very anxious lest Lloyd George, Keynes, and the newspapers and political organizations associated with them would be able to rally widespread support for deficit spending. In the United States, when the Hoover administration announced in June 1931 that the deficit for the fiscal year about to end would be close to $1 billion, there was no strong public outcry for measures to balance the budget. It was Hoover himself who made the deficit an issue later in the year. And Roosevelt's fiscal apostasy did not prevent an increasing number of voters from believing in him.[68] So my conclusion about this hypothesis would be that there was enough of an orthodox budgetary ethos in France, Britain, and the United States to create a problem, to make

[66] For press opinion in Britain and France on financial issues, see Marguerite Perrot, *La monnaie et l'opinion publique en France et en Angleterre de 1924 à 1936* (Paris: Colin, 1955).

[67] Gallup Poll, Survey #15, interviewing dates 30 Dec. 1935–5 Jan. 1936, published 2 Feb. 1936, reprinted in George H. Gallup, *The Gallup Poll*, vol. 1; *1935–1948* (New York, 1972), p. 12.

[68] For the ambiguous results of an attempt to test for a cross-sectional statistical relationship between the Roosevelt administration's "emergency" spending and the president's electoral gains, see Gavin Wright, "The Political Economy of New Deal Spending: An Econometric Analysis," *Review of Economics and Statistics* 56 (Feb. 1974), pp. 30–38.

the fiscal crunch more palpable, but not enough to dictate a solution, to exclude all policy options other than budget-balancing measures.

Another hypothesis with a base in the outer ring is one popular among political scientists, notably Peter Gourevitch: breaks from fiscal orthodoxy were linked to the emergence of farmer-labor alliances, with fragments of the business community playing a supporting role in some cases or even supplanting labor in others.[69] A "weak" variant of this hypothesis is simply that widespread political support facilitated innovation in the 1930s. No one, presumably, would take great exception to this point, but there are two important qualifications. First, though Say's Law does not hold in macroeconomics, it may apply to the politics of fiscal policy. That is to say, the supply of a new policy may well create its own political demand. In offering his *politique de la prospérité* in late 1929, Tardieu seems to have been counting on this possibility. Second, even if political support does not materialize for a new policy *ex post*, a political leader may already have enough support on other grounds or on other issues to allow him to trade on, and get by without any specifically committed backing for new fiscal initiatives. We shall return to this question of political support later. The "strong" version of the hypothesis is that when and where a farmer-labor-heterodox business coalition emerged, a breakthrough to proto-Keynesian policies followed; when and where it did not emerge, political leaders clung to fiscal orthodoxy. Consider in this connection the three major national cases of sustained proto-Keynesian innovation in fiscal policy from 1932 on: Sweden, Germany, and Japan. Consider also one case where fiscal policy oscillated: the United States. The story works well for Sweden—as do many other stories—but not for Germany and Japan. In the German case, a proto-Keynesian fiscal policy took root under the Papen government in mid-1932 and then flourished under the Hitler regime. Von Papen's base of support (actual or anticipated) was narrower and Hitler's was broader and more diffuse than the hypothesis suggests. In Japan, fiscal innovation was the work of Takahashi Korekiyo, finance minister from late 1931 to early 1936 in a series of short-lived governments, of which all but the first were nonpartisan. Takahashi's policy is best understood in terms not of a sociopolitical coalition in the early

[69] Peter Alexis Gourevitch, "Breaking with Orthodoxy: The Politics of Economic Policy Responses to the Depression of the 1930s," *International Organization* 38 (Winter 1984), pp. 95–129; also, Peter Gourevitch, *Politics in Hard Times: Comparative Responses to International Economic Crises* (Ithaca: Cornell University Press, 1986). There is a similar but simpler hypothesis according to which a correlation exists, historically, between fiscal innovation and the strength of labor movements in various national political systems. Margaret Weir and Theda Skocpol, "State Structures and the Possibilities for 'Keynesian' Responses to the Great Depression in Sweden, Britain, and the United States," in Peter B. Evans, Dietrich Rueschemeyer, and Theda Skocpol, eds., *Bringing the State Back In* (Cambridge: Cambridge University Press, 1985), pp. 112–14, show the limits of the explanatory power of this hypothesis.

1930s but of his own common-sense grasp of the proto-Keynesian argument as Keynes himself had sketched it in the 1920s.[79] The "coalition hypothesis" is also hard to reconcile with a major turning point in the U.S. case. In 1936, just as Roosevelt was consolidating a coalition with a farmer-labor alliance at its core, he was veering away from deficit financing. When a deterministic hypothesis does not stand up against historical fact, the ground is cut away under its counterfactual story, to wit, that Britain and France clung to fiscal orthodoxy for much of the 1930s because of the absence of a farmer-labor-heterodox business coalition.

Moving in from our outside ring, but stopping short (for the moment) of the layers of the public sector, one might ponder the possibility that a single class, or some organized group, was powerful enough to keep fiscal policy from deviating too much from orthodoxy. The leading candidate for such a role is the business community. But we should disaggregate that community into its industrial sector and its financial sector, not only because their economic interests diverged, but because their scope for influence on policy differed. In studying the relationship between business and government, social scientists have tended to be mesmerized by industrialists. That makes sense for the regulatory arena (in Theodore Lowi's conception of the term): British, U.S., and French industrialists all had considerable influence at some points in the 1930s on policies that shifted the supply curve for their sectors.[71] But general fiscal policy—as opposed to specific measures of taxation or spending (Lowi's distributive arena)—was of urgent concern to relatively few industrialists, and not all of them bridled at the idea of stimulating demand. It was bankers who were preoccupied with general fiscal policy. And in theory at least, they had a means at hand to impress policy makers with their concerns. Whereas before the maturation of multinational corporations

[79] There is no extended analysis in English of Takahashi's fiscal policy in Japan in the 1930s, but see the brief sketch in Dick K. Nanto and Shinji Takagi, "Korekiyo Takahashi and Japan's Recovery from the Great Depression," *American Economic Review* 75 (May 1985), pp. 369–74, which includes references to some of the Japanese literature. On fiscal policy in Germany, see Harold James' essay in this volume. See also Michael Schneider, *Das Arbeitsbeschaffungsprogramm des ADGB* (Bonn-Bad Godesberg: Verlag Neue Gesellschaft, 1975); Michael Wolffsohn, *Industrie und Handwerk im Konflikt mit staatlicher Wirtschaftspolitik?* (Berlin: Duneker und Humblot, 1977); Helmut Marcon, *Arbeitsbeschaffungspolitik der Regierungen Papen und Schleicher* (Bern: Land, 1974); René Erbe, *Die nationalsozialistische Wirtschaftspolitik 1933–1939 im Lichte der modernen Theorie* (Zurich: Polygraphischer Verlag, 1958); and Harold James, *The German Slump* (Oxford: Oxford University Press, 1986).

[71] For the notion of different policy arenas, each with its distinctive group of players and pattern of relationships, see Theodore J. Lowi, "American Business, Public Policy, Case-Studies, and Political Theory," *World Politics* 16 (July 1964), pp. 677–715. For a solid monograph on how U.S. industrialists came to exercise strong influence on "supply-side" policy in 1933, see Robert F. Himmelberg, *The Origins of the National Recovery Administration* (New York: Fordham University Press, 1976). There is nothing so illuminating for Britain and France in the existing literature.

it was not easy for industrialists to shift the bulk of their assets overseas, it was a simple matter for bankers unencumbered by exchange controls to send the money in their charge to a foreign refuge. When "hot" capital took flight, policy makers had a strong incentive to take into account the preoccupations of the banks and their clients; and among those preoccupations the budget was likely to rank high.

In practice, the situation was much more complicated than this abstract sketch would suggest. Bankers in France and, even more, in the United States had problems of their own—not least of which were nervous depositors and the lack of profitable and liquid outlets for what deposits remained. Leverage therefore could work both ways. U.S. banks needed help from the state. Even after they got it, they were only too happy to absorb the masses of Treasury bonds and bills with which the government financed its deficits. In France, meanwhile, the sticking point in the issue of such securities was not, by and large, an unreceptive attitude on the part of the large Parisian banks, but rather an unwillingness on the part of the Bank of France to discount the government bonds and bills.[72] As we shall see, Herriot in 1932 did shy away from an expansionary fiscal policy for fear of what the financial community might do to him, but from 1933 to 1935 it was the central bank *tout court* that posed the most formidable problem for policy makers. In Britain, the bankers did actively play a constraining role at one point—the financial crisis of 1931—but here, too, the main pressure on the government came from the central bank, the Bank of England.[73]

Thus, we must move inward to the political arena more narrowly conceived if we are to make much progress in solving our puzzle. But before we plunge into the power structure there, we ought to consider the most straightforward political hypothesis: governments in these three major democracies eschewed a proto-Keynesian fiscal policy because, in Britain and France, it would have put their parliamentary majorities in jeopardy or, in the United States, it would have put a greater strain than usual on the relationship between the president and Congress. There was one important episode in the French case that is consistent with this hypothesis—the fatal parliamentary difficulties in which the Popular Front government of Léon Blum found itself in 1937 largely as a result of its deficit spending. Otherwise the hypothesis lacks explanatory power. The center-right governments of Tardieu and Laval stepped up spending from 1929 to 1931 primarily in the hope of strengthening their majority, by extending it further to the left. Suc-

[72] I base my statement on evidence in F30/2340-2344, Ministère des Finances, and in the *procès-verbaux* of the Conseil des Régents of the Bank of France.

[73] For two recent and well-researched accounts of the 1931 crisis in Britain, see Philip Williamson, "A 'Bankers' Ramp? Financiers and the British Political Crisis of August 1931," *English Historical Review* 99 (Oct. 1984), pp. 770–806; and Diane B. Kunz, *The Battle for Britain's Gold Standard in 1931* (London: Croom Helm, 1987).

cessive Radical governments in 1932 and 1933 required parliamentary support from the Socialist party that would have been easier to maintain if Radical leaders had not balked at the growth of ever-larger deficits. Much the same holds true for the Labour government in Britain after mid-1929, because it depended on the support of Lloyd George, who wanted a large program of public works financed by borrowing. Even for the National government, the path of least political resistance in 1933 and 1935 would have been to give in to the clamor for a more adventurous fiscal policy. In 1933, much of this clamor came from Conservative newspapers, and it had a marked impact on Conservative backbenchers in Parliament.[74] In the United States, after the upsurge of increasingly radical sentiment on fiscal issues among Democratic congressmen from March 1932, a return to a more relaxed attitude toward spending would have made political life in Washington (and beyond) much easier for Hoover. Roosevelt, for his part, never had serious trouble getting a spending bill through Congress until 1939.

If parliamentary and congressional politics do not provide the key to our puzzle, what about bureaucratic politics? Here the most compelling story would highlight the defense of fiscal orthodoxy by the British Treasury and the French Ministry of Finance. Both those departments had long enjoyed a disproportionate share of bureaucratic power. The principle of budgetary balance was an important source of that power, because it provided a formidable weapon to cut down the spending demands of other departments. A more subtle weapon was that the French Finance Ministry had a corps of inspectors that dug into the affairs of other ministries, while the Permanent Under-Secretary of the British Treasury was also the head of the Civil Service, and bureaucrats who did battle with the Treasury had to consider the possible harm to their careers.

In ordinary circumstances, therefore, the British Treasury and the French Finance Ministry had the means to ensure that the budgetary process remained routine and its outcomes incremental. But recall that the circumstances impinging on the allocation of resources by the state in the 1930s were not ordinary. With so much at stake for national security and domestic welfare, the Treasury and the Finance Ministry found it far more difficult than usual to get other departments to fall in line without taking bureaucratic disputes over expensive programs to the political leaders of the governments. The upshot was that at most of the turning points of the 1930s the fate of fiscal orthodoxy depended less on bureaucratic politics than on the personal inclinations, the political relationship, and the force of character of the Prime Minister and the Chancellor of the Exchequer in Britain and of the President of the Council and the Finance Minister in France. The finan-

[74] See letters from Neville Chamberlain to his sisters, 18 and 25 March and 1 April, 1933, 18/1, Neville Chamberlain MS, Birmingham University Library.

cial mandarins could fight with great tactical skill in the trenches with other bureaucrats but were vulnerable to a bold strategic flanking movement carried out by political leaders; only if such a movement overextended itself could they counterattack effectively. That metaphor captures especially well what happened with the Blum government in France in 1936–1937. If Lloyd George or Oswald Mosley had gotten his way, much the same would have happened in Britain six years before.

In the United States, the inclinations and relationships of those at the commanding heights of the government were even more important than in Britain or France. The U.S. Treasury had not accumulated the bureaucratic power of its counterparts in London and Paris; in fact, it was not even a genuine counterpart because, while the British Treasury prepared the budget, and the French Finance Ministry did under most governments, in Washington there was a separate—and weak—Bureau of the Budget. Hoover's first Secretary of the Treasury, Andrew Mellon, had little influence, but Mellon's Under-Secretary (and later successor), Ogden Mills, developed a close relationship with the president and played a significant role in the reorientation of the administration's fiscal policy in late 1931. The Secretary of the Treasury from late 1933, Henry Morgenthau, had the advantage of a long friendship with Roosevelt, though that did not keep the president from playing him off against the bureaucratic "spenders" of the New Deal. To some extent, the political appointees at the top of the Treasury were able personally to compensate for the department's relative lack of bureaucratic power.

In view of these complexities in the bureaucratic situation, one's conclusions about the importance of the British Treasury, the French Finance Ministry, and the U.S. Treasury Department must be nuanced. None of the three could have constrained political leaders who were resolved to make a pronounced deviation from an orthodox fiscal policy—at least until it was evident that such a wayward path was leading to an economic or financial abyss. But the French and especially the British financial mandarins could slow the pace of political leaders who were deviating in an ad hoc fashion and were uncertain of how far to go. That the British Treasury was somewhat stronger than the French Finance Ministry, and much stronger than the U.S. Treasury Department under Mellon, does help explain why the Labour government's deviation in 1929–1931 fell short of that of Tardieu, Laval, and Hoover. After 1931, however, the bureaucratic successes of the British Treasury were very much a function of Neville Chamberlain's ability to shape policy of all sorts at the Cabinet level. Chamberlain had a mind of his own—albeit one ordinarily in accord with "the Treasury mind."

There is another angle from which to consider the structure of the state, an angle that takes us past bureaucratic politics and into limits on institutional capacity to pursue an expansionary fiscal policy. As Herbert Stein has pointed out, the outlays on construction of the U.S. federal government in 1929 were less than .2 percent of GNP; all federal purchases of goods and services amounted to only 1.3 percent. Total public construction at all levels of government in 1930 was under $3 billion. It was no easy task, administratively, even to double this figure in a few years. Indeed, Stein notes that by the end of the 1930s the Roosevelt administration, for all its efforts, had only raised by 50 percent, in real terms, the annual level of public construction over what it had been at the beginning of the decade.[75] Much federal spending on public projects under the New Deal simply "displaced" outlays by state and local governments.[76]

In Britain, the Labour government started from a base only slightly higher than that on which the Hoover administration had to build. Total government expenditure on goods and services was 10.1 percent of British GNP in 1929, as compared with 8.24 percent in the United States. The Labour government had great difficulty in meeting its projections for increases in road building. The Ministry of Transport itself did not build roads, but instead gave subsidies of various percentages to local authorities, who had to negotiate with property owners, plan the construction, and hire work crews. The process took a long time. Many harried and financially straitened local governments were unenthusiastic about accepting the burden. The central government could have paid a grant of 100 percent or done the work itself, but both ministers and bureaucrats were very reluctant to violate in this fashion what they considered to be the proper division of responsibility between the national and local levels of government. And in any case they assumed the upshot would be displacement of expenditure on such a scale that net outlays would not increase much for some time to come.[77]

Such administrative difficulties did not stand in the way of all types of spending. Though Keynes himself seemed more enthusiastic about digging holes than paying the dole, it was possible to build up a deficit quickly on the basis of welfare payments. But in Britain, as the Labour government discovered, relief on such a scale generated more political controversy than did roads. In the United States, Hoover had an aversion to the dole—as did Roosevelt, over the long run. So the more tangible institutional constraints were a greater factor than they might otherwise have been.

In the French case, there was a less prosaic institutional constraint that, until 1935 or 1936, had a more sweeping impact on government spending across the

[75] Stein, *Fiscal Revolution in America*, pp. 14, 23–24.

[76] John Joseph Wallis, "The Birth of the Old Federalism: Financing the New Deal, 1932–1940," *Journal of Economic History* 44 (March 1984), pp. 139–59.

[77] On this administrative tangle, see CAB 27/389–390, 397, 437–438 (records of various cabinet committees during the Labour government) and T 161/577, S.34462/3–5 (Treasury files on road building), Public Record Office, London.

board. That constraint arose from the operating procedures of the Bank of France—procedures which came closer than anything else in the 1930s to representing a "second face of power." They made it extremely difficult to finance a substantial deficit.[78] Any spending not covered by revenues, and by whatever reserve funds there were in the Treasury, had to be financed by selling bonds or by getting the central bank to create new money. After the ability of the franc to remain on the gold standard came into question from 1933, capital outflows and domestic hoarding—along with the renewed decline in national income from the middle of that year—diminished the pool of available savings out of which the government could borrow from the public at large. The Bank of France would not, and until 1938 legally could not, undertake open-market operations to expand the money supply. Nor, ordinarily, would it discount government securities for commercial banks. But those banks, obsessed with liquidity, were reluctant to absorb bonds unless they could discount them, if the need arose.

The Bank of France loosened its procedures only very slowly under government pressure. As off-budget spending began to rise sharply from the second half of 1934, that pressure rose with it. In a letter to the Governor of the Bank, Finance Minister Germain Martin pointedly declared that it was the duty of all public institutions to do what they could to stimulate an economic recovery.[79] But the central bank's sense of duty was inspired by its institutional memory of a decade before, when its advances to the state had provided fuel for an inflation that exploded in a traumatic financial crisis. Only in mid-1935 was a *modus vivendi* first reached: the Bank of France would help finance off-budget spending, while Laval made dramatic cuts in expenditure from the ordinary budget. The second face of power gave way to the two faces of French fiscal policy. Observers were fooled at the time, and historians have been fooled ever since. Laval, however, was evidently not engaged in a calculated double game; he wanted soon to bring off-budget spending under control.

We have now sliced deeply through our concentric rings. The further we have penetrated, the more explanatory power we have laid bare. But even within the layers of state structure, we have not yet uncovered a robust explanation of the failure of a proto-Keynesian policy to take deep root and flourish openly. At most, what we have found are partial answers to questions about why there was a greater or lesser deviation from fiscal orthodoxy at particular times in particular places. Even the exposition of the constraint posed by the Bank of France on the financing of a substantial deficit begs the question of whether French political leaders wanted to go in the red in the first place.

[78] The exposition that follows is based on the sources cited in n. 72 above.

[79] Germain-Martin to Clement Moret, 6 Sept. 1934, Box 65, Flandin MS, Bibliothèque Nationale, Paris.

By a process of elimination, we can infer that if indeed there is a robust explanation of fiscal orthodoxy, the burden of that explanation must fall on the innermost ring—the confined space of the minds of U.S., British, and French policy makers in the 1930s. That, unfortunately for a historian, is also a private space. Documentary sources only provide occasional and oblique glimpses into what went on in those minds as they pondered the uncertainties of budgetary choice. On first impression, it is tempting to suppose that the absence of solid evidence reflects a lack of serious thought by the political leaders—in other words, that we are simply dealing with an axiom, an encrusted dogma, a sacrosanct orthodoxy. But recall the prominence of proto-Keynesian ideas in public discourse and the perilous trade-offs made for the sake of balancing budgets. Recall also the cases where policy makers deviated, consciously though equivocally or surreptitiously, into a more adventurous fiscal policy.

If, then, calculation did come into play, was it simply directed toward pressing short-term economic or political problems? Or did it involve more profound long-term considerations? In explaining Hoover's sudden move toward budgetary balance in late 1931, Herbert Stein has stressed the importance of three problems arising from Britain's departure from the gold standard that September—an outflow of gold from the United States that threatened to drive the dollar off the gold standard, a sharp rise in interest rates, and a flurry of bank failures. To reassure holders of dollars and depositors at banks, and to prevent "crowding out" of private bond issues, it was necessary to balance the budget. The implication of this argument is that Hoover acted as he did less because he was now alarmed over the deficit than because other people suddenly were.[80] One group that did worry about the deficit was the New York banking community. Hoover met with the leaders of that community in October 1931, during the financial crisis. But the substantial documentation about the meeting gives no indication that he discussed the budget.[81]

Another argument plays up short-term political calculations that Hoover might have made. In 1931, there was a crescendo of appeals not only by economists but also by more prominent political figures for large public works programs financed by borrowing. Since these proposals called for much greater expenditure than Hoover dared to contemplate, he found himself on the defensive. To regain the initiative, so the story would go, he decided to launch a counteroffensive

[80] Stein, *Fiscal Revolution in America*, pp. 26–38. Barber, *New Era*, pp. 134ff., argues that Hoover's reorientation of fiscal policy in late 1931 was primarily a function of his concern over maintaining bond prices.

[81] Statement to the meeting, 4 October 1931, Box 8, G. L. Harrison MS, Columbia University Library; and Herbert Hoover, *Public Papers of the Presidents of the United States: Herbert Hoover . . . 1930* (Washington, D.C.: G.P.O., 1976), pp. 454–59.

around the principle of budgetary balance. If the Democratic majority in the House of Representatives did what he expected and thwarted his new budget-balancing drive, he would have an issue to exploit in the 1932 presidential election campaign.[82] There is, however, strong documentary evidence against this argument. The diaries of one of Hoover's political operatives on Capitol Hill make clear that far from itching for a fight with Congress from the outset of 1932, the president fervently hoped that his proposals for a tax increase and spending cuts would pass without trouble.[83]

In the case of Roosevelt's retreat to an orthodox budgetary line before the presidential campaign of 1936, a story centering on short-term electoral considerations seems plausible at first glance. After all, he had attacked Hoover in 1932 for running large deficits, and now the Republicans were certain to use the same weapon against him; progress toward a balanced budget might disarm them. But there is a serious problem with this story: Roosevelt continued his budget-balancing drive long after the election was over. Indeed, he even continued it well into the sharp recession of 1937–1938, which suggests that short-term economic calculations were not uppermost in his mind either.

As for Britain, short-term considerations certainly help explain the zeal with which the National government restored a balanced budget after the breakup of the Labour cabinet in 1931. The raison d'être of the new coalition was to get the country out of the financial crisis and keep the pound on the gold standard. Even after the government failed to save the pound, it still felt impelled to worry about a renewed financial crisis. From the German and French financial crises of the 1920s, it drew the lesson that once a currency started to depreciate, there was a grave danger of an inflationary spiral. But in 1932, the financial situation stabilized, and with the specter of inflation laid to rest, the aim of the National government's economic policy actually became to stimulate a rise in prices.[84] It is no wonder, therefore, that Keynes and others had concluded by early 1933 that the time was ripe for an expansionary fiscal policy. But Chamberlain and his colleagues clung to budgetary orthodoxy. The consistency with which a balanced budget was pursued even while circumstances changed suggests that much more than short-term calculation was at work.

Finally, in France, where the turn toward balanced budgets came latest, in June 1932 under the new Radical government led by Edouard Herriot, short-term

[82] See, for example, Jordan A. Schwartz, "Hoover and Congress: Politics, Personality, and Perspective in the Presidency," in Martin L. Fausold and George T. Mazuzan, eds., *The Hoover Presidency* (Albany: State University of New York Press, 1974), pp. 87–100.

[83] Entries for early 1932 in James H. MacLafferty Diary, Herbert Hoover Presidential Library.

[84] See, for example, minutes by Hopkins, 6 January 1932, T161/508; memo by Phillips, 5 March 1932, Hopkins MS, T175/57; and letter from Chamberlain to his sisters, 27 February 1932, 18/1, Chamberlain MS.

calculations are not difficult to find. Few political systems have put as great a premium on such calculations as the Third Republic in the 1930s. In Herriot's case, considerations of the moment were leavened with vivid memories not so much of the international crisis of 1931 but of the French crisis of the mid-1920s, when conservative politicians and bankers had destroyed his government with the financial weapon. After Tardieu and Laval began to run a large budget deficit in the early 1930s, Herriot saw an opportunity to seize the financial weapon and turn it against those right-center political leaders.[85] Having campaigned against their fiscal extravagance, he was committed to budget cutting when he took office. His commitment was reinforced by the fact that by mid-1932 Treasury reserve funds had drained away almost to nothing from their high level of 1929. But that problem he could have handled (as it would have been in the United States or Britain) by allowing the Treasury to issue whatever notes were necessary to cover its needs.

Here is the point, unpromising as it may seem, where we should probe for deeper underpinnings to a concern for balanced budgets. My analytical stratagem, in the Holmesian spirit of this paper, will be to search for clues and make what inferences I can from them and any pertinent documentary evidence. In Herriot's case, what is puzzling is that he first made major cuts in spending and then contemplated a substantial program of public works to be financed by long-term government bonds, without abandoning his interest in further reductions in expenditure in the meantime. One reason for this seemingly convoluted stance was that the Socialists, whose parliamentary support he needed, were unhappy about the budget cutting, and he hoped to humor them with public works. Was there something more basic underlying his stance? Consider a related clue. In 1930, both Radicals and Socialists attacked Tardieu's proposed program of public works because it was to be financed by surplus Treasury funds and, if those funds ran out at times, by short-term treasury bills; but they advocated an even larger program to be financed by long-term treasury bonds. One reason for this curious posture was that Radicals and Socialists feared losing the mantle of reform, and mass support, to the dynamic Tardieu. But more than that worried them. Whereas long-term bonds would be purchased by the public at large, at least when the

[85] For a revealing collection of articles, speeches, and pamphlets by Herriot and other radicals on the financial issue in the early 1930s, see journal, vol. 10, Herriot MS, archives of the Ministère des Affaires Etrangères, Paris. For Herriot's memories of the mid-1920s, see what he said on 4 July 1932 to a meeting of the Finance Commission of the Chamber of Deputies, the unpublished minutes of which are in the archives of the Assemblée Nationale, Paris. On what happened in the mid-1920s, see Jean-Noël Jeanneney, *Leçon d'histoire pour une gauche au pouvoir* (Paris: Seuil, 1977); Stephen A. Schuker, *The End of French Predominance in Europe* (Chapel Hill, N.C.: University of North Carolina Press, 1976); and Charles S. Maier, *Recasting Bourgeois Europe* (Princeton: Princeton University Press, 1975), pp. 494–507.

economic outlook was not bleak, short-term bills would almost always be held by the financial community. If the bills had to be renewed, say, at a time when the left was in power, bankers and investors could hold the government hostage.[86] Not only might the government fall—as Herriot had found out in the mid-1920s—but the very autonomy of the state would be threatened. It was that threat which shaped the attitude of Herriot, and many others on the left, toward deficit financing. In 1933, a prominent Socialist, Vincent Auriol, later minister of finance in the Blum government, declared that budgetary balance was a "necessity," because "democracies must avoid the dangers of Treasury borrowing"; issuing treasury bills would mean "giving up the independence of the State to the sovereignty of the banks."[87]

In the case of Herbert Hoover, the clue to examine involves his attitude toward legislation that Congress passed in July 1932, after much tugging and hauling between the White House and Capitol Hill. The legislation substantially expanded the powers of the Reconstruction Finance Corporation, which had been set up earlier in the year. The RFC was now authorized to lend on a large scale to states for both relief and public works, and to finance federal public works as well. In principle, this expansion of authority opened a way for Hoover to maintain the appearance of budgetary restraint while stepping up spending to high levels. For by the accounting procedure applied to the agency, its loans were considered off-budget transactions. But even with an election just months away, Hoover took remarkably little advantage of this opening in practice. He wanted the RFC to loan money only for projects that would pay for themselves. What one can see in his stance is a firm resolve to draw a line separating proper from improper federal expenditure.[88] Without that line, he feared, the government would be overwhelmed by groups seeking subsidies and handouts. Their dependency on the state would not only rot their moral fiber, but also put the state itself in danger of being dominated by the beneficiaries of its largesse. Hoover had

[86] A good source on the jockeying both between the Herriot government and the Socialists in 1932 and between the Tardieu government and the Radicals and Socialists in 1930 is the minutes of the meetings of the Finance Commission of the Chamber of Deputies. On the apprehension about treasury bills, see the meetings of 5 February, 12 and 13 June, and 23 October 1930.

[87] *Journal Officiel . . . Chambre des Députés*, 8 Dec. 1933, p. 4492. After I first presented this argument in the initial draft of this paper for the Social Science Research Council's conference on Keynesianism in February 1985, Julian Jackson made the same point in his book (cited in n. 44) on France in the 1930s. The fact that two historians have reached the same conclusion independently should raise our level of confidence in its validity.

[88] See the series of statements by Hoover from May to July 1932 in [Herbert Hoover], *Public Papers of the Presidents of the United States: Herbert Hoover . . . 1932–33* (Washington: G.P.O., 1977), pp. 227–33, 237–39, 276–77, 295–300. See also the entry for 28 May 1932 in the MacLafferty Diary; and the letter from Ogden Mills to Walter Lippmann, 27 May 1932, Box 111, Ogden Mills MS, Library of Congress, Washington, D.C.

harbored such fears before the financial crisis of 1931. He had long resisted demands for federal relief to individuals. But what caused his fears to surge to overarching heights was the ever-increasing pressure in 1931 for bonus payments to veterans and the clamor that had arisen by September of that year for very large public works programs. Far from pushing Hoover to go further with his own spending programs, the agitation made him determined to reestablish a defensive position behind the principle of budgetary balance.

When Roosevelt took office in 1933, he first made substantial cuts from the budget—like Herriot had done—before going ahead with "emergency" spending that he diverted into an "extraordinary" budget. In justifying the initial cuts, he stated that "[t]oo often in recent history liberal governments have been wrecked on rocks of loose fiscal policy."[89] He certainly had in mind the experience of the Labour government in 1931, and probably that of Herriot in the mid-1920s as well. J. P. Morgan & Co. had been deeply involved in both those cases, and Roosevelt shared the apprehension of many liberals at the time about the power of the Wall Street bankers.[90] It may well be that such apprehension helped prompt his early gesture to fiscal orthodoxy. Yet if so, Roosevelt soon discovered that bankers were powerless to impede his financial and economic experiments. He had taken advantage of the banking crisis in March 1933 to begin easing the dollar off the gold standard; in bringing that process to its conclusion in mid-April, he undercut the threat posed by capital flight.[91] When he restabilized the dollar in early 1934, large amounts of capital flowed into the United States. The demand for treasury bills by foreign holders of the dollar as well as by U.S. banks was enormous. There was no need for Roosevelt to worry as Herriot did about being manipulated by the financial community.

Over the longer term, Roosevelt's anxiety about budget deficits took a form similar not to Herriot's but to Hoover's. The best clues to his anxiety are to be found in the Social Security system as it was conceived in 1934–1935; Social Security is important for understanding his fiscal attitudes because its financial scale far exceeded that of all his long-term, as distinct from emergency, pro-

[89] Message from Roosevelt to Congress, 10 March 1933, in Samuel I. Rosenman, ed., *The Public Papers and Addresses of Franklin D. Roosevelt* (New York: Random House, 1938), 2: 50.

[90] The most careful recent research on those two episodes has not found Morgan especially malevolent: Williamson, "A 'Bankers' Ramp?" and Schuker, *Predominance*. For recent work that reflects, even magnifies, the apprehension at the time over the power of the House of Morgan and other Wall Street bankers, see Thomas Ferguson, "From Normalcy to New Deal: Industrial Structure, Party Competition, and American Public Policy in the Great Depression," *International Organization* 38 (Winter 1984), pp. 41–94.

[91] It is worth noting that J. P. Morgan and his most prominent partners welcomed the devaluation of the dollar. See Frank Freidel, *Franklin D. Roosevelt: Launching the New Deal* (Boston: Little, Brown, 1973), pp. 180, 336, 526 n.15.

grams. Note the two critical points he insisted upon in the new system: the "contractual" link between contributions and benefits and the absence of a subsidy from the government budget.[92] These points not only suggest that Roosevelt was already looking toward a balanced budget in the near future, but also indicate that he, like Hoover, worried about the prospect of a vicious circle of dependency on the state leading to an erosion of its autonomy that would in turn invite further dependence and so on.

There is no reason to search for any odd clues or anomalies in Chamberlain's pattern of behavior, because it was all of a piece. His uniformly overriding priority was to preserve the balance of the budget. His great fear was that politicians, especially Lloyd George and the leaders of the Labour party, would bid for popularity with the electorate at the expense of financial stability. The bidding would stimulate a rising stream of claims on the Treasury by various groups in British society. The only reliable bulwark against such an onslaught was to impress the discipline of strict fiscal orthodoxy on politicians and on their constituents.[93]

It was along such lines that Chamberlain acted not only as Chancellor of the Exchequer from late 1931, but also as a key participant in the financial crisis earlier that year. The crisis was not the cause of his commitment to budgetary orthodoxy, but the occasion for imposing it on the left. Taking the lead for the Tories in the interparty bargaining of August 1931, he first aimed to get the Labour government to make spending cuts for the sake of a balanced budget. When he realized that the cabinet would resign rather than cut unemployment benefits, he changed his aim to that of detaching MacDonald and other moderate ministers from the Labour party. With MacDonald at the head of a new coalition government, the Conservative party would not have to bear by itself the unpopularity of making cuts, and there would be a greater measure of legitimacy for fiscal orthodoxy as the overriding national priority.[94]

There has been inexhaustible controversy over why MacDonald agreed to be-

[92] Mark H. Leff, "Taxing the 'Forgotten Man': The Politics of Social Security Finance in the New Deal," *Journal of American History* 70 (Sept. 1983), pp. 359–81.

[93] For intimations to this effect, consider the image that Chamberlain projected of budgetary politics and of his role as Chancellor of the Exchequer, in his letters to his sisters, 23 and 30 April and 15 October 1932, 1 April 1933, and 17 March, 4 August, and 8 December 1935, 18/1, Chamberlain MS. Roger Middleton, *Towards the Managed Economy: Keynes, the Treasury and the Fiscal Policy Debate of the 1930s* (London: Methuen, 1985), has recently stressed that the same concern lay at the heart of the commitment to fiscal orthodoxy among the treasury officials who served under Chamberlain. Middleton does not say much about Chamberlain himself, but here again my point in n. 87 holds: the fact that two historians familiar with the documentary evidence have independently reached similar conclusions is striking.

[94] Chamberlain's calculations can be inferred from the entries for 22 and 23 August 1931 in his diaries, 2/22, and from his letters to his sisters, 18 July and 2, 16, and 23 August 1931, 18/1, Chamberlain MS.

come Prime Minister of the National government. For us, a differently posed and less discussed question is of greater interest: even before MacDonald finally decided to head the new coalition, how in his drive for a balanced budget had he come to be prepared openly to split his party and abandon his longtime leadership over it? Much of the answer lies in his revulsion at what he saw as an effort by the leaders of the Trades Union Congress to dictate to the Labour cabinet at the height of the crisis. To him such an encroachment on the autonomy of the state had to be resisted by any government—and by a Labour government above all, because its credibility as a guardian of "the national interest" was suspect.[95] Oddly, he did not regard pressure by the Bank of England as an equal threat to the autonomy of the state, perhaps because the bankers were more adept at expressing their fiscal preferences in the language of national interest.

When all the pieces of our puzzle are put together, one can discern a broad pattern in the failure of a Keynesian fiscal revolution to develop in the major democratic states during the Great Depression. Each key figure—MacDonald, Chamberlain, Hoover, Herriot—either clung to or turned back toward fiscal orthodoxy principally because he was concerned about defending the autonomy of the state; so, too, was Roosevelt in 1935–1937 as he abandoned his deviation from orthodoxy. Not all of them, to be sure, defined the threat to state autonomy in the same way. U.S. and British political leaders feared pressures from numerically potent masses in their societies, or from those who sought to speak for those masses. Herriot and others on the French left, and perhaps Roosevelt as well at the beginning of his first term, feared pressures from a strategically placed elite, the bankers. But whichever specific threat they perceived, there was a common tendency among them to think about the balance of the budget in terms of the balance between state and society. They valued highly the line of defense afforded by the rule, and result, that expenditure match revenue.

I use the term *autonomy* because the concern of those democratic leaders was to avoid a situation in which the executive authorities of the state, be it themselves or their successors, would feel compelled by some group or overwhelming sectional pressure to reorder priorities or redistribute fiscal resources in a way that violated their own political will or sense of ideological propriety. A few social scientists who read early versions of this essay questioned whether it is appropriate to speak of autonomy in this "negative" sense; to them the concept has meaning primarily in terms of autonomy to fulfill a "positive" purpose. But what I have in mind not only stems from the Greek roots of the word itself, but also echoes similar usage of other concepts in the history of political theory. For

[95] On MacDonald and the TUC, see the entries of 21 and 22 August 1931 in MacDonald's diaries, PRO 30/69/8/1, MacDonald MS, Public Record Office, London; and the masterful analysis in David Marquand, *Ramsay MacDonald* (London: Jonathan Cape, 1977), pp. 624–25.

example, in the political tradition of the West, there has long been a liberal concept of "freedom from" (grounded in common law or inherent rights) as well as a republican concept of "freedom for" (oriented toward political participation).[96] And even more germane to my concept of autonomy, as Albert Hirschman has reminded me, is the Kantian notion that to be free one must act in accordance with rules. Finally, in commenting on a collection of essays that helped set the agenda for this volume, Peter Evans, Dietrich Rueschemeyer, and Theda Skocpol noted that there is no straightforward relationship between the autonomy of states and their power in the socioeconomic realm.[97] My argument could be construed as an elaboration of that point: while a proto-Keynesian policy would have involved an increase in the power of democratic states in the 1930s, it might have brought a decrease in their autonomy; that at any rate was the trade-off that political leaders perceived and from which they shied away.

Another objection to my formulation might be that "state" is not the proper term, that what those leaders were concerned about was nothing more than the fate of their own government or party. But my analysis of the relevant clues or cases has demonstrated otherwise. Hoover's tax increase and spending cuts were scarcely calculated to improve his odds of being reelected. When Roosevelt sought to restore budgetary balance, his reelection was not seriously in doubt; and his concern about the Social Security system extended beyond his tenure in office as he anticipated it in 1935. Herriot deliberately chose to fall in late 1932 on a nonbudgetary issue lest he be brought down over fiscal policy in circumstances that might compromise the autonomy of the state.[98] MacDonald in August 1931 subordinated the fate of his government and the unity of his party to fiscal orthodoxy. Chamberlain's primary motive in 1931 was not to use the financial crisis to put his party in power.[99] And in 1937, one reason that he wanted a five-year ceiling on the budget-busting growth of military spending was his extended "time horizon," on which loomed large deficits well into the 1940s—after the constitutional deadline for the next general election. In all these cases, one finds a greater concern for the long-term autonomy of "the state" than for the short-term prospects of a government or a party.

[96] J. H. Hexter, *On Historians* (Cambridge, Mass.: Harvard University Press, 1979), pp. 293–303.

[97] Evans, Rueschemeyer, and Skocpol, eds., *Bringing the State Back In*, pp. 353–54.

[98] On the circumstances in which Herriot's government fell in December 1932, see Serge Berstein, *Histoire du Parti Radical* (Paris: Presses de la Fondation Nationale des Sciences Politiques, 1982), 2: 250–52; Peter J. Larmour, *The French Radical Party in the 1930s* (Stanford: Stanford University Press, 1964), p. 124; and Jackson, *Politics of Depression*, p. 62.

[99] See the well-informed analysis by David I. Wrench, " 'Cashing In': The Parties and the National Government, August 1931–September 1932," *Journal of British Studies* 23 (Spring 1984), pp. 135–53.

The form of wording used to characterize an argument is less important than the fit with the historical evidence provided by a type of explanation. The strength of my conclusion is that it makes sense of various striking clues and a broad range of puzzling behavior. Still, we have to consider how sensitive the conclusion is to the method by which it has been reached. In examining each concentric circle in its turn, we may have severed vital links between the rings. As political leaders looked out across the settings that surrounded them, they may have apprehended "vertical coalitions" extending from the bureaucracy into the legislature and then on to interest groups and the society at large. For example, in France, a leader who contemplated a proto-Keynesian fiscal policy might have envisaged an interlocking chain of opponents: the Finance Ministry, the Bank of France, the Senate Finance Commission, the financial community, and those voters who saw budget deficits as a threat to the stability of the franc. But at the same time, that French leader might have anticipated a coalition in support of spending: the military services as well as various domestic ministries; many parliamentarians whose constituencies included large numbers of peasants, workers, veterans, and *fonctionnaires*; and whatever interest groups might benefit from spending.

If political leaders put fiscal policy in this perspective, then an explanation of their orthodoxy might be that vertical coalitions in favor of budgetary balance loomed substantially larger than the parallel coalitions in support of spending. It is true that in France and Britain the "binding" chain was often the more manifest or well-defined of the two; the "liberating" coalition tended to be latent or somewhat inchoate. But it is also true that political leaders in all three countries did sense the potential strength of the network of ministries, groups, and constituencies with a stake in spending. Indeed, that is the very point exposed by my uncovering of the deep concern of many of those leaders about the autonomy of the state. They feared that the political dynamics of spending would get out of control: the actual or prospective supply of government expenditure would generate an ever-increasing demand for more—unless there was somewhere to draw the line.

It may seem that I am engaging in some analytical sleight of hand by assuming the validity of my hypothesis and using it to refute an alternative hypothesis. That is not so. One must bear in mind what is fact and what is hypothesis. The fact is that key political leaders were demonstrably concerned about the impact over time of deficit spending on the autonomy of the state; the hypothesis is that this concern has greater power than more "objective" constraints to explain their unwillingness to deviate too far or too long from budgetary balance. I am using the fact, not the hypothesis, to cast strong doubt on the notion that politicians perceived the interlocking chain of opposition to a proto-Keynesian policy to be stronger than an actual or potential chain of support for massive spending.

The conclusion to draw is that policy makers did have political room in which to maneuver. Constraints there were, but by no means did all of them press in the same direction. Extensive support could be called forth for different courses of action. As Peter Gourevitch has noted, the Great Depression brought political opportunity along with economic crisis. It was a solvent that ate away at existing structures or relationships and made politics more fluid.[100] Accordingly, in the confused crisscross of constraints, there was scope for genuine fiscal choice.

Yet the choices made were not devoid of broader context. They were implicated in significant historical patterns. The most obvious such pattern, particularly striking in Herriot's case, has to do with "lessons" learned from the inflationary trauma and political turbulence in the aftermath of the First World War. A more profound pattern leads us back to the structure of the modern democratic state as it had developed from the late nineteenth century. That structure took shape on one side with the expansion of electorates, the mobilization of new interest groups, and the increased political saliency of the distribution of income and wealth, and on the other side with the apotheosis of the gold standard and the attendant internationalization of finance, increase in the political leverage of financial communities, and greater prominence of the state of the budget. The concerns of political leaders in Britain, France, and the United States in the 1930s resonated with the tensions built into the structure of the modern state over the previous fifty years. Those leaders had only a dim sense of the depth of the historical roots of their anxieties. Even now, historians and other historically minded social scientists have merely scratched the surface of the ground that covers those roots. The task of digging deeper, of exposing the tangled pattern in which structure and choice were interwoven over the long run, should rank high on our intellectual agenda.

[100] Gourevitch, "Breaking with Orthodoxy," p. 99.

7

THE DEVELOPMENT OF KEYNESIANISM IN FRANCE

Pierre Rosanvallon

THE HISTORIAN might be tempted to explain the penetration and triumph of Keynesian ideas in France between the 1930s and the 1960s using the concepts developed by Thomas Kuhn for analyzing the process of scientific revolutions: examining how "anomalies" confronting classical theory in the 1930s arose and brought the theory into question; the emergence of the Keynesian paradigm; the transition period marked by fierce theoretical debate; the final victory of Keynesianism and a return to "normal science" once problems which led the former paradigm into crisis had been resolved. The same interpretive framework might also be used to examine the historical development of Keynesianism in other countries. All that would vary in this case would be the practical conditions of the confrontation between the old and the new. Such a comparative perspective is highly appealing a priori. But the identification of Keynesianism and classical theory with scientific paradigms, which such an approach implies, should be called into question. Unlike scientific theories, economic ideas do not confront one another within a homogenous plane of knowledge. While the world of scientists is relatively self-referential, economists act in a field that is deeply structured by other players: political decision makers, bureaucrats, and social agents. Economic theory, in this sense, is embedded within a highly complex system of articulation along with various ideologies and common sense. In other words, it is impossible to trace the history of Keynesianism from an overly analytic perspective which understands it simply as the progressive reduction of various forms of resistance to a new idea. The French case demonstrates this quite vividly. France is the country in which the penetration of Keynesian doctrine took place most slowly, but its ultimate triumph was perhaps more complete there than virtually anywhere else. There is nothing linear about this story; it is riddled throughout with ambiguities, misconceptions, and paradoxes. Herein lies its particular interest.

The 1930s or the Time of Misconception

The General Theory, published in England in 1936, was not available in French translation until the end of 1942.[1] From 1936 to 1942, very few French people, including economists, read *The General Theory* in the original. If one takes into account the difficulty of procuring a translation during World War II,[2] it becomes apparent that the French did not really begin reading *The General Theory* until after 1945.

This relatively belated penetration is itself a problem, for Keynes was not unknown to the French between the wars. Between 1919 and 1933, five of his works were translated and received with some success: *Les conséquences économiques de la paix* (1919), which went through fifteen printings; *Nouvelles considérations sur les conséquences de la paix* (1922); *Réforme monétaire* (1924); *Réflexions sur la France* (1928), in seven successive printings; and *Essais de persuasion* (1933). Why, then, the discrepancy between the relatively wide dissemination of Keynes' essays and the delay in translating his major work? It was obviously not just the result of pure coincidence. Indeed, his other major theoretical work, the *Treatise on Money* (1930), also received remarkably little critical attention and has never been translated into French.

In the first place, there were obstacles related to the public image of the author. Keynes was known in France mainly as an essayist, as a journalist or pamphleteer; he had no real status as a theoretician. Keynes was also viewed as a "purveyor of lessons" hostile to France. Had he not written in his preface to the French edition of *The Economic Consequences of the Peace* that "those surrounding M. Clémenceau have betrayed the interests of France"? The work was seen as pro-German and received "with indignant disbelief."[3] In his 1946 preface to Etienne Mantoux's *La paix calomniée ou les conséquences économiques de M. Keynes*, Raymond Aron attests to the persistence of this view. "As between Bainville and Keynes," he writes, "it was Bainville who saw things clearly. *Les conséquences économiques de la paix* is to be dismissed, *Les conséquences politiques de la paix* is to be reread."[4] Keynes' *Open Letter to the Minister of Finance* (1926), criticizing the economic and budgetary policies of the

[1] Payot publishers, translation by Jean Rioust de Largentaye (who was a financial inspector and not university-affiliated).

[2] See the information given by J. Bernard, a senior official, in F. Fourquet, *Les comptes de la puissance, histoire de la comptabilité nationale du plan* (Paris: Encres-Editions Recherches, 1980), p. 43.

[3] See E. Mantoux, *La paix calomniée ou les conséquences économiques de M. Keynes* (Paris, 1946), p. 36.

[4] Ibid., p. 9.

French government, was also very badly received, and not only among the conservative circles associated with Poincaré.

This dispute between Keynes and French public opinion undeniably had its impact, but more fundamental and more interesting reasons can also be adduced to explain the feeble penetration of the ideas set down in *The General Theory* during the 1930s. We can distinguish three: doctrinal hostility in the academic community; the context of the economic policy debate; and the equivocal relationship between Keynesian ideas and the French tradition regarding state intervention.

There were five noteworthy economists in France during the 1930s: Albert Aftalion (professor in the School of Law), Clément Colson (professor at the Ecole Polytechnique), Gaetan Pirou (professor in the School of Law), Charles Rist (a professor who later turned to advising and consulting), and Jacques Rueff (senior official of the Treasury). Many of them had read and assessed Keynes. Jacques Rueff in particular had properly noted the originality of Keynes' ideas on monetary matters and opposed him for this very reason. Rueff remained a believer in classical theory (which saw monetary phenomena as nothing more than the passive reflection of real economic activity) and he was opposed in principle to *The General Theory*'s vision of economic management based on the deliberate manipulation of the quantity of money in circulation. Indeed, his position on this point never wavered, as evidenced in his 1965 work, *L'âge de l'inflation*. In *Combats pour l'ordre financier*, he wrote: "*The General Theory* legitimizes the creation of buying power which is supposed to foster investment without savings and thereby succeeds in making a virtue of necessity. In this respect, the work lies behind the tendency toward inflation which is the decisive trait of all post-Keynesian economies."[5] Charles Rist developed a similar criticism of the *Treatise on Money* in his 1933 work, *Histoire des doctrines relatives au crédit et à la monnaie*.

These liberal economists especially condemned Keynes' analysis of the Depression, which to them was no more than a temporary disequilibrium. As Charles Rist wrote: "On the occasion of this crisis, the Anglo-Saxon economists have given themselves over to rantings all of which are based on the idea that we are dealing with a new crisis in our economic regime. To my mind, we are simply dealing with an exceptional and abnormal crisis of price readjustment after the price upheaval caused by the war and by paper money."[6] (Charles Rist's position is especially interesting in that he bore no a priori grudge against Keynes; he was, in fact, among the few French who approved of Keynes' diatribes against the

[5] J. Rueff, *Combats pour l'ordre financier* (Paris: Plon, 1972).

[6] Charles Rist, autobiographical note, in "Charles Rist: l'homme, la pensée, l'action," *Revue d'économie politique* (Nov.–Dec. 1955), p. 1031.

supporters of a merciless reparations policy for Germany. His opposition to the ideas in the *Treatise on Money* and *The General Theory* was therefore purely doctrinal.) This liberal critique contained nothing original in relation to debates which were going on at the same time within academic circles in other countries. The occasional political attacks on Keynes—tagging him a "socialist," for instance—were also not specifically French. They did, however, assume a distinct character in France. The problem of the "socialist" aspect of Keynes[7]—in the same sense of the term as it was sometimes applied to Roosevelt in Anglo-Saxon countries—in fact appeared less important in France than did his "German" aspect (i.e., his association with the principle of a closed economy). For while Keynes was little read between the wars, the policies of Schacht were quite widely discussed. Even if it was in a rather confused way, the French associated the rise of Nazism with the development of a closed economic system. This context contributed to the weak diffusion of Keynesian ideas, the perception of German sympathies becoming, as it were, a second reason for an a priori rejection of Keynes.

However, the doctrinal hostility of liberal economists and instinctive political reservations do not fully account for the resistance which Keynesianism faced in France. This resistance was in fact closely related to the context of debate on economic policy in the mid-1930s. Until the autumn of 1936, the major concern was devaluation versus deflation. The rift was not between an old and a new school of economic thought, but between nearly all the economists on the one side and all the politicians on the other. Rueff and Rist, thus, supported devaluation of the franc in 1936 (even if the latter did not openly state his position until the spring of 1936, in a resounding article in *Petit Parisien*): the ill effects of Laval's 1935 policies had convinced even those who, like Rueff, had previously supported deflation, of the need for devaluation. Beginning in the spring of 1936 and against expert advice, the new Socialist government refused to devalue the franc. Economic debate revolved around this topic until autumn.[8] It was not economic arguments, strictly speaking, which clashed, but rather economic argumentation as a whole which locked horns with political action. If Blum came to accept expert opinion only belatedly, it was because he considered devaluation to be first and foremost a political problem. It is impossible to understand this

[7] Note here that the publication of the French translation of *The General Theory* seems to have been delayed for political reasons. Jean de Largentaye's translation was completed in early 1939. The *Comité des Forges*, very influential in the Payot House which was to publish the work, pressured the editor to delay the French version, judging the work to have "communist" tendencies. (This story was told to me by de Largentaye's son.)

[8] The conditions under which Blum came to devaluate the franc are related by E. Monick, who in 1936 was financial advisor in the French Embassy in London, in the booklet *Pour mémoire* (Paris, 1970).

period if we forget the extremely crude conception which politicians then had of economic mechanisms. There were many reasons for this, including above all the general weakness of economics instruction in France, a point we will come back to, and perhaps especially, the long-standing mistrust which French political leaders felt toward economists.

Since the nineteenth century, politicians had regarded the science of economics with a suspicious eye.[9] Socialists condemned it as nothing more than an immoral science of greed, and traditionalists rejected the philosophic materialism it embodied. What is most important, however, is that the majority of political leaders of the period, be they liberal, conservative, or republican, all staunchly assailed the claims that economics could be a guide to government actions. Whether under the July Monarchy or the Third Republic, economists and government leaders, including the most conservative, were constantly at odds. Guizot and Thiers opposed Bastiat, Dunoyer, Passy, and Blanqui. Ferry and Waldeck-Rousseau were in virtually continual disagreement with Léon Say and Paul Leroy-Beaulieu. The cause of the argument? It centered around the question of what should direct and orient the action of the state. In the eyes of the liberal economists, economics alone could reveal the path toward the general interest. In *De la liberté du travail* (1845), Dunoyer posed the problem quite clearly: "Which of the two sciences—politics or economics—is most naturally and most appropriately suited to deal with society?" he asked. "That role belongs incontestably to economics . . . economics alone is essentially preoccupied with society, its nature, its purpose, its end, the work it entails, the laws governing that work; consequently, economics alone can truly speak of society in general terms. . . . In fact, politics is increasingly becoming economics everywhere, and is inextricably linked to an increasing degree with economic science."[10] For politicians, on the contrary, economics could never be more than a modest, supplementary science. Guizot and Thiers opposed the pretensions of the economists on numerous occasions. "Governments," wrote Guizot, "are not schools of philosophy . . . they hold all interests, all rights, all facts in their hands; they are obliged to consult them all, to take account of them all, to husband them all carefully. That is their very difficult condition. The scientific condition is infinitely easier."[11] To these men economics was not the universal science; it was but a circumscribed science with limited scope. It could not shed light on political action except on very

[9] See L. Epstein, *L'économie et la morale au début du capitalisme industriel en France et en Grande-Bretagne* (Paris: A. Colin, 1966); and L. Le Van-Mesle, "La promotion de l'économie politique en France au XIXème siècle, jusqu'à son introduction dans les facultés," *Revue d'histoire moderne et contemporaine* (Apr.–June 1980).

[10] Dunoyer, *De la liberté du travail* (Paris, 1845), 1: 172–73.

[11] F. Guizot, *Histoire parlementaire* (Paris, 1864), 5: 132.

specific points. Only the Saint-Simonians would ease this rift between economics and politics when they rose to positions of influence during the Second Empire. But during the rest of the nineteenth century, liberal economics did not really play a decisive role in orienting government action.

With the devaluation of the franc in the autumn of 1936, the French economic debate polarized around the problem of the law to establish a forty-hour workweek. Here again, economists were virtually unanimous in their criticism of the measure taken by the Blum government. Liberal economists like Rist and Rueff were naturally against it, but so were economists with socialist leanings, like Alfred Sauvy or even Raymond Aron,[12] not to mention experts on the ministerial staffs of Charles Spinasse and Vincent Auriol.[13] In this context, the problems that Keynes raised seemed to be out-of-sync, and Robert Marjolin demonstrated this in a very meaningful way. As an assistant to Charles Rist at the *Institut scientifique de recherches économiques et sociales*, Marjolin was exposed to Keynes' theories quite early. Beginning in 1934, his activities led him to nurture close relationships with professors at the London School of Economics, and he met almost monthly with the principal English economists (including Robbins and Hayek at the London Reform Club). He read *The General Theory* in early 1937 and was perfectly aware of all the debates the work had provoked across the Channel.[14] Marjolin thereby became the first French economist who could truly be called "Keynesian." He devoted his academic thesis, *Prix, monnaie et production* (1940), to an examination of Keynes' theories that was very favorable overall. Yet it was this pioneer of Keynesianism who criticized Kalecki in 1938 for having analyzed the Blum experiment in the light of Keynes. In "The Lessons of the Blum Experiment," published in 1938 in the *Economic Journal*, Kalecki sought to show that the Blum failure confirmed Keynesian ideas (he criticized the return to financial orthodoxy, the hesitation about whether to stimulate the economy or reduce the budget deficit, and the absence of foreign exchange controls). In "Reflections on the Blum Experiment," published in May 1938 in *Economica*, Robert Marjolin faulted Kalecki for not having understood the French sit-

[12] See R. Aron, "La politique économique du front populaire," *Revue de métaphysique et de morale* 4 (Nov. 1937). The article was reprinted in the volume honoring Aron published by *Commentaire* 28–29 (1985). See also the essential work on this period by A. Sauvy, *Histoire économique de la France entre les deux guerres* (Paris: Economica, 1984), 3 vols.; as well as Michel Margairaz, "Les socialistes face à l'économie et à la société en juin 1936," *Le mouvement social* 93 (1975).

[13] See, for example, G. Cusin, then Vincent Auriol's staff director. He reports that Blum's attitude concerning devaluation almost caused him to resign from the SFIO. This element, moreover, played a significant role in alienating young intellectuals who were once attracted to socialism (see, for example, R. Aron's *Mémoires* [Paris, 1984]).

[14] In an interview with me in early 1985, a few months before his death. Marjolin was assistant to the secretary general of the *Présidence du Conseil* in Léon Blum's first government.

uation and for having glossed over what he considered to be Blum's two major errors: the belated timing of the devaluation, and the forty-hour law which led to a considerable reduction in the level of employment opportunities necessary for economic expansion. Coming from Marjolin, the criticism was especially forceful evidence of the schism between the terms of the English debate on Keynes and the terms of the simultaneous French debate on the Popular Front's economic policies.

The third reason for the weak penetration of Keynesian ideas in France lies paradoxically in the convergence between some of his proposals and a long-standing French tradition regarding the economic intervention of the state. It is worthwhile to cite Charles Rist at length on this point:

> All of Keynes' thought was determined by the specific situation of England just after World War I. This situation was characterized by high unemployment following the return of the pound to par, and a bit later, by a violent drop in prices unleashed by the American depression of 1929-1930. Around these two events, Keynes constructed a purely opportunistic conception whose practical goal was essentially to lead the English government to create a system of large-scale public works to combat unemployment, to which the British Treasury was entirely hostile. . . . The idea of making "full employment" the key issue of economic policy in an increasingly industrialized world, and a world in which industrial workers represented a growing portion of the population, was obviously appealing though biased. It corresponds to the old "right to work" idea proclaimed by the 1848 Revolutión during a particularly bitter unemployment crisis.[15]

Rist thereby amplified his doctrinal criticism with an implicit accusation of archaism, of déjà vu. France had had a long-standing tradition of state-led action where public works were concerned, for strategic reasons as well as for purposes of territorial unification since the eighteenth century. But in the nineteenth century, public works were also perceived as a means of countering unemployment. If the men of 1848 gave the concept its most celebrated expression by establishing national workshops (*ateliers nationaux*), the most conservative political leaders, too, considered public works to be legitimate means of state intervention in times of crisis, as the stance of someone like Thiers indicates. In an 1850 report on social services, he devoted many a page to public works as a "means of fending off unemployment crises."[16] He proposed that the state set up a reserve of poten-

[15] See previously cited autobiographical note, p. 1036.

[16] Thiers, *Rapport général sur l'assistance et la prévoyance publiques* (Paris, 1850). Note that Thiers speaks of unemployment crises in the plural; the phenomenon had yet to be analyzed as a socioeconomic unity. (See historical and methodological developments on this subject by R. Salais in *L'invention du chômage* [Paris: PUF, 1985].)

tial projects to be effected in times of crisis: "If, instead of being private industry's competition in prosperous times . . . the State had been idle when industry was working, in order to work when industry was idle, there would have been less agitation in active times, and less of a slowdown in times of slowdown and inertia."[17] From this time on, the idea became common. The governments between the wars did not feel that they were innovating when they launched public works programs. In November 1929, even before the Great Depression struck France, Tardieu proposed a plan of national equipment (*outillage national*). In 1931, a works plan was established to "fend off the danger of an unemployment crisis."[18] In August 1936, Blum adopted a law "related to the execution of a works plan destined to combat and to prevent unemployment" (twenty billion francs were to be spent in three years for this purpose). Similar initiatives were taken by the Laval, Herriot, and Daladier governments during this period.

This context allows us to understand the difference in the reception accorded Keynes in France and in England. Quite apart from the theoretical debate, which was much less important in France than in Great Britain, Keynesian theory did not relate to the economic common sense of the two countries in the same way: it conflicted with English common sense while being much more in tune with French common sense. This explains both how economists like Rist could judge Keynes' positions as unoriginal and specific to the English context and why a larger audience was not motivated to read Keynes. One of the striking characteristics of this period in France was a kind of indifference to Keynesian ideas arising from the nonrecognition of the innovative quality of *The General Theory*.[19] Besides the public works issue, informed opinion had also been struck by Keynes' mercantilist aspect. When Keynes spoke of the "pioneers of economic thought of the sixteenth and seventeenth centuries," Charles Rist was all the more certain that he was dealing with an archaic work. Economists of a Colbertist and gold-based country were inclined, here again, to minimize the originality of Keynesian proposals.

[17] Ibid., p. 75.

[18] Besides Sauvy's analyses, see P. Saly, *La politique des grands travaux en France, 1929–1939* (New York: Arno Press, 1977).

[19] One of the most remarkable things about the French situation was the dearth of articles on Keynes before 1949. The principal economic review of the time, *Revue d'économie politique*, carried only two, though its stated purpose was to make the work of foreign economists better known in France. The publication of *The General Theory* in 1936 was only briefly alluded to, and E. Mantoux devoted a thirty-one-page article to Keynes in 1937 (a very critical one, concluding that the work was too theoretical and irrelevant). More on this topic can be found in G. de Margerie's Master's thesis, *L'enseignement de l'économie en France de 1930 à 1945* (Université de Paris I, July 1979) under the direction of J. Bouvier (see especially the brief chapter entitled "La connaissance des économistes étrangers"). Furthermore, a very interesting article by sociologist M. Halbwachs, "La théorie générale de Keynes" (*Annales sociologiques*, série D, 1940), went completely unnoticed.

This "cultural" aspect of the resistance to the penetration of Keynesianism in France is very important from an epistemological point of view. The approach Thomas Kuhn developed in *The Structure of Scientific Revolutions* might well explain the penetration of Keynesianism in places where that was played out purely as a contest with classical theory: the process can then be analyzed basically as a struggle between a new and an old paradigm. But the history of Keynesianism in France can be described only very slightly in these terms. The battle with classical theory was less lively in France than elsewhere (in part thanks to the lack of combatants), and the contextual misalignment is also especially noteworthy (the issues with which French economists were particularly concerned in 1936 were not exactly those which mobilized their English colleagues). But the most important factor is the phenomenon we can call the blindness of proximity: what stood in the way of Keynesian ideas was not a perception of their difference but a vague feeling of resemblance, a sort of familiarity, whereas it is novelty that generates a problematic by calling into question the consonance between economic common sense and theory. In France, this consonance was even more considerable because the old "theory of purchasing power" was well known in the 1930s. Alfred Sauvy has rightly pointed out that the idea of an economic stimulus based on increased demand was already commonplace in France, be it the "underconsumption" (*sous-consommationniste*) or the "oversupply" (*abondanciste*) version.[20]

The economic common sense of the 1930s, at least on the left, can therefore be called para-Keynesian. Looking at the economy from the consumer's and not the producer's perspective, socialists formulated a program which *seemed* Keynesian. Commenting on this program, R. Mossé, one of the rare economics professors of the period who was a socialist, used terms that appeared to come straight out of *The General Theory* which, however, he seems not to have read.

> The general idea is to provoke an increase in consumer demand necessary for the sale of abundant goods and for the full utilization of the capacity of production. To do this, we must first increase salaries. It is undoubtedly true that increasing salaries represents a transfer of purchasing power, but we must compare the employment created previously by capitalists and entrepreneurs and the work which the wage-earners will create. The former hoard, save . . . ; the latter, on the contrary, hasten to spend, to consume in order to satisfy their immediate needs. Consequently, money begins to circulate more rapidly, it begins to fill the thousand channels of economic life and gives it renewed vigor and health.[21]

[20] Sismondi originated underconsumption proposals; oversupply ideas were put forth by J. Duboin in several widely read works: *Ce qu'on appelle la crise* (Paris, 1934); *La grande révolution qui vient* (Paris, 1934); *En route vers l'abondance* (Paris, 1935), 2 vols.

[21] See R. Mossé, *L'expérience Blum* (Paris, 1937, cited in Sauvy's *Histoire économique*, 7: 238).

This perceived proximity, however, was laced with ambiguities. Witness Léon Blum's timorous respect for the principle of a balanced budget, his very traditional vision of monetary administration (he had not hesitated, admittedly on political calculation, to entrust Jacques Rueff with the direction of the *Mouvement général des fonds du ministère des Finances*—the equivalent to the direction of the treasury), and his position on the forty-hour-week.[22] If the socialist economic program was crypto-Keynesian, the Popular Front's was more pseudo-Keynesian in that it maintained an ambiguous, contradictory, and undeveloped relationship with Keynesian ideas.

Thus, *The General Theory* met a series of intellectual, cultural, and political obstacles in France during the 1930s. These explain why the impact of *The General Theory* was both belated and limited to relatively marginal sectors, far removed from the universities and from major political currents. We can distinguish three groups that were receptive to Keynesian ideas.

Mostly graduates of the *Ecole Polytechnique*, economist-engineers became organized in 1931 around the group *X-Crise*.[23] Seeking to apply the governing principles of industrial organization to the overall economy, their guiding idea was a vision of the economy centered on the individual entrepreneur. Auguste Detoeuf aptly described their reasoning in his article, "La fin du libéralisme." Their ideal was, first, scientific. They considered it imperative to secure a better understanding of economic data, and to apply principles of rationality to a field hitherto dominated by what they considered only literary speculations and commonplaces. Besides Alfred Sauvy, the most notable members of this group were Jean Ullmo, Jean Coutrot, Jules Moch, Louis Vallon, and Jacques Branger. It is worth noting that their scientific ideal was accompanied by a certain political pluralism, with members ranging from moderate socialists to socially concerned conservatives.

Inspired by the Belgian socialist Henri de Man (*Socialisme constructif*, 1932), certain socialist circles, mostly connected with the trade unions, made the idea of planning the focus of a new reformist vision for the transformation of society.[24]

[22] For more information on these contradictions, see A. Sauvy, *De Paul Reynaud à Charles de Gaulle, un économiste face aux hommes politiques, 1934–1967* (Paris, 1972); J. Bouvier, "Un débat toujours ouvert: la politique économique du front populaire," *Le mouvement social* 54 (Jan.–Mar. 1966); J. M. Jeanneney, "La politique économique de Léon Blum," in *Léon Blum, Chef de gouvernement 1936–1937* (Paris, 1967); B. Georges, "La C.G.T. et le gouvernement Léon Blum," *Le mouvement social*, 54.

[23] See G. Desaunay, *X-Crise, Contribution à l'étude des idéologies économiques d'un groupe de polytechniciens durant la grande crise économique (1931–1939)* (Paris, 1965); F. Etner, *Les ingénieurs-économistes français (1841–1950)* (Paris, 1978); and X-Crise, *De la récurrence des crises économiques* (Fiftieth anniversary publication) (Paris, 1982).

[24] See G. Lefranc, "Le courant planiste dans le mouvement ouvrier français de 1933 à 1936,"

The group *Révolution Constructive* and the *Centre Confédéral d'études ouvrières de la C.G.T.* were the principal strongholds of these ideas. In 1934, they adopted a *Plan de la C.G.T.* which proposed a new economic organization founded on the principles of a directed economy (nationalizations, credit policy) and acceptance of the need for a mixed economic regime. Along with the political promoters of this program, Jouhaux (secretary general of the CGT) and Lacoste (secretary of the powerful *Fédération CGT des fonctionnaires*), a whole cluster of intellectuals allied themselves with the plan: G. Lefranc, R. Marjolin, Duboin (the theoretician of oversupply), and Jean Duret.

The French advocates of planning also participated in a European movement designed to popularize the approach. Socialist militants, along with Belgian, Swiss, English, and French trade unionists met at two international conferences on planning. The first took place in September 1934, at Pontigny, and the second April 1936, at Geneva. Among those present were De Man, Jouhaux, Cole, John Cripps, and Gaitskell.

Aside from these formal groups, a number of individuals played a major role in paving the way for Keynesianism. We can cite at least three.

Jean de Largentaye was then a young financial inspector and assistant to Vincent Auriol in the first Blum ministry. His interest in economic theory led him to translate *The General Theory*, and in the course of translating, to expound on the work to a small group of high-ranking civil servants assembled by R. Cusin, Vincent Auriol's staff director during the winter of 1937–1938. (It should be noted that Cusin was very close to the group interested in planning and had participated in the two international meetings at Pontigny and Geneva.) Cusin later reported on the quasi-initiatory character of these small gatherings,[25] as if the participants were receiving a kind of revelation.

Georges Boris, who would become Pierre Mendès-France's most devoted colleague, had read Keynes' work beginning in the summer of 1937 (see Georges Boris, *Servir la République, Textes et témoignages* [Paris, 1963]). A journalist for years, he had begun in 1927 an important work of popular economics, wrote in the weekly *La Lumière*, and had published a book entitled *La Révolution Roosevelt* in 1933.

Robert Marjolin, colleague of Charles Rist at the *Institut scientifique de recherches économiques et sociales*, participated in *Révolution Constructive* in 1931–1932.

Significantly, there were no real university economists among these men. The first informed supporters of Keynes were mainly concerned with practical affairs.

Le mouvement social 54 (Jan.-Mar. 1966); and Richard Kuisel, *Le capitalisme et l'Etat en France* (Paris: Gallimard, 1984).

[25] From my perusal of G. Cusin's "memoires," as recorded by H. de Largentaye.

Jean de Largentaye and Robert Marjolin aside, there was no real Keynesian school in France at the end of the 1930s. It is more appropriate to speak of small circles of initiates surrounded by several groups that were *potentially* open or receptive to such ideas. Although these different circles never really fused, they interacted continually. The important thing is that they constituted the matrix of the technocratic, modernizing, and reforming sectors which would mark postwar France.

The Keynesianism of these sectors, when it was evident, was far from "pure." Particularly telling is the case of Georges Boris, who would introduce Keynes to Pierre Mendès-France. For Boris, Keynes was something of a theoretician of directed economy and of a statist neointerventionism. Boris was far from understanding the relationship between *The General Theory* and the Roosevelt experiment or the policies of Schacht in Germany. More precisely, he had not grasped how Keynes had been inspired by these experiments—much as he returned to old monetary notions—but had constructed from them a new and original synthesis.

Léon Blum was wary of the planning advocates' ideas for two reasons. The first was political, involving the battle against Marcel Déat's neosocialists. This group, like the reformist trade unionists, advocated planning and a mixed economy, and herein lay the seed of the socialist majority's almost instinctive distrust of planning. Many of them feared that such ideas would lead to fascism. The interest that the planning advocates showed in Schacht's policies in Germany seemed suspect a priori; it was hard to understand a body of ideas that seemed to refer indiscriminately to Schacht's experiment as well as to Soviet and U.S. policies. But the Socialist rejection of planning in this period was based chiefly on doctrinal principle. The Socialists chided the neosocialists for breaking with the revolutionary perspective on the overthrow of capitalism. "The studies and projects for a Plan," said the report presented in May 1934 to the Socialist Congress, "will not induce the Party to pursue that insane chimera of realizing socialism in a partial and progressive manner by whittling away at the heart of a continuing capitalism."[26] The Communists shared this point of view: they rejected what to them seemed a simple process of fixing up capitalism.

Thus, there was a political obstacle to the acceptance of Keynesian ideas in socialist circles. While *The General Theory* certainly implied new social compromises in one way or another, it was far removed from a revolutionary perspective. Worse yet, it proposed rather overtly to strip that perspective of all foundation.

At the time of his second government, however, in the spring of 1938, Léon Blum had to relax his position. Faced with domestic difficulties and foreign

[26] Quoted by G. LeFranc, "Le courant planiste. . . ."

threats, he presented on April 5, 1938, a "bill meant to give the government the powers necessary to enable the nation to meet obligations incumbent upon it and especially defense needs." This bill was drawn up by Pierre Mendès-France, Under Secretary of State for the Treasury, and Georges Boris, his staff director, with the help of Cusin, staff director for Vincent Auriol (the text can be found in the annex of volume 1 of *Oeuvres complètes* by Pierre Mendès-France [Paris, 1984]). The English press, and notably the *Financial Times*, considered this the first attempt to implement Keynesian ideas. The bill was defeated in the Senate, however, and Blum resigned on April 10, 1938.

Was this project Keynesian? Yes, in the sense that it stressed monetary circulation (underpinned by import and exchange controls) and the idea of stimulation through spending (including spending on defense). But the principal inspiration was in fact German policy. Before the Court of Riom, Blum said of this project: "It moves resolutely out of the liberal economy, and toward a war economy. It aims for exchange controls, the creation of domestic resources, and a currency control which can then allow for the purchase of raw materials, machine-tools and finished goods necessary for rearmament. It closes the circuit. It could have freed us from reckoning with the borrowing, and with the financial, monetary and economic difficulties of the rearmament effort."[27] Before the investigative commission of the *Assemblée Nationale* on July 30, 1947, he went further by saying that this plan would have made possible "to furnish assistance to the war industry within a closed economy, by means analogous to those which Dr. Schacht implemented in Germany."

Here again, the diffusion of Keynesianism cannot be seen as a simple progression in the influence of Keynesian ideas. Its diffusion was inseparable from the supporting context and from a set of associations or references which sometimes ended up concealing Keynes' actual work.

THE 1940S TO 1960S: THE TRIUMPH OF KEYNESIANISM

After World War II, France would become one of the countries where Keynesianism established itself most thoroughly. Before outlining this turnaround, it is useful to consider its underlying modalities. In this regard, we should distinguish two factors: the conditions that facilitated the diffusion of Keynesian ideas, and a transformation in the view of the statist phenomenon on the other.

[27] Statement given before the Cour de Riom, March 10, 1942, in Léon Blum, *L'histoire jugera* (Montreal, 1943), p. 286. For information on this 1938 initiative see annex 6 of the cited work by Fourquet, Sauvy's *Histoire économique*, as well as vol. 1 of *Oeuvres complètes* de Pierre Mendès-France (Paris: Gallimard, 1984).

The Diffusion of Keynesian Theory After 1945

While Keynes had been little read between the wars, many post-1945 works helped disseminate his ideas. On the university level, François Perroux played a major role. He directed Jean Domarchi's thesis, *La pensée économique de John Maynard Keynes et son influence en Angleterre*, defended in 1943, and, more importantly, Alain Barrère's *Théorie économique et impulsion keynésienne*, published in 1952. Perroux himself published a brief but profound study in 1950, *La généralisation de la "General Theory."*[28] In 1945–1946, the *Revue d'économie politique* published many favorable articles on Keynes (including the famous "La théorie de Keynes après neuf ans" by J. Hicks).[29] But this hardly meant that the university had converted to Keynesianism. Perroux was in fact relatively marginal in the academic system where he remained an isolated power. Moreover, he directed all his energies to the inception of the ISEA (*Institut supérieur d'économie appliquée*), whose principal aim was to prepare studies for the Plan. The young economists whom Perroux attracted—particularly Uri and Marczewski—did not hold university positions.

Until the mid-1950s, economic instruction remained the poor relation of law schools and was taught only as a minor field.[30] It was in engineering schools, at ENSAE and at ENA, that the discipline progressed in the postwar years: Allais held a position at the *Ecole des Ponts et Chaussées* (School of Bridges and Roads) and Jean Ullmo at the *Ecole Polytechnique*. However, the members of the *grands corps* who constituted the upper echelons of the administrative technocracy were formed in these schools. Thus, the best French economists of the period were almost all technocrats. Significantly, the first course dedicated to Keynesian doctrine took place at ENA in 1946 (with Jean Ullmo and Jean Marchal). Keynesian ideas took root most rapidly and most forcefully in these milieus, not in the universities. Robert Marjolin had been the first to publish a thesis on Keynes in 1941; after World War II, a young financial inspector, Claude Gruson, published a remarkable work, *Esquisse d'une théorie générale de l'équilibre économique, réflexions sur la théorie générale de Lord Keynes* (1949).[31]

[28] Oddly enough, published in French in Istanbul.

[29] The list can be found in G. de Margerie's thesis cited in n. 19.

[30] For information on the fundamental weakness of French economics instruction, see G. Pirou, "L'enseignement économique en France: les facultés de droit" in G. Pirou and Charles Rist, *L'enseignement économique en France et à l'étranger* (Paris, 1937) (published for the Fiftieth anniversary of the *Revue d'économie politique*); L. Le Van-Lemesle, "La promotion de l'économie politique en France jusqu'à son institutionnalisation dans les facultés, 1815-1881," *Revue d'histoire moderne et contemporaine* (Apr.–June 1980); "La crise de 1930 et la remise en cause d'une légitimité," *Bulletin de l'Institut d'histoire économique et sociale de l'Université de Paris I* (Nov. 1982); "L'économie politique à la conquête d'une légitimité," *Actes de la recherche en sciences sociales* 47–48 (June 1983).

[31] In the "Théoria" collection, edited by F. Perroux, Presses Universitaires de France.

With the exception of a few isolated figures like Alain Barrère and Jean Marchal, the academic milieu was out of step with the extraordinary intellectual activity which then characterized an entire nucleus of young, high-ranking civil servants: Bloch-Lainé, Marjolin, Nora, Gruson, Serisé, Lauré, Uri, Denizet, Delouvrier, Ardant.[32] These were the same people associated, starting in 1945, with the Plan, the SEEF,[33] and the INSEE and the *Commission des comptes de la nation*. The penetration of Keynesian ideas in this milieu was inseparable from the construction of a whole new apparatus of economic information. Jean Denizet went as far as saying, "Keynesianism is national accounting."[34] For this generation, Keynes was the instigator of a new relationship between theory and practice. In *La pensée économique en France depuis 1945*, published in 1953, Jean Marchal rightly notes that the most innovative phenomenon of the period lay in the attempt to tie in economics with social problems and to link its theory with the action of the state. We can speak in this sense of the formation of a Keynesian practice in France from the early 1950s. The penetration of his work was inseparable from the transformation of the relationship of the state to society.

The discrepancy between the university and the technocracy was symbolized by the creation of the CEPE (*Centre d'études des programmes économiques*) in 1957, under the impetus of Gaston Berger, François Bloch-Lainé, and Claude Gruson. While university economics instruction had been reformed in 1954 with the creation of a specific *agrégation*, this hardly compensated for French backwardness. However, the state apparatus, as well as several large enterprises, had a growing need for high-quality economists, and university-trained economists were suspected of being much too "literary." The CEPE responded to this demand by giving engineers and high-ranking civil servants quality economic and mathematical training, under the impetus of its first director of studies, E. Malinvaud.[35] Its creation marked a symbolic rupture with the pioneering postwar period during which a first generation of high-ranking civil servants were given

[32] In addition to the previously cited works by Fourquet and Kuisel, information on the history and ideas of this generation can be found in: E. Chadeau, "Les modernisateurs de la France et l'économie du XXème siècle," *Bulletin de l'histoire du temps présent* 9 (Sept. 1982); F. Bloch-Lainé, *Profession: fonctionnaire* (Paris, 1976); P. Lalumière, *L'inspection des finances* (Paris, 1959); C. Brindillac (O. Chevrillon), "Les hauts fonctionnaires," *Esprit* (June 1953); C. Gruson, *Origines et espoirs de la planification française* (Paris, 1968); P. Massé, *Le plan de l'anti-hasard* (Paris, 1965); J. Monnet, *Mémoires* (Paris, 1976). To assess the watershed 1930s, specifically as regards the key area of financial inspectors, see N. Carré de Malberg's article, "Les limites du libéralisme économique chez les inspecteurs des finances sous la IIIème République," *Bulletin du Centre d'histoire de la France contemporaine* 6 (1985).

[33] *Service des études économiques et financières du ministère des Finances*, which became the *Direction de la prévision* in the 1960s.

[34] Quoted by Fourquet, *Les comptes*.

[35] For the history and programs of the CEPE, see Y. Bernard and P. Y. Cossé, *L'Etat et la prévision macro-économique* (Paris: Berger-Levrault, 1979), p. 21.

"on-the-job" economic training, at ISEA, the Plan, or SEEF. A significant fact: practitioners would be systematically chosen over university economists to teach at CEPE. This explains why the best French economists would be virtually absent from the universities until the late 1960s.[36]

Finally, it should be noted that the penetration of Keynesian ideas also resulted from the dynamic intellectual exchange associated with the implementation of the Marshall Plan after 1947 and with the creation of the OEEC. It was Robert Marjolin, moreover, who left the Plan to become the latter's first secretary general.[37]

The State and the Economy

In two years (1945–1946) the economic role of the state grew considerably. The state became the country's principal investor, simultaneously banker and industrialist, and set up a system of economic planning. This change surely corresponded to certain conjunctural imperatives. It was necessary, as it was after the First World War, to raise the country out of its ruins and to stimulate economic activity. But the form that state intervention assumed after World War II marked a fundamental rupture with the 1918–1920 period, quantitatively and qualitatively. In quantitative terms, the toll of World War II differed completely from that of World War I. While there was less human loss in World War II, material destruction was much greater: 74 *départements* had been affected, compared to only thirteen in the First World War; entire regions had been devastated; agricultural and industrial production suffered more (the industrial production index fell to 38 in 1945 from 100 in 1938); and close to 1,200,000 buildings were destroyed or damaged. Overall, it was estimated that more than a quarter of the country's capital had been destroyed (compared to around 10 percent in World War I). Shortages were also much more acute in 1945 than in 1918, and the reconstruction tasks were of a phenomenal scope. The new involvement of the state as an economic agent was initially a response to these unprecedented material emergencies. But it also entailed a cultural break: the ordeal of the war transformed the view which French society took of the state.

Multiple factors contributed to this: an anticapitalism affirmed by the resistance movements, nourished by the rejection of "economic feudalism" and by

[36] From this time on, there was even a certain academic renewal due to, among other things, the reorientation of INSEE and of plan-connected research centers like CEPREMAP toward the university.

[37] See Raymond Barre, "Eloge de Robert Marjolin," *Commentaire* 35 (Fall 1986). The intellectual exchanges involved in developing national accounting also played a key role in tying French technocrats to Anglo-Saxon, Keynesian economists. (Fourquet offers invaluable information on this subject.)

distrust in the old, disqualified ruling classes; some reduction in the left's suspicion of the state-as-employer in the wake of the 1945–1946 social reforms; the spread of a Keynesian vision of the economy among an entire generation of young, high-ranking civil servants. These elements combined with imperatives of reconstruction to turn the state into a force that seemed to incarnate the spirit of the Liberation. Jean-Pierre Rioux has rightly emphasized that, after 1945, a certain sense of the state provided the principal cement holding together a scattered and spent France, prolonging through a certain national unanimity the unity of the resistance.[38] Thus, the economic role of the state grew for reasons that might be called "political," and it was associated with a consensus around which the principal French political families grouped themselves. In 1945, the state was celebrated in much the same way that the sovereignty of the nation had been celebrated in 1789. This similarity corresponds to something very profound: in the themes of the Liberation, there is undeniably a sort of return to the origins of French political culture, a nostalgia for the founding consensus. By the same token, the activism of the state was no longer viewed simply as a temporary and reversible intervention, as it had been after World War I; it became part of a long-term perspective.

Keynesianism appeared within this context as the theory best suited to this situation. However, we cannot understand the new economic role played by the state during this period only in terms of the notion of "interventionism."[39] If the state actually intervened rather more in the economy and society, that was not simply because its action was considered more desirable or more legitimate than in the past. The liberalism/interventionism issue was in fact completely transformed in this period by a new perception of the economic world as a system of action. Growth, employment, and purchasing power were no longer understood as results and balances: they became objectives. In this regard, the transformation in the role of the state was simply a consequence of this new vision of the economy; it was not based on a modification in the relationship between the state and society which contained within itself its own rationale (in the sense that liberalism and socialism suggest, for instance, two different philosophical and practical approaches to this relationship). From this flows the central conception of economic policy which became the basis for a voluntarist relationship tied to economic circumstances. The economy came to be seen as a system of variables and flows to be optimized. This was a considerable break with the visions of the past. For classical liberal economists of the nineteenth century, the artificial notion of eco-

[38] See his introduction to F. Bloch-Lainé and J. Bouvier, *La France restaurée, 1945–1954* (Paris: Fayard, 1986).

[39] Even if there was something fundamental about the return to a democratic vision of the state's role, the comparison of *étatisme* with fascism or with Vichy was fading rapidly.

nomic policy had to be meaningless since all adjustments were held to be governed by "natural" laws of equilibrium. Their only preoccupation was to keep the state from abusing its institutional role while pursuing an adequate monetary policy and respecting the principle of budgetary equilibrium. Ideas like "stimulation" or "stabilization" had no place in this scheme of things. At most, the state might be allowed to counteract cycles of unemployment by launching public works during economic slumps (on the condition that they be financed by savings previously arranged for this purpose). In the end, economists of Marxist allegiance essentially believed likewise: crises in capitalism were inevitable, and only a change of regime—the progression to socialism—could modify this given.

If the economy is viewed as a system of variables and flows to be optimized, it then becomes an object for action. All economic variables could be acted upon: the money supply, budget, revenues, prices, supply, demand. The term *policy* now extended to all these domains. The Keynesian revolution even created a new language—only in its aftermath could one speak of price policy, salary policy, fiscal policy, and the like. Conjunctural interventions and structural actions were henceforth perceived as simultaneously complementary and inseparable. The "economic" and the "social" were no longer distinct but became totally interwoven. A new function appeared as well: that of regulation. Its distinctive trait lay in changing all previous approaches to state intervention. The latter was to be seen neither as a "domain" of intervention nor as a "social value," the terms in which the state's role had always been discussed before 1945. Whether a matter was on or off the agenda was previously determined by considerations related to the private or public nature of the relevant domains or envisaged problems (should the state intervene in the domain of poverty, of transportation, of schools, etc.?) or by philosophical principles (should it preempt the individual, and if so, when? If it is to guarantee social equality, should it define that in terms of an equality of condition?). The notion of regulation transcends these analytical frameworks: it calls for a central agent, a connecting force, which can only be the state. Thus, Keynesianism altered our perspective on even the most traditional elements of the world of the state. Pierre Mendès-France wrote in *La science économique et l'action* (1954, p. 10), "From this theoretical system flowed a group of practical solutions. Financial institutions, the budget, credit, the money supply, taxes, all took on a new meaning and a new function." Variables which had been the components of the daily life of the state were elevated into comprehensive policy tools.

The Two Ages of Keynesianism in France

We can distinguish two periods in the success of Keynesianism in France after 1945. From 1945 to the late 1950s, French Keynesianism can be understood above all as the economic expression of a reformist and modernist political culture; in the 1960s and 1970s, it assumed a more restricted form as the theoretical foundation for a policy of regulation.[40]

After 1945, Keynesianism was no longer relevant as a theory of effective demand, so different were these years from those between the wars. The economic situation was in fact one of shortage, and the objective was to repair a badly tattered industrial fabric.[41] Before putting Keynesianism to work, it was necessary to "return to normal"; the main economic choices of the period were thus totally foreign to the Keynesian problematic. This became clear in early 1945, during the great debate between René Pleven and Pierre Mendès-France. It was the more Keynesian of the two men, Mendès-France, who advocated financial and monetary rigor, considering inflation to be the most dangerous threat.[42] Pleven's recommended policy, on the contrary, was only remotely Keynesian, appearances notwithstanding; it sought mainly to avoid an "orthodox stagnation"[43] of supply. Similarly, nationalization and planning were not Keynesian measures: they envisage direct forms of economic control, whereas Keynesianism is a technology of regulation, that is, a framework for the market system based on fiscal, budgetary, and monetary tools. The technocracy of the late 1940s thus worked within a framework that was clearly more antiliberal than that within which Keynesianism was situated. Therefore, it is inappropriate to speak of Keynesian *policies* during this period—at most there were Keynesian *tools* of which the establishment of a national accounting system constituted the matrix. However, the pioneers who developed the system all agree that it was initially conceived with an eye to economic planning. Without forcing the point, then, we can contrast the *methodological* Keynesianism associated with the reformist objectives of the 1940s and 1950s, to the *regulatory* Keynesianism that followed.

After the Liberation, French Keynesianism became the economic expression of a reformist political and social vision, a more or less clear component of the search for a policy of the "third way." As Simon Nora observes, to be Keynesian

[40] R. Boyer rightly distinguishes between "fundamentalist Keynesian reformism" and "a more limited view: effective demand Keynesianism and fine-tuning policies" in *The Influence of Keynes in French Economic Policy* (CEPREMAP, Aug. 1983; document 8404). See also Boyer's *Formes d'organisation implicites à la théorie générale, une interpretation de l'essor puis de la crise des politiques économiques keynésiennes* (CEPREMAP, Dec. 1983, document 8402).

[41] See G. Cusin, "Les problèmes économiques de la France libérée," *Espoir* 47 (June 1984), as well as the collective work, *La libération de la France* (proceedings from the October 1974 colloquium) (Paris: CNRS, 1976).

[42] For information on the subject, see Pierre Mendès-France, *Oeuvres complètes*, vol. 2 (Paris: Gallimard, 1985); J. P. Rioux and F. Bedarida, *Pierre-Mendès-France et le mendésisme* (Paris: Fayard, 1985); R. Rémond and J. Bourdin, *La France et l'après-guerre: au tournant de la modernisation* (Paris: Presses de la FNSP, 1986).

[43] The expression is F. Bloch-Lainé's from "La France restaurée," an interview published in *Alternatives économiques* (Nov. 1986).

during these years "was a polite way of being a socialist."[44] Keynes served as a convenient "scientific" reference point for those who believed in an economic and social neo-Colbertism or social democracy *à la française*. It thereby gave a language and a set of common references to high-ranking civil servants who were straightforward modernists and to an entire milieu of them more or less attracted to the Communist party. This was particularly notable in the SEEF and in the small groups that focused on national accounting. Keynes moderated the inclination of several sectors of the intelligentsia toward communism at a time when communism had an undeniable intellectual and moral attraction within French society. It allowed a large portion of the technocracy to displace and avoid political choices and involvements by offering them the possibility of giving new vitality to the ideal of rational government. In the early 1950s, Mendesism was largely the expression of this ideal. G. Ardant and P. Mendès-France's *La science économique et l'action*, published in 1954, describes this movement well: it presents Keynesian theory as the foundation of policy making guided by essentially scientific criteria. In the late 1960s, Giscard d'Estaing continued to place himself within this perspective, writing that the economic stalemate of the 1930s lay in a lack of knowledge much more than in an absence of will.[45] By declaring himself a Keynesian, he also sought to define himself outside the bounds of ordinary political cleavages. Keynesianism thus forged the basis for a common language among people of widely different political sensibilities.

Methodological Keynesianism in the reformist vein gradually made way for regulatory Keynesianism, with the more limited goals of coordinated management of economic policy in order to maximize the growth rate. Four factors contributed to this development.

In the first instance, there was the evolution of the economic context. When the initial phase of reconstructing the productive apparatus was completed toward the mid-1950s, economic priorities evolved. The quantitative objective of increasing production in a context of full employment, and even in one of labor shortage, was replaced by a preoccupation with maximizing and fine-tuning this growth. It should be noted here that the direction of Keynesianism had evolved in relation to the context and objectives of the 1930s. The concern in the 1960s was no longer absorbing unemployment—on the contrary, many immigrant workers had to be brought in—but one of normalizing and optimizing growth. This reversal provoked a new reading of Keynes disseminated in numerous economic policy texts.[46]

[44] From an interview in early 1985.

[45] Introduction to J. Denizet, *Monnaie et financement, essai de théorie dans un cadre de comptabilité économique* (Paris: Dunod, 1967).

[46] See, for example, J. Saint-Geours, *La politique économique dans les principaux pays occiden-*

The ensuing decline of economic planning was a second factor. After the second Plan (1952–1957), French planning retained no truly organizational function in economic development, even if the institution retained a very strong symbolic aura. The purposes to which the methodological tools developed within the framework of planning were put, therefore, progressively changed. While still used by the Plan to prepare forecasts and simulations, these tools were used to an increasing extent to clarify economic policy itself. The construction of large-scale econometric models and the evolution of the relationship between the Plan and the budget bear witness to this progression.[47]

There were also the failed attempts to establish an incomes policy. In the early 1960s, an entire current came to the fore proposing that an incomes policy be implemented with the dual goal of mastering inflationary tensions and ensuring an organized and equitable distribution of the fruits of growth.[48] The impossibility of finding enough of a social consensus to implement such a policy helped to reinforce the regulatory role of actual economic policy, especially given that salary growth was governed very imperfectly in France by collective bargaining procedures.

Finally, the opening of the French economy in the 1960s was a factor. This opening happened in two phases. Early on, the effects of the creation of the European Economic Community intensified the consequences of losing a colonial empire that had constituted a guaranteed outlet for French industry (from 1959 to 1970, the share of exports to the former colonies dropped from 34 percent to 12 percent of total exports, and imports from these countries fell from 25 percent to 10 percent of total imports). During this period, the state was a driving force in stimulating the merger of industrial enterprises, thus helping to form more competitive groups. In the 1970s, the opening of the economy underwent a brutal acceleration, especially after the first oil crisis in 1973 made the export imperative an increasingly vital necessity. From 1958 to 1980, imports rose from 9.7 percent to 26.5 percent of the gross domestic product and exports from 8.9 percent to 24.2 percent.

The Keynesianism of the 1960s was thus a substitute for the more institution-

taux (Paris: Sirey, 1969); and L. Stoléru, *L'équilibre et la croissance économiques* (Paris: Dunod, 1968).

[47] See Y. Bernard and P. Y. Cossé, *L'Etat et la prévision macro-économique*.

[48] The idea originated in 1963 with the formation of a group of experts, under the direction of J. Delors and P. Massé, who would explore the possibilities for a "National Conference on Incomes" (*Conférence national des revenus*). For information on relevant debates, refer to J. Boissonat, *La politique des revenus* (Paris: Le Seuil, 1965). The project was abandoned, and the government settled for a means of monitoring incomes: the *Centre d'étude des revenus et des coûts* (CERC). But the concept of an income policy struggled along a few more years. See, for example, P. Bernard and P. Massé, *Les dividendes du progrès* (Paris: Le Seuil, 1969).

alized regulations of the Plan and of incomes policy. But it brought about a mode of state intervention in French society which erased the borders between the structural reform that many supported in the immediate postwar period and straightforward conjunctural economic regulation. The regulatory Keynesianism of the 1960s was in fact grafted onto a program of national economic and industrial education in perfect cultural continuity with the interventionist spirit of 1945. It cannot be overemphasized that French interventionism—Colbertism, for example—is not in essence "ideological." It corresponds principally to sociological and cultural factors. The generation of high-ranking civil servants that emerged after the Liberation felt themselves in a certain sense *above* society, which they judged as obsolete and archaic; they assumed the roles of guides and pedagogues. The creation of ENA in 1945 justified this assertion. Herein lies perhaps the most profound difference between France and the Anglo-Saxon countries: the anticapitalist ethic and the consecration of high-ranking civil servants as central elites were combined to relegitimate a state that had been strongly contested during the interwar period.

The twentieth-century Keynesian state follows quite naturally in the footsteps of *l'Etat instituteur de la nation*. It is the state-as-teacher applied to industry. Its actions are based on the presupposition that the French economy lacks the overall capacity to manage and modernize itself. They are not simply a response to desires for harmony or to bring the particularistic interests of enterprises into conformity with the general interest. At the same time that the authorities set up the *Commissariat Général au Plan* in 1947, they entrusted to Gabriel Ardant the task of establishing a *Commissariat Général à la Productivité*, an institution that has no equivalent in the other industrialized nations and bears witness to the French state's distrust of industrialists. In this context, a law of July 22, 1948, implemented a vast program of productivity missions whose aim was to motivate economic and social leaders to "take lessons" from the most efficient foreign enterprises. From 1949 to 1952, 267 missions were organized (211 of which went to the United States), sending a total 2,610 employers accompanied by trade unionists and bureaucrats in small groups. Although the practical benefits of this program were not overwhelming, it nevertheless had an essential symbolic dimension: the state-as-modernizer displayed the same attitude toward industry that Jules Ferry's republican state demonstrated toward the uneducated masses of the late nineteenth century. An education in industrial affairs became in 1945 the equivalent of public schooling in the 1880s: it was the prop essential to economic liberalism, just as public schooling was the crutch for political liberalism and universal suffrage. In both cases, the same kind of pedagogical relationship was established between state and society. From 1945 to the 1980s, the French war against inflation has followed the dictates of a similar distrust. It was assumed that industry "did not merit" price deregulation and that a long guardianship was indispensable, beyond even the particular constraints occasionally exacted by the imperatives of conjunctural economic policy. This policy of control is, again, without equivalent in other industrialized nations. The attitude of the state is explained neither by a vague "interventionist tradition" nor by the existence of a sort of "disguised socialism." It appears rather with a remarkable consistency, transcending the different orientations of successive governments over the past forty years. Its continuity lies in the encompassing vision of the state as industrial guardian (*Etat tutélaire*).

It is true that Keynesianism in Anglo-Saxon countries can be seen as the bearer of a sociopolitical formula for compromise, and it undeniably had this dimension in France as well. But in France Keynesianism also seems to have been a cultural form for the state-society relationship, and herein, perhaps, lies the reason that the triumph of Keynesianism was so complete there. Moving forward from the perspective of a middle ground between socialism and liberalism, French Keynesianism dug its roots little by little into the long history of a pedagogical relationship between state and society. In this sense, its development is the product of cultural vulgarization. It is not Thomas Kuhn with his theory of changing scientific paradigms, then, who provides us with the best understanding of the forces behind this process, but rather Tomasi di Lampedusa, who observes that, "Everything must change so that nothing moves." In France, Keynesianism provided a means for averting modern conflicts—those of the class struggle—by reviving the essential traits of a political culture that long preceded these conflicts. Keynesianism in France was so strong precisely because it became one element of that indissoluble alloy of tradition and modernity.

Translation by Deborah M. Brissman

8

KEYNES AND ITALIAN ECONOMICS

Marcello de Cecco

IT CAN PROBABLY be stated without encountering much disagreement that the main political message John Maynard Keynes wanted, and managed, to convey was that unemployment is the principal danger of mature capitalist economies. In order to remedy this source of social and economic malaise, Keynes maintained that the capitalist socioeconomic system must be constantly tampered with, or, to use a more polite word, "managed," so that it might be preserved and that violent upheavals might be avoided. Like the ambitious Tancredi of Tomasi di Lampedusa's novel, *The Leopard*, Keynes wanted "to change everything, so that everything may remain the same."

This message inevitably appealed to all the "Tancredis" of the Western world, who could finally embrace a faith which entailed the repudiation of some of the postulates of the old faith, without reneging on the essential ones. The working of the capitalist system had become too complex, thus his message ran, to leave it to be managed solely by the decentralized actions of savers and investors. And the financial system had entangled itself in such a web of expectations and imitative behavioral problems that it could no more be relied upon to successfully mediate between savers and investors.

A new breed of macroeconomic managers was thus needed to take over mediatorial functions, to make sure that adequate investment was forthcoming, to generate the effective demand sufficient to employ all available resources, in particular, labor.

What David Ricardo had done to help the triumph of capitalism in the early nineteenth century, Keynes did to allow mature capitalism to survive in the twentieth century. They both made necessary reforms intellectually acceptable and attractive to the younger ruling elites, thus successfully counteracting the revolutionary doctrines prevalent in their respective times. And, since the Keynesian creed meant for the younger bourgeoisie going against the received religion of their fathers, reform was for them as psychologically disequilibrating as revolution. Hence, they called the Keynesian reform program the "Keynesian revolution."

"*The General Theory*," in Paul Samuelson's vivid words, "caught most economists under the age of 35 with the unexpected virulence of a disease first attacking and decimating an isolated tribe of South Sea islanders. Economists beyond fifty turned out to be quite immune to the ailment. With time, most economists in-between began to run the fever, often without knowing or admitting their condition."[1]

This description certainly does not apply to the Italian economic profession. Keynes had been very popular in Italy since the stunning success of the translation of his *Economic Consequences of the Peace*. His other works had been translated equally promptly. But *The General Theory* had to wait more than ten years to be translated into Italian. (An earlier plan to translate it soon after it came out aborted.)[2] Keynes' popularity, however, was restricted mainly to sections of the Italian economic profession he would have been ill at ease with had he had reason to have commerce with them—the corporatists and the catholics. The mainstream of the Italian economic profession was profoundly steeped in the tradition of neoclassical economics, especially in the general equilibrium version of Pareto and his disciples. They did not agree with the methodology of *The General Theory*, with partial equilibrium analysis, with the multiplier, even with macroeconomic concepts, which they found primitive and inferior to the completeness and elegance of microeconomic analysis. They were against the "criminalization of the savings function" and the "euthanasia of the rentier." They were mostly over fifty. And they tightly controlled the job market, so that even economists under thirty-five or just over that age, if they wanted a chair or even a minor position in Italian academe, were requested to profess a deep neoclassical faith or to recant on earlier Keynesian errors they may have been guilty of.

There were, of course, noble exceptions. But they were few and far between. In due course, every Italian economist, as the postwar years went by, became accustomed to the "new economics." But it took a long time, and the diffusion of Keynesianism never acquired the status described by Samuelson.

What are the reasons for this differential behavior? To understand them, we must first of all review the nature of Italian economic development following the

[1] Paul A. Samuelson, "The General Theory," in Seymour E. Harris, ed., *The New Economics* (New York: Alfred A. Knopf, 1947), p. 146.

[2] The Italian translation of the *Economic Consequences of the Peace* is an interesting story in itself. I have summarized it in the preface I have written to its new edition, published in 1984. See J. M. Keynes, *Le Consequenze economiche della Pace* (Turin, 1984). *The General Theory* came out in Italian translation in the late 1940s. See J. M. Keynes, *La Teoria Generale dell'Occupazione, Interesse e Moneta* (Torino, 1947).

unification of Italy, and secondly analyze the type of economic doctrine which co-existed with the Italian development process.

Italy became a nation in a very short time, because of the skilled diplomacy of Camillo Cavour. It became a very sizeable nation because of the almost unbelievable success of Garibaldi's march of liberation from Sicily to Naples. No gradual economic integration, like the *Zollverein*, preceded political unification. Before 1860, the Italian states had participated, like other European peripheral economies, in the development process of France and Britain by contributing raw materials, agricultural products, and seasonal emigrants.

The years from 1860 to the fascist putsch of 1922 are commonly called *L'Italia Liberale*. But people ought to be very careful not to take this expression to mean that laissez-faire prevailed in Italy in that period. To the contrary, from 1860 to 1922, economic policy making in Italy consisted of determined measures to build up a modern economy through deliberate state intervention.

A modern economy, with a large industrial sector, was considered by almost all parts of the Italian ruling elite as a necessary feature of an important modern nation. Nationalism was the driving ideology of the Italian independence movement. The men of the *Risorgimento* were aware that nation building required modernization, and that modernization required industrialization. All powerful European nations had industry, an army and a navy, a road network and a railway network, banks and post offices. Italy, if it wanted to achieve a status comparable to that of other large European countries, had to have all these things. The Italian ruling elite thus set about to acquire them all and by 1922 they had succeeded.

The prefascist period was an age of rapid modernization imposed by a minority on a country and a population that very often did not want to play along, and by the imposition on the population of very heavy sacrifices. The job was made more difficult by the fact that a large part of the modernization effort took place during the depression of the 1870s and the 1880s.

Capitalism was thus imposed on Italy by the state. The country had not possessed, before 1860, a capitalist class worthy of its earlier history. There were isolated regional instances, but nothing even remotely comparable to what was available in France or Britain. Capitalism was introduced into Italy by politicians, bureaucrats, generals, and admirals, who needed to furnish the new Italy with the requisites of the modern state. The currency was managed as an inconvertible paper standard from almost the very beginning. The state borrowed its way happily to pay for the huge expenses necessary to bring the King's Law into the riotous south and to build roads and railways. Banks were founded with the help of French financiers and with direct state involvement.

In the early decades of independence Italy kept an open door as far as foreign trade was concerned. But the management of the inconvertible paper standard meant that the exchange rate was used as a general protective tariff. And heavy state expenditure created demand without any qualms about markets and profit maximization. A unique case in Europe, the railway network, was built by direct state intervention.[3]

The switch to open protectionism occurred when it was realized that even with direct state intervention, railway construction had not induced growth of industry, but only the growth of industrial imports, and when the dislocation caused by the massive arrival of U.S. wheat in Italian markets became unbearable to local agriculture.

The early protectionist experiment has been accused of being too biased toward steel and against metal working. This may very well be, but it proves once more that the men who imposed the tariff system were not motivated by economics. They wanted a steel industry to build modern weapons. And they made sure to get it, whatever it cost the country. To finance the construction of the steel mills banks were created with the help of French finance and of straight Central Bank money. When the symbiosis of steel and finance ended up in inevitable bank failures, German banks were called in by direct government-to-government negotiations between Rome and Berlin. "Mixed banking" was officially introduced, with the arrival of German banks after 1893, but it had been there all the time, as banks had always been asked to finance long-term investment with short-term deposits.

Even in the Giolitti period, when state intervention is supposed to have receded, it was no less pervasive. It took the form of the organization of an incipient Social Security system, of increased military expenditures, of very important public works. Things were made easier (and intervention less pressing) for the Italian government by the almost ten years of world boom, and by the unprecedented exodus of the southern population across the oceans. Exports and emigrants' remittances became in those years a semipermanent way of closing the Italian balance-of-payment gap without sacrificing growth. And yet, the railways, which had been built by state money but had remained in private ownership, were nationalized and a huge financial effort was made to modernize them. This time most of the tracks, rolling stock, and other materials were purchased from Italian manufacturers.[4] In the Giolitti years, the nationalized railways, the army, and the navy provided about 30 percent of total demand for the Italian

[3] On the subject of state intervention in the Italian economy, the best survey available is Vera Zamagni, *L'Intervento dello Stato nell'economia italiana* (Firenze; Università, 1981).

[4] The problem of insufficient spin-offs from railway construction in Italian industry has generated a lively debate among Italian economic historians. For a complete list of references, see M. Merger, "Un modello di sostituzione, la locomotiva italiana dal 1850 al 1914," *Rivista di Storia Economica* (1986).

metal-working industries. In the same years, massive programs were launched to reclaim land, to build schools, to subsidize ship building. The protective tariff was not changed, save for what concerned the re-export of steel used in manufactures made in Italy.

In addition, two extremely important bank bail-outs occurred in 1907 and in 1911: the first to shore up Italian banks hit by the world financial crisis, the second to rescue the Italian steel industry.[5]

Italy's entry into the First World War was consciously seen as an attempt, on the part of the country, to shake itself free from financial and economic domination by German capital. It was also considered by Italian industry as a providential shot in the arm, which would end the eight years of slump that had followed the crisis of 1907, and had induced railway nationalization and the banks' bail-outs.

Even more than in other belligerent countries, the state was the protagonist of the war economy. Huge investments were financed through state help to enlarge the country's industrial capacity. Firms like FIAT, BREDA, Ansaldo, and ILVA vastly expanded their work forces in the course of the war. Ansaldo, in particular, went from six thousand to fifty thousand workers, plus another fifty thousand employed in its affiliates. At the end of the war, about six hundred thousand industrial workers were employed in war production, most of them in the areas of Genova, Milano, and Torino.[6]

Italy thus saw its industrial capacity increase enormously because of the war. At the end of hostilities this new structure, which had been created from scratch, in a way that was almost a miracle of mixed capitalism, but was also dangerously unrelated to peacetime demand, had to find a purpose. The problems of reconversion Italy encountered after the First World War were therefore enormous—much greater than those she would face after the Second World War.

Who were the protagonists of these fifty years of accelerated modernization, and what (if any) was the economic ideology they professed? This was *not* the age of the self-made man, the self-help entrepreneur who "never went to college." The protagonists of Italian modernization were bureaucrats and intellectuals who turned themselves into entrepreneurs and financiers by answering the call of the times. Because of the almost total absence of capitalist entrepreneurs in preunitary Italy, and because of the speed and the scale of the effort, modernization, and in particular, industrialization, could not be expected to be a diffusive process, taking place "from below," starting with small firms which would

[5] On these two important episodes, see again Zamagni, *L'Intervento*.

[6] All figures quoted in ibid., p. 54 et passim.

then grow into large ones. Nor could the process allow industrialists' sons to become state administrators or bankers.

As early as 1896 Werner Sombart had caught the real nature of Italy's industrialization:

> Italy after 1860 had not managed to have an industry of some importance. This was a state of affairs which was largely felt as a "lacuna." The need was felt for Italy to acquire something supremely desirable, the status of a modern industrial nation. . . . By appealing to all their forces, Italians had created a formidable army and a powerful navy; now they also wanted that a national industry grow up in the country, *because they wanted to be a strong people* . . . while at the end of the 1860s the commercial policy measures adopted in Europe were suggested by the need to look after existing industries, the ultimate determinant of the protectionist movement in Italy was the desire to create from nothing a *national* industry.[7]

The Italian governing elite was thus composed almost exclusively of mercantilists and protectionists—and this in spite of the fact that the leading economists of the first half of the century had been convinced of laissez-faire as the ultimate conquest of economic science. But the protagonists of the practical *Risorgimento* were fired by the flame of nationalism. Their early models were France and Britain; their late and influential one was Imperial Germany.

As men who wanted their country to become rich and powerful in the shortest possible time, they brushed aside all models of "industrialization from below." They knew the great European countries had built their industries on mercantilism and protectionism. They read Pellegrino Rossi and Friedrich List, and found them much more applicable than Adam Smith or David Ricardo. Besides, the model of international integration based on exports of raw materials, agricultural products, and men, was the emblem of preunitary Italy and it had obvious negative associations. Heavy industry was a good in itself, and its existence was also dictated by strategic imperatives. There was no time to reform agriculture so that it would yield a class of yeomen, whose sons would become traders and industrialists. There was no time to wait for agriculture to generate enough demand for industrial goods to put the country on a balanced growth path.

The protagonists of the *Risorgimento* were men who wanted to change a country whose present state they abhorred and of whose recent past they were ashamed. They wanted to cancel the shame of the *Italia serva*, exporter of mu-

[7] The quotation from Sombert (emphasis added) is taken from Silvio Lanaro's excellent *Nazione e lavoro*. See S. Lanaro, *Nazione e lavoro—Saggio sulla cultura borghese in Italia 1870–1925* (Venezia: Marsilio, 1979). This very intelligent essay has been of very great help to me in writing the present chapter.

sicians to the courts and of navvies to the railway construction sites of Europe. How could Adam Smith's model appeal to them?

They were all solidly interventionist and protectionist. Even the self-appointed defenders of laissez-faire and free trade were not really so strongly convinced, as Vilfredo Pareto bitterly remarked.[8] The ultimate goal for everybody was national greatness in a short time, and they were ready to sacrifice to it all economic ideology that might stand in its way.

The fifty years following political unification saw the nearest thing to a homogeneous ruling elite Italy has had in its modern history. The biographies of the political and economic protagonists of that age look remarkably alike. And what is even more remarkable, so do the biographies of the statisticians and economists who became the *grands commis d'Etat*. The interchange between university positions and bureaucratic positions was frequent and successful. Bureaucrats became members of parliament and ministers, and the same happened to university professors.

This new and highly homogenous power elite was utterly convinced that the moral imperative to turn Italy into a great modern nation was not shared by the greatest part of the Italian population, peasants, workers, and the precapitalist urban petite bourgeoisie. Modernization was an objective to be pursued against the will of the lower classes, and the ruling elite never hesitated, when brutality was required to get the people to do what was requested of them. Prefascist Italy was permanently ridden with bread riots and peasant revolts, and the toll of human lives was higher than at any other time in modern Italian history. But the ruling elite was also ruthless in its treatment of landed interests, especially the smaller ones. Church property was sold at high prices and land was heavily taxed. The funds that were necessary to build the modern infrastructure of the country and to start heavy industry were obtained through a merciless exploitation of peasants and land-based middle classes directly via taxation or indirectly via currency depreciation and the issue of government stock.

Continuous state intervention and *dirigisme*, however, were not meant to introduce socialism. They were exclusively aimed at mobilizing, at all costs, the resources necessary for an accelerated modernization whose core was the building of heavy industry. The ownership of industry and finance was supposed to remain in private hands. The socialization of investment, protectionism, and all the other numerous forms of state intervention were thus always associated with the rapid accumulation of great private fortunes, with financial scandal, with corruption, embezzlement, and graft. This was the time when the expression "so-

[8] Ibid.

cialization of losses, privatization of gains'' became most applicable and was, in fact, frequently used.

It is thus understandable how this phase of open mercantilism, not unlike what had happened in Britain, would induce a reaction on the part of intellectuals and political forces. While the bulk of the Italian bourgeoisie continued to subscribe with utmost conviction to the ideology of protectionism and nationalism, and to its latest variant, imperialism, a small group of economists began to assemble, who preached with renewed passion the modern version of the doctrine of free trade, of laissez-faire, of minimal state intervention, of fiscal neutrality, of a stable currency based on gold. This new school of economists, because of the academic eminence of many of its members, built up, in a considerably short time, a great reputation, especially in the field of economic theory. They also tried to operate at the political level, by personally going into parliament and by engaging libertarian battles in the press. But their influence was to remain very limited until the end of the Second World War.

The members of this school, which flowered at the turn of the century, are known to most economists. Pareto, Pantaleoni, Einaudi, Cabiati, Bresciani-Turroni, De Viti De Marco, Barone, all made lasting contributions to the development of neoclassical economic theory. Their emergence showed how, after almost fifty years of concentration on the target of industrialization at all costs and by all possible means, the Italian governing bourgeoisie was now large enough to allow for ideological splits. But, except for the interval of Mussolini's NEP, five years between his coup d'état and the manifestation of the first negative consequences of the revaluation of 1927, the Italian laissez-faire school never had any influence on economic policy making. And, while the neoclassical professors were busy teaching, in law faculties and economics faculties, the gospel of pure competition and the techniques of general equilibrium analysis, a new breed of practical intellectuals gradually took over the state apparatus, key financial positions, and the levers of large-scale industry. They, like their predecessors, were fired by the flame of nationalism and embraced a totally pragmatic doctrine of economic management. Their inspiration came from France and Germany, while the neoclassical school was absorbed in the permanent study and open admiration of all things British. These were men who remained at the helm of Italian economic institutions sometimes for fifty years, and who shaped Italian socioeconomic structure for decades.

However, there was a brief period when the Italian neoclassical school had a hope of seeing its ideals realized. This was when the ''man of destiny'' acceded to power in 1922, and gave, by his early actions, a clear indication that he wanted to reduce the role of the state in the economy, to allow red-blooded new entrepreneurs to flourish, to restore the currency after the wartime excesses. Mussolini loudly proclaimed that his ideal was a return to the *Manchestertum* and that to see it realized in Italy, he would have given back to private enterprise the telephone system, railways, even the post office, and would have stopped milking the private sector through wealth taxes and government debt issues.[9]

This program of *liberalisme à l'outrance* had been proclaimed by Mussolini before his accession to power. It was the economic platform presented to the Fascist Party Congress of September 1922, saluted as "a return to the old liberal traditions" by the standard-bearer of the Italian neoclassical school, Luigi Einaudi, in a famous article published in the *Corriere della Sera* on September 6, 1922.

Mussolini showed, in the concrete policy making that followed his accession to power, that he intended to practice what he preached. He appointed Alberto De Stefani, an economics professor raised on neoclassical theory, to the Ministry of Finance. De Stefani was the author of the economic platform of the Fascist Party Congress of September 1922. He was convinced, like Luigi Einaudi, that the vital energies of a country could be liberated only by fostering the emergence of a class of yeomen, in industry as well as in agriculture. He was a declared enemy of the large structures of monopoly capitalism, as well as of trade union monopolies. His vision, which was to remain for a few years the official vision of fascism, was distinctly pluralistic and antitotalitarian, thus clashing with the vision of modern society advanced by other convinced fascists, who would in the end prevail, as they had prevailed in prefascist Italy, in the name of a liberalism which in the hands of Benedetto Croce was much nearer to Hegel than to Smith and Stuart Mill.

With De Stefani as economic supremo, Mussolini's promises were realized. Inheritanced duties were abolished for close relatives and special war taxes were lifted. The ownership of joint-stock company shares was again made anonymous, wealth tax was reduced, and the tax on war profits leniently interpreted. The wages of workers were taxed for the first time, to the tune of 12.5 percent, as were the incomes of agricultural smallholders and peasants. Sixty-five thousand state employees were fired. The railway and post office deficits were eliminated, the telephone system was farmed out to private companies, and the state monopoly on life insurance was terminated. As a result of all these measures, the ratio of public expenditure to GNP declined from 26 percent in 1922 to 12.4 percent in 1925–1926. Direct taxation plunged, and indirect taxation was boosted.[10]

[9] In addition to Zamagni, *L'Intervento*, see *Banca e Industria fra le Due Guerre*, vol. 1, *L'economia e il Pensiero Economico* (Rome: Il Mulino, 1981). The papers by G. Toniolo, "L'economica italiana tra il 1919 e il 1939," pp. 15-36; and P. Barucci, "Il contributo degli economisti italiani (1921-1936)," pp. 179–244, contained in that volume are particularly perceptive and useful.

[10] Figures quoted in Zamagni, *L'Intervento*, p. 29.

Commercial policy, which had not been touched in the Giolitti period, was considerably liberalized. Import duties were reduced from an average of 10 to 8.4 percent. And the suspension of the duty on wheat (which had been introduced during the war) was maintained.

At the same time a compulsory incomes policy was imposed which worked powerfully against wages. Workers were also contained by the full force of state authority. The army and police were liberally used against them.

This very drastic program, which was even more than the Italian neoclassical economists had hoped for, was implemented without fear. But inflation was not subdued and the exchange rate of the lira continued to float and depreciate. The neoclassical economists thought that, without a determined stabilization policy which would bring up the international value of the lira and restore the gold standard, the other economic policies of the fascist government ran the risk of being nullified. They also complained that the tradition of bank bail-outs had not been terminated. On the contrary, it was blossoming again, induced by need.

In the *Tract on Monetary Reform*, Keynes had made express reference to Italian monetary affairs. He maintained that "in Italy, where sound economic views have much influence and which may be nearly ripe for currency reform, Signor Mussolini has threatened to raise the lira to its former value. Fortunately for the Italian taxpayer and Italian businessman, the lira does not listen even to a dictator and cannot be given castor oil."[11] Italian monetary stabilization, he feared, threatened to follow lines opposite to those he had suggested in the *Tract*, where he had vocally come out against a return to the gold standard.

Keynes' opinions were seen by Italian neoclassical economists as a serious inconvenience. They came from a writer whose *Economic Consequences of the Peace* they had admired and who had established himself as an international authority on monetary affairs. He also came from the very bosom of neoclassical orthodoxy, and was the editor of the *Economic Journal*, which they considered the voice of orthodox economics. Still, he advocated a policy that was the opposite of the one they had recommended to the Italian government. Attilio Cabiati, in a series of articles published between 1915 and 1925, had constantly advised an early return to gold. The same line was held by Riccardo Bachi, Giovanni Demaria, Luigi Einaudi, Gino Borgatta, and Costantino Bresciani-Turroni. They all thought it would be a painful policy, involving deflation, unemployment, and industrial and financial bankruptcies, but they agreed those prices had to be paid to get back the priceless asset of a stable currency.[12]

Riccardo Bachi and Giuseppe Prato were, however, among the very few econ-

[11] John Maynard Keynes, *La Riforma Monetaria* (Milan: Feltrinelli, 1975), p. 112.

[12] On the Italian economists' view of Italy's return to gold, see Barucci, "Il contributo."

omists to oppose a stabilization which implied a considerable revaluation. Most of the others—Cabiati, Loria, Luzzati, Del Vecchio—came out in favor of revaluation. And some like Benvenuto Griziotti and his group of young economists (one of them was Ezio Vanoni) campaigned vociferously in favor of revaluation and exposed the "devaluation party" formed by the industrialists and by the bankers who had huge sums bottled up in loans to industry.

Mussolini took the opinions of Italian orthodox economists very seriously. He knew that industry and finance were against revaluation and a return to gold. He had tried to exorcise their power by replacing De Stefani with Giuseppe Volpi, a well-known industrialist and financier, when the last and most painful act of his stabilization policy had to be performed. As Keynes had acutely noted, revaluation would be enthusiastically received by fixed income earners and government bond-holders, that is, by the middle and lower middle classes. But Mussolini needed the orthodox economic intelligentsia to fend off the wrath of the upper middle classes. He mentioned Griziotti's opinion—favorable to revaluation—to Volpi. He also probably saw a memorandum favorable to revaluation sent by the general equilibrium theorist (and convinced fascist) Luigi Amoroso to De Stefani and through him to Volpi. He tried to get the economists to suggest an "optimum revaluation level," but they were not prepared to play along. Cabiati and Del Vecchio repeatedly stated that the exchange rate level was a political decision, where economic theory could not help. Mussolini had, as a result, to present the decision to stabilize the lira at nineteen to the dollar, or ninety to the pound, as a political one, not corroborated by scientific calculations.[13]

But, apart from the level of revaluation, economists applauded the *Quota Novanta*, as it implied, in their opinion, a reduction of the role of the state in monetary affairs. In an early review of Keynes' *Tract on Monetary Reform*, Carlo Rosselli (who would be assassinated in a few years' time by a fascist agent) had expressed the fear that Keynes was too enthusiastic about a currency totally managed by nonelected bureaucrats at the Central Bank. That fear was shared by most Italian orthodox economists. After the stabilization of the lira, they thought it had been exorcised. Gino Borgatta wrote that "the anti-revaluation prejudice proclaimed with such haughtiness by Keynes and others, has received a fair beating."[14]

Neoclassical economists, after the return of the lira to gold at high parity, saw clearly that a series of events, which they considered inevitable for a return to a healthier Italian economy, would inevitably follow. Bresciani-Turroni noted that "an end was coming to the process by which entrepreneurs were assured of large

[13] Ibid.

[14] See G. Borgatta, "La Sistemazione Monetalia," *Rivista Internazionale di Scienze Sociali* (1928), p. 265 et passim.

financial resources at the expense of the owners of financial wealth, of the owners of houses, of the fixed income earners." The age of "forced saving" had come to a close and only voluntary saving could, from now on, be relied upon. And "a good part of the grandiose plants built during inflation had now no economic value."[15]

In this analysis of the stabilization crisis, Bresciani and other neoclassical economists demonstrated their professional skills and their ideological commitment. What they did not foresee was that the grave effects of the stabilization crisis on the Italian economy would, in a very few years, convince Mussolini of the need to adopt policies completely opposite to those he had enforced in the first years of his rule. Neoclassical economists were sure that the dictator would stick to his guns. They could have not been more wrong. The revaluation they had worked so hard to see realized induced so long a chain of industrial bankruptcies and financial defaults that, to repair them, Mussolini had to make a complete about-turn, to forget about the *Manchestertum*, and to totally disregard, indeed even ridicule, the advice of neoclassical economists. He went completely over to the old Italian constants of economic policy making: state intervention, protectionism, and managed currency.

The neoclassical economists were thus "hoist on their own petard." They lost all influence over economic policy making. They would briefly regain it when they were asked, in 1947, to perform—this time by direct involvement—another monetary stabilization.

The policy of deflation and revaluation inaugurated with the *Quota Novanta* would ring the death toll for overextended industry and for the banks which had financed it. The neoclassical economists sat down and waited for the explosion. The government, however, like any government, could not consider the effects of its own monetary policy with the same equanimity. Laissez-faire theoreticians would rejoice at the sight of a bloated, protected, and inefficient industrial and financial complex crumbling down. The government, on the other hand, understood that this would mean the destruction of most of the industrial capacity that the country had built up with huge sacrifices in the first sixty years of its history. Besides, the acclaim that *Quota Novanta* was receiving from the petite bourgeoisie was not enough to offset the wrath of the industrial and financial circles. And workers' protest could be foreseen.

We can give both Mussolini and his neoclassical advisors the benefit of the doubt. The world crisis ushered in by the crash of 1929 and subsequent events could not have been foreseen. No doubt they were the weights that tilted the

[15] See C. Bresciani-Turroni, "La Crisa della Stabilizzazione Monetaria," *Il Giornale degli Economisti* (1926), p. 44 et passim.

balance against the Italian stabilization policy. But, even with a more favorable international economic climate, it is hard to imagine that the fascist government would have been able to stick to its deflation plus revaluation policy without having to sacrifice its policy of reduction of state intervention. Industrial failures and financial defaults appeared en masse long before the international economic climate changed for the worse. As long as they involved the plethora of cooperative banks which had grown up before and after the war, the fascist government was not moved; in fact, it might even have been pleased. When the difficulties concerned large banks and big industry, then it was a completely different matter.

To solve the interesting problems of Italian industry and banks, Mussolini turned to the prefascist technocrats and their younger replacements. After the unfortunate dalliance with neoclassical economics, he went back to the traditional *dirigiste* fold. A group of *grands commis* was assembled, which would conduct economic policy for the rest of the fascist period. The very interesting thing is that *they* represented the real orthodoxy, as far as Italian economic policy making was concerned. It was an orthodoxy based on pragmatic mercantilism. The limits and modes of state intervention were to be established not by theory but by necessity, and the only imperative was that of making the country as rich and powerful as possible given the existing constraints. Industry meant large-scale industry, and its financial requirements, which could be expected to be large, were to be procured through financial engineering. Investment thus, for these men, generated its own savings, by hook or by crook. Italy was condemned by its destiny as latecomer and imitator of richer European neighbors to a growth path that could only be unbalanced and therefore needed firm steering by the state.

In the twenty-two years of fascist rule, there was ample scope for financial engineering. Financial reforms were, for the most part, measures that were concocted in reaction to the pressure of serious crises. In fact, the whole fascist period can be seen as one long experiment in crisis management. Some of the crises were exogenously determined, others were of more internal origin. But, after the short dalliance with laissez-faire economics, the fascist government resigned itself to permanently embracing the philosophy and the practice of *organisierter Kapitalismus*, which involved an attitude favorable to continuous macroeconomic management and microeconomic interventionism.

After the fascist government had made it clear that it had gone back to the fold of the Italian traditional modernization philosophy, the neoclassical economists realized that their hopes had been dashed, and that the regime was determinedly abandoning red-blooded individualism in favor of organized mixed capitalism. They could not express their disagreement with more than grumbles about Italian economic policy measures. The unification of the Italian banks of issue and creation of a real Central Bank in 1926 drew veiled remarks about the dangers of centralization, and the banking reform of the same year, which penalized small banks, was also criticized as favoring concentration.

But the major aspects of fascist economic policy could not be criticized openly. Foreign economic policies and doctrines, on the other hand, were open to full criticism, and through the chastising of foreigners for their ideas and policies, the Italian neoclassical economists could indirectly express their opinion on similar heresies preached and practiced at home.

The work of Keynes seemed to be written exactly for that purpose, to be, as it was, severely analyzed and vigorously criticized.

As in other European countries, Keynes had become famous among the Italian intellectual and ruling elites with the appearance of *The Economic Consequences of the Peace*. His later works, until *The General Theory*, were promptly translated into Italian. All his utterances received a great deal of attention.

Italian neoclassical economists, who had admired the *Economic Consequences*, started looking at the later work with increasing suspicion which soon gave way to outright, and sometimes violent, criticism and dissent, as the Keynesian critique of the neoclassical theories and of the policies those theories inspired began to unfold. From the start, people like Einaudi, Cabiati, and Bresciani-Turroni understood the danger of a critique that issued from the *sancta sanctorum* of orthodox economics and was published in the most elitist newspapers and journals. This was a message of profound reform preached not by a class enemy with proletarian demagoguery, but by a mandarin who used the language of the ruling elite and possessed every credential to legitimately appeal to the highest intellectual and political circles.

Einaudi, in particular, was fascinated and repelled from the very start by a man who had the same qualities that he had: immense energy, great skills as a communicator, and a gospel to preach. But the two gospels were the exact opposite of each other. Einaudi all his life sang the saga of the self-made man, of the fiercely independent yeoman, who was strengthened by the pristine virtues of honesty, thrift, and hard work. A society composed of such men was his ideal, where big organizations, big business, big labor, big government, would not appear to spoil the picture. This ideal, he believed, had finally been realized in nineteenth-century Britain. It had been threatened by the emergence, especially in Europe, of huge monsters. But Britain had fought and defeated the monsters. And now people like Keynes rose from the very heart of the "ideal country" and preached that indeed the age which had been golden was only a passing phenomenon, that it had come to an end, and that the new age was such that all the virtues of the previous one had become vices which, if still indulged, would totally ruin the country and the world!

This message, so eloquently delivered, ran directly counter to the message Einaudi had been delivering, with comparable eloquence, in the Italian press. Einaudi's self-assigned role was very similar to the one Keynes had elected to perform: the defender of sanity against folly, of common sense against established but erroneous practices. Both men belonged to the elite, both fought against the views prevalent among its members. Only they had opposite views of the world. And both men ran a scientific journal, and wrote for influential daily papers.

We have already seen how the view of recent world economic history and the policy prescriptions recommended to face the changed world economic situation contained in the *Tract* had been severely criticized by Italian orthodox economists. Criticism became even more open and scathing with the publication of *The Means to Prosperity*. There Keynes had proposed that the state could give jobs to the unemployed by public works, to be financed through direct monetary creation or by borrowing.

"The man in the street and the old-fashioned economist," commented Einaudi, "may consider it absurd to borrow 10 billions, if those ten billions have not been previously saved and are not yet available. Without hare one cannot make hare-pies. It seems—however—that in the advanced countries pies are now made with rabbits." Keynes proposed that the BIS in Basel create five billion in paper certificates, that it distribute them to Central Banks, which would in turn consider them as reserves and would create internal credit proportionately. But this way of restarting the world economy after the crisis was absolutely wrong. "To inject paper, even international paper, into a world from which the fools, the scoundrels and the presumptuous have not yet been kicked out completely, will be no cure for the illness; it will only lengthen it and make it worse. We do not need the euphoria of paper money; rather we need repentance, constriction, and punishment of sinners, and inventive exertion by survivors. Outside the teaching of the church there is no salvation; we will not come out of the crisis unless we punish vice and practise virtue." Crisis had come because of these sins, not by involuntary events. It was the result of people's actions, and it could only be resolved by opposite actions. Attilio Cabiati's book *Crisi del liberalismo o errori di uomini* had, by asking that rhetorical question, answered it on the same lines as Einaudi's anti-Keynesian invective. The remedy was not public works financed by credit creation. "The real remedy," wrote Einaudi, "is in withdrawing the credit extended to entrepreneurs, or in making it more expensive, and to gently induce amicable liquidations." Central Banks ought to rediscount good paper, strengthen the basically solid banks, and not rediscount, for any reason, bad paper, "letting depositors run on the bad banks so that they may be compelled to close down. In a few days the panic is over. The sieve has done its job and the slate is clean.''[16]

These were the Darwinian prescriptions of the Italian orthodox economists. They could hardly believe they had to call them to the attention of Keynes, the brightest descendant of the Darwinian school. But the errant son, as he persevered in his error, soon became the black sheep. Thus criticism fell on Keynes like hail. He became the main culprit of inflationist theories. He was accused of believing that ''a prolonged inflation could be a powerful instrument of accumulation and production'' (Achille Loria, reviewing the *Treatise*). Luigi Federici identified him as ''the standard bearer of the spendthrift.'' Mario Alberti wrote that Keynes' ideas on managed money were ''artfully submerged in much obscurity . . . in order to cover, with a sort of black magic cloak, full of abstract symbols, his concrete sympathy for monetary inflationism.'' But it was Einaudi who went to the heart of the matter. Keynes' writings had to be refuted because ''they inculcate into people's heads the wrong idea that over any other is dear to him: that the responsibility for the evils which afflict men can be pinned on 'somebody.' This somebody is supposed to be the 'bankers' who keep shut in their coffers the money that exists and prevent it from circulating'' (Einaudi, reviewing *Essays in Persuasion*).[17]

While Italian orthodox economists were chastising with rigor Keynes' avant-garde analysis but modest reform proposals, the Italian government was engaged in extremely innovative economic institution building, to which it had been pushed, as we saw above, by the failure of its previous liberalist policies.

Bank bail-outs had been the fact of life for Italian postunitary economic policy makers. They occurred even when the international economy was generating a high level of demand, as in 1911. But they became almost inevitable whenever an international financial crisis occurred. This had happened in 1907. It happened again, with greater virulence, in the late 1920s and early 1930s. The Italian mixed banking system, charged with the responsibility of financing the overgrown heavy industrial complex inherited from the war, could have been rescued by appropriate measures in a climate of moderate inflation and high demand. But it could not withstand revaluation and deflation.

The three main banking groups had attempted to resolve their postwar crisis first by cannibalism. They had forced the liquidation of the Banca Italiana di Sconto (''il banco Nitti,'' as Maffeo Pantaleoni had called the anti-German financial group which had risen meteorically with the war and was associated with the Ansaldo steel and engineering holding).

[16] The comment about rabbits is one of Einaudi's most famous quips. See the appropriate references in Barucci, ''Il contributo,'' pp. 215–16, 218.

[17] All cited in Barucci, ''Il Contributo,'' p. 219.

When that had proved useless and even counterproductive, they tried to divest themselves of their worst commitments to industry first by getting massive amounts of paper rediscounted at the Banca d'Italia, and then by parking their shares with specially constituted financial companies. The Central Bank, to deal with these problems, had built a so-called "Sezione Autonoma del Consorzio Sovvenzioni Industriali," which revamped a body constituted to deal with the problems of financing the war effort. While the Central Bank and the three large banks struggled to find a solution to their problems, a large public works program was being launched to build roads and motorways, and to build new railway lines and modernize the existing ones. These works were to be financed by resources purveyed by two new public financial bodies, the CREDIOP and the ICIPU, both creatures of the man who was perhaps the most influential person in the Italian economic life of the fascist period, Alberto Beneduce. He devised, by imitation of what was done especially in prewar Austria, a system of bond issues, which mopped up the liquidity in the hands of a public which preferred to lend to public bodies, and used the proceeds to pay for the public works program. His formula was to prove extremely successful and found wide application to finance the Italian public sector's investments for decades to come (more or less until the 1970s).

Alberto Beneduce was a distinguished statistician. He had cooperated with one of the best-known Italian prefascist, and antifascist, politicians, Francesco Saverio Nitti, to establish before the war the Life Insurance Public Monopoly (repealed, as we have seen, by the fascists). Most large-scale industrialists before the First World War had been active participants in the wars and insurrections of the *Risorgimento*. Most of the protagonists of the formation of the Italian public corporations were "interventists," volunteeers of the First World War, Arditi, Legionari Fiumani, and often *fascisti della prima ora*. Beneduce had been a war volunteer, but he was a socialist, and remained outside the fascist party even when he was Mussolini's closest economic advisor. He was, however, extremely loyal to his duce. He was a southerner and a man of humble petit bourgeois origins. His main aim in public life, if one can venture an educated guess, was to divest the mixed banks of much of the power they had acquired in the prewar boom years and with the war, and to reinforce the power of the government in economic affairs. After he had successfully managed to launch and finance the public works program of the 1920s, he was given the task of salvaging and reforming the banking and industrial complex which had been caught in the reconversion crisis. While orthodox economists preached banking and industrial Darwinism, Beneduce managed to divest the large banks of most of their industrial holdings, and to create a huge public body, the Istituto per la Ricostruzione Industriale, which owned the banks as well as the industries the latter had previously owned. When his work was finished, the state controlled in Italy a share of economic activity only second to that owned in Russia by the Soviet state.

But the philosophy of statism, which inspired Beneduce and the group of young technocrats he put together was very different from Soviet state ownership. Beneduce was also the chairman of BASTOGI, a private financial holding company which owned most of the electric generation and transmission companies of central and southern Italy. He thus could be compared to Walter Rathenau as an architect of *organisierter Kapitalismus.* His model was the Weimar Republic. Almost all the companies and banks which fell into IRI's control were still partially owned by private groups. Public ownership was not supposed to become total, in order to make sure that private and public groups would cooperate rather than compete. Public and private interests were thus spun together, as a result of Beneduce's institution building, into a web from which they have not to this day been disentangled.

It is clear that a man like Beneduce had no sympathy, perhaps even no concept, of "the market," of arm's length relations among firms. He saw modern industry as characterized by economies of scale, concentration, and integration which required huge amounts of fixed capital. Modern industry to him was a set of technical, organizational, and financial problems, to be solved as efficiently as possible. Like Rathenau he was almost totally uninterested in the "demand side." His task, and that of his group of technocrats, was to organize supply. The men who helped him in his task were very young. Some of them became the protagonists of Italian postwar economic life. Beneduce died at the end of the war, but his work was continued, in the same spirit, but with somewhat reduced scope, by his son-in-law, Enrico Cuccia, who, at the helm of Mediobanca, a peculiar financial institution, has remained the high mediator of public and private industrial and financial interests until the present day.

Raffaele Mattioli was placed at the head of the Banca Commerciale Italiana at age thirty-five. Donato Menichella became general manager of IRI at a similar age. Pasquale Saraceno, who helped Menichella to draft the Banking Law of 1936, was even younger. And the group of men who would run the Italian steel industry for the next thirty years and transform it into a world giant was also assembled in this period, at an equally young age. Oscar Sinigaglia, Agostino Rocca, Roberto Einaudi, and Ernesto Manuelli were all recruited to run the SOFINDIT, the company to which the Banca Commerciale Italiana had entrusted its industrial holdings. Guido Jung, who came from the Banca Commerciale, also worked at SOFINDIT from which he moved to become minister of finance at the crucial time when IRI was founded.

It is doubtful that any of these young technocrats paid much attention to Keynes and his doctrines. Mussolini's reining in of workers made wage problems of little relevance in Italy. The technocrats could thus concentrate on financial engineering, and technological and organizational problems.

Public works programs and deficit spending were for these men the normal way of running the economic life of their country. The basic problem of Italian postunitary development having been how to invest more than the actual savings of the country would allow, there had been just the Italian neoclassical economists to suggest a reduction of spending to match available resources. For decades, everybody else had used their intellectual skills to devise practical ways to maintain a high rate of public and private investment: financial engineering, managed money, compression of wages, exploitation of agriculture, and expulsion of huge masses of the population so that they could earn their living abroad and send back remittances that allowed imports to exceed exports.

That this was the Italian ''mode of development'' was very clear to fascist technocrats as well as to their opponents. Raffaele Mattioli was not a fascist; nevertheless he subscribed to this view wholeheartedly. Bonaldo Stringher was not a fascist. He wrote memorable pages about this ''mode of development.'' Piero Sraffa was an active antifascist. But his description of Italian development was the same. One cannot be surprised to find the same ideas repeated, again and again, in the public utterances and private position papers of the Italian technocrats.

Who could the Keynesian message appeal to in Italy? From the start, it was an attempt to use the science of economics to give policy prescriptions opposite to those which orthodox nineteenth- and early twentieth-century economists had given. The tools and techniques of orthodox economic theory were disassembled and reassembled by Keynes to make them utter a gospel which, in fact, ran against most of the articles of neoclassical faith. The Italian intelligentsia was, as we have seen, composed of a majority of people to whom neoclassical economics was either alien or inimical, and by a small minority for whom, by contrast, it was what religion is to a persecuted sect. The technocrats who shaped modern Italy were, as a class, quite near to the Keynesian elitist philosophy, but they shared with him only an intellectual attitude and a social condition. They had a very different task to perform from the one Keynes had set himself. They had to deal with a latecomer to industrialization reeling under the impact of world crisis. The monsters they had to fight were not excess savings, fixed capital, and a large working class which did not want to renounce the gains of a century of trade unionism. The Italian technocrats did not have to reckon with the most powerful financial system in the world, capable of nullifying the messages of expansion which a Central Bank may be convinced to issue through lowered interest rates. Only a fraction of the Italian population used anything except currency and post-office savings. The Italian stock exchange was a small speculators' bazaar. There were no institutional savers and investors. Most of the country was still composed of impoverished peasants. And workers, when they had tried to keep the wage levels where the prewar growth decade and wartime boom had placed them, had been brutally put down by the fascists. How could anybody in the Italian Left be interested in a research program whose aim was to devise a method to extract concessions from savers and workers without sacrificing democracy and the market system of resource allocation? How could any of the technocrats feel sympathetic to it? Only the Italian neoclassicists who spoke the same intellectual language of the people Keynes wanted to persuade by means of his polemical attacks, were roused by his writings. Had they been a majority, some of them would no doubt have been lured to Keynesianism. But they were a persecuted minority, whose practical advice had been tried, and found wanting, by Mussolini. They were surrounded by a sea of interventionists and protectionists, by left-wing as well as right-wing mercantilists. The spectacle of the temple of orthodox economics defamed by one of its high priests was too much for them.

Not surprisingly, therefore, Keynes' most important works, the *Treatise* and *The General Theory*, found the Italian orthodox economists ready to submerge them under an avalanche of criticism. The only economists who seemed to be at all favorably disposed toward Keynesian ideas were some corporatists and some catholics. *Some*, because even the corporatists and the catholics were overwhelmed by the intellectual superiority of the orthodox economists and only few of them dared to go against the basic doctrines of the Italian general equilibrium school.

The General Theory did not find too many reviewers in Italy in the years immediately before the war. However, Bresciani-Turroni and Einaudi dedicated long articles to it.[18] Bresciani-Turroni addressed himself to the theory of the multiplier. He criticized the concept because it required instantaneous action, and had to be constant. He also thought the working of the multiplier would imply inflation, as investment would be reconstituted in the form of saving only at the end of the cycle. In the intermediate phases new issues of public money would be necessary and would push up prices. He also quoted the recent German experience, and concluded that in Germany reflation had come as a result of Brüning's deflation, not of Nazi rearmament and public works.

Einaudi's criticism was, as usual, that of the political economist. He compared Keynes' suggestions to those of John Law, and gave a completely opposite explanaton to liquidity preference. To him, it was the embodiment of the human predicament, the attempt, on the part of defenseless men, to seek repair into gold

[18] See C. Bresciani-Turroni, "Osservazioni sulla teoria del moltiplicatore," in *Rivista Bancaria* (1939); and L. Einaudi, "Della moneta serbatoio di valori e di altri problemi monetari," in *Rivista di Storia Economica* (1939), pp. 133–66.

from the fiscal and monetary predations of the state. He did not deny the liquidity trap. Only, he thought, it was a legitimate "ultima Thule" of the saver threatened with euthanasia by people like Law and Keynes.

Other orthodox economists joined in the choir of criticism. Augusto Graziani, a doyen of Italian economics, thought Keynes' theory was a perverse version of the discount theory. Carlo Pagni thought the adjective *general* used by Keynes for his theory was hardly justified considering the analysis contained in the book.[19]

Francesco Vito, however, one of the earliest Italian reviewers of *The General Theory*, and the most gifted among the Italian catholic economists, wrote very positively about the book. He admired Keynes' theory of savings, which he thought superior to the classical one. He thought less of liquidity preference, which, in his view, was made to carry too much analytical weight.[20] But then Vito had spent a research period at LSE, where he had come into contact with "the enemy," and with the Swedish School, through Lindahl. In previous articles, he had already invoked the wrath of Gino Arias, the arch-corporatist, because he had said that corporatism had to promote social justice. He had also written that it was the forced saving imposed by finance capital that caused cyclical downswings.

As noted above, other influential catholic economists kept a much more orthodox stance. And some went all the way over to corporatism and considered Keynes (and Vito) still too favorable to capitalism.

Corporatist writers thought of themselves as the ideologists of the "fascist revolution," which had inaugurated a "third road" away from both capitalism and socialism. Thus Consiglio, one of the corporatist reviewers of *The General Theory*, complimented Keynes for his introduction of the macroeconomic method, but thought that he still considered men too much in the classical way, and not in the "necessary integrity."[21] He quoted Enrico Fermi to support his view of the "holistic" nature of the individual.

In spite of these rather esoteric comments, Consiglio had some interesting remarks to make on Keynes' maintenance, through the support of nominal wages, of the need to depress real wages to maintain full employment.

From the theoretical point of view, corporatism was a typical demonstration of Italian eclecticism. Some of the contributions of corporatist economists were

[19] See A. Graziani, "Vecchie e nuove teorie dell'interesse," in *Rivista di Politica Economica*, 16, 12 (December 1937), pp. 945–54; and C. Pagni, "Keynes contro i classici: una nuova teoria dell'occupazione," in *Giornale degli Economisti*, 15, 3 (March 1937), pp. 197–201.

[20] See. F. Vito, "Recensione alla 'General Theory,' " in *Rivista Internazionale di Scienze Sociali*, 7, 6 (November 1936), pp. 654–56.

[21] See V. Consiglio, "Impiego, interesse e moneta nella teoria di Keynes," in *Economia* (1938).

obviously dictated by the need to preserve one's tranquility (and daily bread) in a difficult period by daubing a thin corporatist veneer over traditional economics. Other contributions were more sincere; however, the task was a difficult one. It was no less than a reconstruction of economics on nonindividualistic principles. The results were usually quite sensible in the negative part, as far as the critique of orthodox economic theory was concerned. But the positive part was usually a patchwork of what new ideas were to be found in foreign scientific journals put together with a great or small degree of ingenuity. And in building these patchworks, we find numerous bits of Keynesian analysis inserted, sometimes with great skill. The best instances are certainly represented by two well-known articles, one by Luigi Amoroso and Alberto De Stefani, which appeared in 1934, the other by Amedeo Gambino, published in 1939. Both smack, even if only faintly, of opportunism, but they are highly acceptable by the international standards of the time.[22]

Luigi Amoroso had a shining career as a general equilibrium theorist. He had made seminal contributions to economic dynamics, and was one of the best known "equilibrists" (as corporatists scathingly called the followers of Walras and Pareto). De Stefani was a former equilibrist himself, but, as we have seen, he had also been at the helm of economic policy in Mussolini's short "Manchester phase." Both men were capable of rapid and complete about-turns. (Amoroso became an arch-defender of capitalism after the war).

In their article, they tried to free corporatism from its links to neoclassical economics. They stated that the first objection to classical economics had been raised by one of its main exponents, David Ricardo. He had shown how economic Darwinism did not work in the case of rent. This argument had been used ad nauseam by Marxian analysis. They then wrote that competitive theory, having been found inapplicable to agriculture, was developed for industry. But a century of experience had demonstrated that the historical process worked in the opposite direction. Potential competition had not led to atomistic firms but to industrial concentration and plutocracy. This process was induced by technological forces and reinforced by political pressures. So economic Darwinism had become irrelevant to industry as well. Thus, behavioral models derived from traditional mechanics would not do to describe economic activity. At the very center of economic activity there would always be unexplained and dark areas. The spirit of classical mechanics implied that the future is determined by the present.

[22] See L. Amoroso and A. De Stefani, "La Logica del Sistema Corporativo," in *Annali di Economia*, 9 (1934), pp. 149–74; and A. Gambino, "Forze Vive e Forze Propulsive dell'Economia nella Concezione Tradizionale e in Quella Corporativa," in *Giornale degli Economisti* 17, 7–8 (July–August 1939), pp. 532–62, both republished in Eugenio Zagari, et al., *Teoria Economica e Pensiero Corporativo* (Naples: Edizioni Scientifiche Italiane, 1982).

Hence the possibility of scientific prediction. In economic activity, on the contrary, the future depends on the idea men have of it. If consumers believe prices will rise and act accordingly, prices will indeed rise. If depositors panic and run on a bank, they will induce the realization of their fears.

"All these interferences between subject and object, between real phenomena and the idea men have of them, permeate the theories of crises, of banking, of the stock exchange, of money, of the financial market."[23] Here Amoroso and De Stefani quote Keynes, in particular, the passages in the *Treatise* where he describes the mechanism of speculation. They compare the phenomena he describes to those of molecular mechanics, as analyzed by Werner Heisenberg. Quantum mechanics, much more than classical Lagrangian mechanics used for a century by economists, ought to be employed to analyze economic phenomena. And, of course, the "driving force" was fascism. Fascism had stopped the self-destructiveness of capitalism, a system which, having been based on self-interest had, because of the technological revolution, ended up accumulating huge concentrations of powers, states within the state, which were fighting and destroying one another. Fascism had taken away control over the economy from the plutocrats and given it back to the state. Banks and industry were now run by IMI and IRI. It had reestablished monetary integrity, defended savers, and reduced banks to their natural commercial function. It had introduced collective labor contracts to defend workers against grasping capitalists.

But fascism did not want to rob man of his personal initiative. Corporatism was not "the negation of classical economics, only the inversion and revolution of the principles which govern it." Private property had never been "full, general and absolute. It was always tempered. . . . Secular devaluation of money is the most profound manifestation of this temperation. Keynes' most beautiful pages are dedicated to showing how devaluation is one of the keys to understanding the history of human society in its secular unfolding." But under corporatism private property is accepted because "it is a necessary condition for production, an instrument for the valorization of economic forces. It is not a right, which finds in itself its own explanation. It is not the freedom to leave unused the live forces of production. It is not the *just utendi, fruendi ac abutendi* of the Renaissance jurists. It is rather the *facultas procurandi ac dispensandi* of St. Thomas Aquinas. . . . Hence the concept that intransigent positions are not compatible with economic order, in which diverging interests must always be reconciled. Thus the State has the right to intervene every time that private initiative appears to be inadequate or against general interest, *as decided by the State itself*."[24]

[23] Amoroso and De Stefani, "La Logica," p. 160.
[24] Ibid., pp. 165–66.

Amoroso and De Stefani had made direct reference to Keynes. But Gambino, in a later article, drew an open parallel between their analysis and the Keynesian analysis of *The General Theory*. Gambino was a monetary economist through and through. He had made contributions to the theory of the banking multiplier. He had, very respectfully, but also clearly, criticized Einaudi for his famous "hare pie" argument. He had shown that Einaudi had not understood the process of credit creation, the banking multiplier, to which Keynes referred in *The Means to Prosperity*. He showed that Einaudi believed in the "cloakroom" theory of banking, as expounded by Edwin Cannan. He would shortly become a central banker, and remain a banker all his life.

Gambino was thus interested in the more technical, less philosophical aspects of corporativism and Keynesianism. His aim was to show that Amoroso and De Stefani, writing in 1934, had anticipated *The General Theory*. He wrote that the Walrasian system had been criticized by Keynes and Amoroso. Both critiques had involved the heuristic value and logical consistency of the Walrasian system. Both Amoroso and Keynes had, according to Gambino, not built a radically new theory. Rather, they had integrated and revised traditional theory by developing the analysis of forces overlooked by it. Those forces in Keynesian terminology were called "propensities" and "expectations"; in the corporativist terminology they were called, respectively, "inertial forces" and "driving forces." To the "live" forces which led to equilibrium, Keynes and Amoroso had added forces whose impact made the system indeterminate, as they sometimes led to cumulative, sometimes to decumulative, movements. The contrast between "live" and "driving" forces induced an imbalance between demand and supply in the goods and labor markets.[25]

Gambino wrote that both Keynes and the corporatists had shown a healthy suspicion of market forces left to operate without control. They had thus justified state intervention especially to control capital formation and saw economic life as a series of relations among men and human groups, rather than as the fight of man against nature.

Gambino went to the extreme—carried by his own enthusiasm—of drawing the parallel even on the details of the two approaches. But he forgot to mention that Amoroso and De Stefani had absolutely nothing to say about macroeconomics. They did not make any use of the national income approach. In fact, they had utilized the Keynesian concepts of the *Tract* and the *Treatise*, but they had not been able to read *The General Theory*. Their eclecticism could, thus, not include that in the elegant patchwork they had spun.

Gambino's article came out in 1939. By that time the fascist regime had re-

[25] Gambino, "Forze Vive e Forze Propulsive."

pressed the last remnants of freedom of speech. It had removed the Jews from official jobs, even Gino Arias and Giorgio Mortara, who had spent their lives in loyal admiration of Mussolini and active edification of the fascist state. It took courage to compare corporatism to the doctrine of profound liberalism preached by Keynes. Keynes would have shuddered to be compared to St. Thomas and his work to the Counter-Reformation. But such was his fate in Italy. Outwardly, it is undeniable that corporatism and Keynesianism were similar. And the fascist regime had countered the Depression by strongly increasing public expenditure relative to GNP. The Italian tradition of mercantilism could be dressed up, with some imagination, as Keynesianism or corporatism. But Keynesian analysis had been motivated by powerful trade unions and sticky money wages. Keynes had devised an ingenious way of revamping capitalism by banking exactly on those features that neoclassical economists thought were terrible evils. Fascism, on the other hand, had repressed the workers and "unstuck" money wages. It had abolished parliamentary democracy and freedom of the press. How could one compare its approach to Keynes', which was an attempt to preserve "decadent democracy" by altering its decision processes only slightly so that the whole network of liberally organized social relations might survive?

Summing up Keynes' impact on Italian economics before the Second World War, the main thing to underline is how very poorly the macroeconomic side of the message was received. Italian economists, both orthodox and unorthodox, read *The General Theory* as a continuation of Keynes' previous work and, with the help of their theoretical training, which was profoundly microeconomic, either reconciled it to their views or criticized it violently.

By the time the Second World War ended, Keynes' analysis had become the "new economics," the "Keynesian revolution." How it swamped the field has been aptly described by many people, and why it did, by just as many. What is more important for the present study, Keynesian economics became the official doctrine of the United Nations Economic Commission for Europe, and of the U.S. European Recovery Program. European countries, especially the defeated ones, thus came into contact with it, as it were, "on the shields" of the victorious Allied armies. With the division of the world into two blocs and the inauguration of the Cold War, Keynesian economics took an interesting turn. It became the political economy of those who wanted to contain communism in countries like France and Italy, where it had a more likely chance of being experienced, either through the ballot box or by more violent means. In those countries—thus the reasoning went—a large number of workers were unemployed. Being unemployed, they were likely to lose faith in democracy and the economics of free enterprise. Unemployment had therefore to be reduced as fast as possible. And, since it was attributed to a lack of effective demand, demand had to be pushed up by monetary expansion and public works. But a revamping of demand would induce a trade deficit in most of these countries, which needed material resources from abroad to get reconstructed and had very little to export. Hence, the U.S. government should provide foreign aid to close the trade gap induced by reflation.[26]

This interpretation of the problems of reconstruction and their solution met with a very cold reception in Italy by the people who had replaced the fascists at the helm of economic policy. Again, as in the aftermath of the First World War, the orthodox economists who had opposed corporatism or had (successfully) hidden their orthodoxy under a thin layer of corporatism, became very influential. As De Stefani and Amoroso were the protagonists of Mussolini's Manchester period, Einaudi, Del Vecchio, and Bresciani-Turroni gave their names to the period. Their reading of what had happened between 1922 and 1927 was radically different from the one we have given above. They did not think that deflation and revaluation had induced the subsequent statist period. They thought—on the contrary—that fascism, after a short season of sanity, had degenerated into totalitarian excess.

They were thus ready to repeat the experiment, by another radical campaign of liberalization and deregulation. Very few voices were heard at the time against this program. Fascism had become associated with state control of economic life and a good measure of liberalization, which would involve the demolition of a good part of wartime controls, was advocated even by the Left. Planning had a bad press, because of recent experience with corporatism.

But, at the core of the state economic control apparatus were more or less the same men put there by Alberto Beneduce, and their younger pupils. As we noted above, they had been given power at a very young age, and scarcely fifteen years had gone by since those days. Menichella, Saraceno, Mattioli, and Giordani had all kept their jobs with dignity. They had not pandered to the rhetoric of fascist propaganda. They kept the same dignity and balance in the postwar period. We owe it to them if Italian economic policy steered a middle course, and a very successful one, between the radicalism of the neoclassical economists and the heavy pressures of foreign Keynesians.

Thus Menichella managed to stabilize the lira without giving in to the revaluation calls of the neoclassical economists and without starving the economy of cash in the last phase of an inflation for which he had not been responsible (it had been largely due to the decontrolling zeal of Epicarmo Corbino and Luigi Einaudi). At the same time Menichella explained to Andrew Kamarck, who repre-

[26] For a thorough analysis of that period and of its ideological background, see A. S. Milward, *The Reconstruction of Western Europe, 1945–51* (London: Methuen, 1984).

sented the U.S. Treasury in the Allied Control Commission, that IRI and IMI were not dangerous nationalized holdings. They were run on exactly the same lines as private corporations and answered a precise historical need.

The best-known battle the Italian technocrats had to fight was against the Keynesians of the United Nations' Economic Commission for Europe and of the much more important Marshall Plan. Italy was constantly urged to reflate by both these agencies, to create employment and not to waste resources in accumulating useless foreign currency reserves. The men who were shaping Italy's economic policy were not interested, however, in a status quo which would see their country survive with U.S. help for an indefinite number of years. They were interested in getting back the fullest measure of economic sovereignty and independence in the shortest possible time, and they were still motivated by the constant desire of Italian postunitary statesmen and technocrats: to see their country on the same level of economic power and affluence as the other large countries of Europe. In their strategic planning they tried to get a long-run growth spurt, not the perpetuation of a status quo they hardly liked.

They also thought Italy had a very good chance of growing rapidly, with U.S. help and with an export market where the absence of Germany for several years would make things much easier for Italian producers. And they knew that Italian industrial capacity had not been destroyed by war and had not, as in the First World War, built on or converted to war purposes. The orthodox economists and the foreign Keynesians were successfully kept at bay. Epicarmo Corbino lost influence very rapidly, and well before he could do enough harm. Luigi Einaudi, having been proclaimed the "savior of the lira," was elevated to the supreme magistracy of the state, where he could preach daily sermons about the virtues of thrift and self-help but had not much control over actual policy. The foreign Keynesians were successfully contained by a very clever use of equally eminent foreign economic talent. Per Jacobson and Friederich and Vera Lutz were repeatedly called upon to provide an alternative diagnosis about the Italian economy to that presented in the ECA's country studies, a diagnosis which would end up complimenting the Italian authorities for the policy stance they had taken and maintained with such fortitude and against powerful criticism from those who held the purse strings.[27]

Among Italian politicians the foreign Keynesian experts did not have much

[27] I wrote an article about twenty years ago on Italian postwar stabilization. See Marcello De Cecco, "La Politica Economica durante la Ricostruzione 1945-1951," in S. J. Woolf, ed., *Italia 1943-50: La Ricostruzione* (Bari, 1974). Compared to that, the present analysis distinguishes more clearly between the laissez-faire ardors of Corbino and Einaudi, and the practical policy making of Menichella. On the connections between ideology and policy making in Italy in that period, see the fascinating reconstruction of one of its protagonists in P. Baffi, "Via Nazionale e gli economisti stranieri," mimeo (1985).

luck. Their recommendations were, however, adapted by left-wing Christian Democrats, who had received their training from Francesco Vito or had been otherwise near to corporatism. (It must not be forgotten that corporatism was a nineteenth-century Catholic intellectual discovery.)

While they were not successful in influencing the macroeconomic policy stance, the Christian Democrats helped the technocrats maintain the state's hold over the economy. They became the arch-defenders of IRI and other state holdings against a very spirited opposition which did not necessarily only include the political Right. A good number of left-wingers thought of state-owned corporations as creatures of fascism and wanted them dismantled. But IRI was, after the disappearance of Beneduce, the creature of Menichella, Saraceno, and Giordani. The first, as we saw earlier, defended it against the Liberals. The second turned the Christian Democratic Left in its favor, and the third rallied the support of the scientific establishment.

Because of the combined efforts of these men and of their disciples, the fascist state holding corporations system emerged from the war untouched and embarked on a program of almost unbounded expansion. On the other hand, Keynesianism had a much harder time getting established in Italy. Its pull on young economists had become much greater than it had been before the war, with the restoration of the intellectual exchange between Italy and the Anglo-Saxon world. In the five years after the end of the war two very well-written and influential books appeared to explain Keynesian economics to Italian economists. One was by Vittorio Marrama, the other by Ferdinando Di Fenizio.[28] Both of them put most of the emphasis on Keynesian methodology and analytical techniques, while, as we have seen, prewar Italian analysis of Keynes' work had been more interested in the "message" Keynes wanted to convey. This was also due to the "digestion" of the Keynesian method by Anglo-American economists, and by the appearance of the neoclassical version of it, as developed by Hicks, Modigliani, and Lange. Keynesian "models" made the understanding of Keynes' method easier. They also changed the message quite considerably and made it more acceptable.

But, even if the young economists were ready to catch the disease (and the disease had in fact become more fashionable as it was preached by the liberators and thus associated with freedom), the older generation of Italian economists did not lower its guard. They were even more solid in their defense than they had been before the war. Most of their corporatist colleagues had in fact, with great aplomb, moved back into the camp of neoclassical orthodoxy. In order to bleach their black shirts, or because of the sincere realization of their intellectual errors,

[28] See V. Marrama, *Teoria e Politica della Piena Occupazione* (Rome: Edizioni Italiane, 1948); and F. Di Fenizio, *Economia Politica* (Milan, 1949).

they swung in the other direction and could not stop at the half-way house of Keynesianism. But the reconcilation of Keynesian methodology and neoclassical principles worked its magic in Italy, as it had elsewhere. Italian middle-aged economists quickly grasped the chance they were offered of being technically *au courant* without having to sacrifice their (often just regained) neoclassical ideals. By the early 1960s most of the economists who were Keynes' contemporaries were out of the game. And Keynesian economics, as reformulated by Hicks, Modigliani, Lange, and their innumerable imitators, had become the new orthodoxy.

As regards economic policy making, Keynesian terminology gained ground even more rapidly, as more and more economists and statisticians, employed by the government, the Central Bank, and public and private firms and banks, became familiar with national accounting methods. Official documents concerning economics and economic policy began to be drafted in the new terminology and to use Keynesian concepts. It is instructive, for instance, to compare the documents prepared by the Italian authorities for the OEEC until 1948, with the plan to establish the Cassa per il Mezzogiorno, in 1949, and with the Vanoni plan in 1953.

The earlier documents are written in the language of contingency planning. No mention or use is made of multiplier, accelerator, propensity to import or export, to save, to invest, or income elasticities.

In the later documents, on the contrary, the full panoply of Keynesian concepts is used. In the case of the *Schema Vanoni*, the conceptual apparatus was made even more homogeneous with respect to Anglo-Saxon equivalents by the use of Anglo-Saxon experts. But then the World Bank was supposed to provide the funds for the Vanoni plan, and the Italians wanted to give it something it could understand, and approve of. It got an applied Harrod-Domar growth model.

It can be safely stated that the places where Keynesian models were most seriously and frequently studied and applied were SVIMEZ and the research department of the Bank of Italy. The former was an association to promote the development of the Mezzogiorno. Its deus ex machina remained, for thirty years, Pasquale Saraceno, who was also the head of IRI's think tank. It is rather strange that Keynesian analysis would be applied in a place which purported to study the underdeveloped part of Italy, but we must not forget that SVIMEZ was a stronghold of left-wing Christian Democrats, and they had (even in their corporatist days) always been favorable to Keynesian ideas. Economists at SVIMEZ engaged in calculating multipliers for the Italian economy as early as 1951.

But there was a more important explanation for this activity. Italian economists were convinced that, after reconstruction had been completed, a wide margin of unused industrial capacity would appear in northern Italy. The idea was thus hatched of launching a program to modernize the southern economy, which would generate a constant stream of demand for northern industrial capacity.

Italy has often been called a "centaur," half-man, half-horse, because of its economic dualism. The Vanoni plan, as devised by Saraceno, was a very ingenious way of conjugating the needs of the north with those of the south, to use Keynesian analysis and Keynesian recipes as a remedy for the Keynesian unemployment of the north and the structural unemployment of the south. Public works were to be financed with northern money, to build infrastructures in the south and generate demand, at the same time, for northern industry. Excess imports would be financed by the World Bank. This program looked like a textbook exercise in applied Keynesian analysis. And, in fact, SVIMEZ spent a lot of resources on exactly that.

As for the Bank of Italy, Keynesian income determination analysis began to make itself felt there with the return of Salvatore Guidotti, a senior member of the research department from the United States, where he had gone to learn those techniques. He wrote a report couched in Keynesian language. But the bank, for what concerned its analysis of the Italian economy, began to rely on models only in the mid-1960s, when Franco Modigliani was called in, after his experience with the FED-MIT model, to advise on the construction of something similiar for Italy.

However, in the years when Guido Carli was governor, the language of macroeconomics began to seep into the annual report, from which it had been excluded when Menichella had been at the helm. Menichella (and Baffi) relied on something more akin to the tradition of flow of funds analysis, aided by a credit multiplication analysis similar to that developed by Koopmans and Holtrop at the Central Bank of the Netherlands and by J. J. Polak at the research department of the IMF. This type of monetary programming, which superficially appears "monetarist" in the Anglo-Saxon meaning of the word, is in fact a far cry from the monetarism of Milton Friedman. It assumes a very simple and tightly controlled financial sector, and a very close dependence of investment on bank financing. Since no financial intermediaries other than banks exist, there are no alternatives for savers and investors. The Central Bank thus becomes the hub of national planning. This being the case in Italy (and in most other continental European countries), Menichella had very little time for a system, like the Keynesian, whose institutional features and policy variables were quite different from those of Italy.

His successor, on the other hand, had more interest in being like Anglo-Saxon central bankers. He often spoke of the Italian financial system in terms which made it look much more English or American than it really was. And he intermittently tried to transform it in that way. But, when it came to policy, models were pushed aside, blueprints for the financial market receded into the background, and the telephone was used to issue credit rationing directives. Keynesianism was thus wheeled out for the official show of the annual report, and for domestic and foreign public relations use. But the language of Keynesian economics was more pervasive. And the income determination approach was soon the only one which economists and politicians, at home as well as abroad, would understand. For, with the advent of the left-center in the early 1960s, even the government began to equip itself with an economic research department, which, after a while, duly acquired its short-term forecasting models. And the fashion, later on, spread to large-scale industry and the unions.

It is worth noting, however, that in the first two decades following the war, traditional *dirigisme* seemed to continue unperturbed by democracy. The disappearance of the corporativist state had given the technocrats a larger degree of autonomy. The Bank of Italy, for instance, had been tightly controlled under fascism after its involvement first with the rescue of the banking system in the early 1930s (when the state had to first of all rescue the Central Bank, because of it having got stuck with worthless assets which it had purchased from the large banks). Its authority and autonomy had to be reconstructed *ex novo*. This was done in silence by Donato Menichella, who exploited, at the beginning, the great prestige accruing to the Bank from having Luigi Einaudi as its Governor. It was in the 1950s that the Bank of Italy really flourished as a Central Bank and reversed the subordinate position it had had in fascist (and prefascist) times vis-à-vis the government to such an extent that it was jokingly said that the governor of the Bank of Italy appointed the government (a similar joke was made about the Bank of England in the time of David Ricardo).

The power of the Bank over the banking system was never to be as great again—this in spite of the fact that, from the purely legal point of view, the bank was never independent from the government.

The bankruptcy of the corporatist system, moreover, set free to run themselves the other parastate agencies and holdings, like IRI and AGIP, which were, on the other hand, not disbanded. In fact, the public agencies and enterprises which had been founded by fascism really came into their own with the arrival of the democratic state. The dilemma began to appear of a stable public enterprise bureaucracy controlled, at least nominally, by a highly unstable government and parliament. In fascist days these public agencies were controlled by a political class which appointed them, lasted as long as they did, and did not have to be reelected. In the first decade of the fully democratic state, the control system had to be scrapped and reconstructed, while the public agencies and enterprises were kept untouched, except, sometimes, for their highest administrators, who were replaced. The technocrats who staffed the highest positions in these public agencies and corporations, however, tended to belong to one pool of talent, which was not touched by discharge after fascism.

The neoclassical attempt to get rid of this pool of technocrats ("padreterni," as Luigi Einaudi called them, half in joke, half in spite), and of the institutions they presided over was, as we have seen, fended off successfully, and the same people who had run the fascist economy remained in charge of the Italian economy in the phases of postwar reconstruction and expansion.

It would not be an exaggeration to attribute the long crisis of the Italian economy in the 1960s, among other factors, to a finally successful attempt, on the part of the political class, to wrest power over the public agencies and enterprises away from the technocrats and to replace them with their own, often frankly inferior but politically loyal, appointees.

It is not to be believed, however, that the heritage of the neoclassical professors was negligible. They were not able to disassemble the public economy and the autonomous Central Bank (Einaudi, the latter's governor, had been converted to the cause of its autonomy from political control, a far cry from his early beliefs), but they put what spanners they could in the works of the mixed economy, and served as a catalyst for those forces which wanted Italy to integrate as fully and early as possible in the Western economy.

This liberalization of foreign transactions, especially visible trade, meant an early demise of planned foreign trade and the appearance of a structural imbalance for the Italian external accounts.

Early return to multilateral trade and scrapping of quota systems was in line with the requests made by U.S. aid administrators, but Italy overfulfilled their requests. The technocrats, therefore, managed to fend off local and foreign Keynesians by unleashing on them the neoclassical professors, but they had to pay a price: they maintained control over the domestic economy but at the cost of an early return to free trade. Freeing the foreign sector meant to fall prey to the requirements of adjustment within a context of semiconvertibility and free trade. It thus meant exposing the long-term plans hatched for the domestic economy to the vagaries of an uncontrolled trade and payments balance.

This last contradiction was the price paid by the technocrats to remain in control. And, in due course, it would cause their own undoing and final demise. It also served to reintroduce the Keynesian agenda into Italian economic policy making. But it was not the Keynesianism of the instability of the investment function and of the institutionalization of government control over investment and demand which was reintroduced. It was what Joan Robinson called "bastard Keynesianism," which is otherwise known as the neoclassical synthesis or short-term macroeconomic adjustment policy. Domestic long-term spending plans, which went on increasing as public holding corporations proliferated and a very determined infrastructure building and industrial development policy was launched in the south, were for a long time reconciled with the vagaries of the trade balance by the lucky arrival of the remittances of southern Italian workers who emigrated to the United States and northern Europe and of the income from tourism. When the former abated the latter could not cope with the trade deficit created by the crisis of Italian agriculture and by increased demand for food.

The structuralist *dirigiste* model of the Italian technocrats had to face new phenomena induced by its very success and by its forced submission, to remain in control of the domestic economy, to laissez-faire in foreign economic relations. Its success meant that the income per head of Italians increased considerably and induced a northern European diet, which meant higher imports of temperate foodstuffs. It also meant that industrialization depopulated the countryside and further reduced its food-producing potential. But the main problem induced by success was full employment, a state of affairs never dreamed of in one hundred years of Italian economic development, and a reversal of demographic dynamics.

The last two decades of Italian economic life have thus witnessed the outcome of the postwar compromise between traditional structuralist *dirigisme* and laissez-faire principles. A typical Italian solution has been to have one's cake and to eat it. Structuralist policies have been continued, although not in the elitist *dirigiste* style of former times. The technocrats' castles have been conquered one by one by the political class, and structuralist policies have been redesigned to serve as means of political patronage of a very diffused type. At the same time, the country's full integration in the world economy and in the EEC has meant parallel growth of a strong export industry, and of an equally strong import lobby. To preside over the contradictions and the imbalances induced by these developments, the government and the Central Bank have adopted the full panoply of Keynesian short-term adjustment policies, as they have been developed in other Western countries.

Because of the diffusion of patronage engendered by the new style structuralist intervention policies, and as a result of the decentralization of Italian industry which has been forced by having to compete with very strong countries, Italy is now a much more "Keynesian" country than any of its continental European partners, or than Britain or the United States. Saving has become very high because of growth, but it is spread in millions of individual units and is to a large extent disconnected from investment. Investment decisions are in the hands of many more people than they are in any other Western country. And the state is burdened, as it was in interwar Britain, by a huge domestic debt overhang, which derives from the decision not to tax independent workers, who are legion, and to encourage their free riding of the welfare state services. This in turn made it necessary to decrease industry's costs vis-à-vis its foreign competitors.

At the same time, Italy can be considered as the most firmly "Keynesian" among the large Western countries because nobody among its politicians or level-headed industrialists seriously thinks of reducing the state's role in the economy. Deregulation is an issue, especially for the financial sector, but no one seriously thinks about reducing the welfare state or state expenditure. All politicians have always been aware of the disastrous consequences of unemployment, and this awareness has become greater when deindustrialization and unemployment have become associated with terrorism. The result is that Italy has remained the only large European country firmly committed to full employment. Italian unemployment figures are high, but only because they take into account as unemployed—as they should—young (mainly) southern women living at home. Prime-age male employment is among the highest in the world, and in northern and central Italy unemployment figures are low. This perpetuates the traditional family structure, but from its continuation without much change both major government and opposition parties derive clear benefits; they cannot be expected to do much to change it.

The deep roots of Italian social life are thus profoundly anti-Keynesian. Italy is still a universe of families working together to accumulate their joint fortune. The welfare state is extensive, but thoroughly privatized, in the sense that it is centered around the family. Saving is a family affair and so is investment. And Italians first save and then spend. That is why the state is compelled, and at the same time, can afford, to take such a frank and unabashed Keynesian stance in its spending behavior.

There is, however, an inherent source of virtuous and vicious circles in the juxtaposition of private classical (or agricultural, one may more correctly say) economic habits and public Keynesian attitudes. Institutionalized state intervention in a democracy means that public expenditure is tied to patronage and to the widespread practice of using public funds for private purposes. Keynesian state intervention thus becomes essential to both the political class and the private sector. At the same time, the full-fledged participation of Italian industry in foreign trade and its early exposure to foreign competition have meant, after full employment was reached and maintained at all costs (with the relatively high wage levels inherent in it) that the rationale of large-scale industry, which had been an essential part of the Italian growth philosophy, was called into question and a quest was made for more flexibility. This was achieved by means of organizational as well as technological solutions. Will this newly achieved flexibility, which has rendered Italian industry highly capable of responding to sudden demand shocks and shifts, make Keynesian policies less essential, and give a new lease on life to structuralist policies of the old "targeted," elitist type? As we said above, public spending has been in the last twenty years completely "destructured" and has fallen, like manna from heaven, on everyone. It is one of the features of Keynesian public spending that the more diffused it is, the better. What if it is again to become restructured, like Italian state intervention traditionally used to be? What will this mean for the political class and for the public? Discriminating public spending has often proved to be quite incompatible with contemporary Italian society. As long as the economy required that it be indiscriminate, all has been well (except that we have had a type of growth not everyone likes). But when the economy requires that public intervention be discriminating again, how will Italian society take it? These questions are certainly a long way away from traditional Keynesian analysis, but are probably worth asking.

9

WHAT IS KEYNESIAN ABOUT DEFICIT FINANCING? THE CASE OF INTERWAR GERMANY

Harold James

AT THE END of Keynes' *General Theory*, there is an often-quoted statement about the relationship between economic thought and political action:

> Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back. I am sure that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas.[1]

One of the curiosities about Germany's economic development between the wars was that governments pursued quite innovative policies, embarking on new terrain, but with very little theoretical support. The argument of this chapter is that policy formulation, under the impact of political pressures and economic thinking, dominated by revulsion against those political pressures, moved in very different directions.

In Germany, there were bewilderingly contrasting economic scenes. We can identify at least six stages: inflation (1919–1922), hyperinflation (1922–1923), stabilization (1923–1924), brief-lived upturn ("the golden years of Weimar" from 1924 to 1929), deep depression (1929–1932), and then, after 1933 under the Nazi dictatorship, an apparent recovery. In part this diversity was a result of changing approaches to policy issues.

One general characteristic of the German experience was a willingness to tolerate fiscal deficits. If this alone is considered Keynesian, the German policy makers were in general Keynesians. But Keynes' program involved far more than

This paper has benefited from comments by Michael Bernstein, Knut Borchardt, Peter Hall, and Albert Hirschman.

[1] John M. Keynes, *The General Theory of Employment, Interest and Money* (1936), in *Collected Writings of John Maynard Keynes*, vol. 7 (London: Macmillan, 1973), p. 383.

simple encouragement to governments to spend. He was concerned with the use of deficits only as part of an overall pattern of demand management—which might also require deficit reduction in order to curb inflationary growth in demand.

German governments, on the other hand, were prepared to run deficits irrespective of overall demand levels or of price movements. During the postwar inflation, it was impossible to produce balanced budgets, because of the aftercosts of the war (reparations, and also pensions to invalids and widows), and also because of a fear that balancing income and expenditure would reduce national income and drive unemployment up to socially dangerous levels. By 1923, the mark was visibly out of control, and a stabilization—which involved dramatic budgetary economies—became a pressing issue. From 1926, however, deficits began to reemerge. For the budget year 1926–1927, the increase in public debt amounted to 2.3 percent of GNP, for 1927–1928 1.3 percent, and for 1928–1929 4.0 percent. At the end of the decade, during the world depression, the government tried to avoid borrowing and imposed a fiscal deflation whose immediate consequence was the worsening of the Depression. In the trough of the Depression of the fiscal year 1931–1932, new public borrowing amounted to only 0.2 percent of GNP. The Third Reich spent relatively little on work creation, and larger amounts on rearmament, with the result that public sector deficits again grew steadily larger, from 3.6 percent (1934–1935) to 6.1 percent in 1936–1937.

Rising deficits in the 1930s coincided with, and were one (but probably not even the chief) cause of a steady but impressive reduction in unemployment from the exceptionally high levels of the Depression. In January 1933, when Hitler came to power, six million were registered as jobless, by July 1935 the figure had fallen to 1.8 million.[2] Other causes of the apparently dramatic recovery were:

— a restocking process that took place naturally after inventories reached their cyclical low in the spring of 1932
— wage control, whose implementation was made possible by the destruction of trade unions and by the political repression characteristic of the Third Reich
— the imposition of tighter exchange and trade controls, which cut Germany off from world economic developments, and which may have caused unemployment in some import-dependent industries, but which also forced import substitution.

There were clearly major differences between the policies of the Weimar Republic and those of the Nazi dictatorship. In the 1920s deficit finance occurred within the framework of an economy open to world market influences. Large

[2] Ernst Wagemann, *Konjunkturstatistisches Jahrbuch 1936* (Berlin: Hobbing, 1935), p. 12.

capital imports facilitated the deficits, and when the inflows stopped during the Depression, deficit finance became almost impossible. After 1931 exchange control and trade restrictions allowed a wider room for policy maneuver. The state now played a larger role in planning the shape which economic development might take.

However, two very different political systems seemed to end with the same economic result—the creation of budget deficits. In the German case, it is actually impossible to make the distinction which has become the standard interpretation of interwar economic history: between a deflationary, orthodox, and internationalist 1920s, and a reflationary, unorthodox, expansionary, and nationalistic 1930s. Deficit finance was then, with the brief and sad exception of the Depression era itself (1929–1933), a perennial part of Germany's economic environment.

How far can the policies which produced such deficits be attributed to the conscientious following of well-formulated economic theories, and how far were they a product of political decisions taken in theoretical ignorance? That such contrasting political systems as the Weimar Republic and the Third Reich should encounter the same problems in public finance suggests at least the existence of a structural pressure for deficits—perhaps even a sort of loosely defined Keynesianism—emanating, not from the theories of economists, but from the logic of political pressure.

KEYNESIAN POLICIES

It is easiest to see political pressures at work during the postwar inflation. In 1918–1919, Germany had come close to Bolshevik-style revolution. In Bremen and Munich Soviet republics ruled briefly; in January 1919 the communist party attempted to stage a revolution in Berlin. In the early years of the republic conditions were still highly unstable—so unstable, for instance, that the new National Assembly had to meet in quiet, provincial Weimar rather than in revolutionary Berlin. In 1920 a military coup forced the government out of Berlin again. There were new communist risings in 1920 and 1923, and in 1923—on the right—the Hitler-Ludendorff beer hall putsch.

In this precarious situation, the socialist party (SPD) and the trade unions stabilized the republic. A general strike defeated the 1920 Kapp putsch, and an SPD politician, Carl Severing, was in charge of defeating the Red armies on the Ruhr. The collaboration of socialists with traditional state institutions and with the army had its counterpart in economic relations, where unions, businessmen, and the state all achieved a mutually beneficial working relationship.

The inflation experience of 1914–1923 has generally been described by modern scholars in the following way: unions asked for higher wages, industrialists obtained higher prices, and politicians agreed to monetary expansion and fiscal destabilization because they were concerned with avoiding social radicalization. There emerged out of these calculations an "inflation consensus,"[3] which helped to make Weimar more stable politically, but less stable economically, in the turbulent aftermath of the revolution. Alternatives (such as a budget balanced by higher levels of taxation) would have precipitated middle-class protest and tax strikes, or labor protests.

Such inflation-generating political coalitions—organized labor, big business, and government—are characteristic of countries with high levels of social instability.[4] Inflation appears as the only available social cement. In the aftermath of World War I, the countries of Central Europe (with the partial exception of Czechoslovakia)—but also states such as France or Italy—found it impossible to generate sufficient social consensus either to cut spending or to put up taxes. The inflation consensus emerged here in the absence of a deeper social agreement.

This consensus flew in the face of orthodox economics. Few economists were so bold as to openly present inflation as a social stabilizer, or to argue (as Keynes did in 1923, at the height of German inflation) that it was desirable, in an impoverished world, to "disappoint the rentier." (Although he preceded this with the observation that we should "rule out exaggerated inflations such as that of Germany."[5]) The closest the economics profession came to offering an apology for inflationism in Germany was to argue that the currency collapse was a catastrophe which had resulted from Allied war reparations policy. Moritz Julius Bonn and Karl Helfferich were the most prominent proponents of the view that a negative balance of payments, caused by the effects of Versailles, had led to an outflow of marks, to a rise of the price of foreign exchange in Germany, to higher prices (because of higher import prices), and thus, necessarily, to greater levels of government spending.[6]

In November 1923 the government stabilized the mark by introducing a new

[3] Gerald D. Feldman, ed., *Die deutsche Inflation: Eine Zwischenbilanz. Beiträge zu Inflation und Wiederaufbau in Europa 1914–1924* (Berlin: de Gruyter, 1982), p. 18. The phrase was coined by Gerhard A. Ritter.

[4] See A. O. Hirschman, *Journeys Toward Progress: Studies in Economic Policy-Making in Latin America* (New York: Twentieth Century Fund, 1963), p. 215; and A. O. Hirschman, "The Social and Political Matrix of Inflation," in: *Essays in Trespassing: Economics to Politics and Beyond* (Cambridge: Cambridge University Press, 1981), p. 201: "Inflation then is a remarkable invention that permits a society to exist in a situation that is intermediate between the extremes of social harmony and civil war." Also see Fred Hirsch and John H. Goldthorpe, eds., *The Political Economy of Inflation* (Cambridge, Mass.: Harvard University Press, 1978).

[5] *Tract on Monetary Reform*, in *Collected Writings*, 4: 36.

[6] Carl-Ludwig Holtfrerich, *The German Inflation 1914–1923: Causes and Effects in International Perspective* (Berlin and New York: de Gruyter, 1986), p. 158.

currency (the rentenmark), by cutting the number of civil servants, and by imposing a realistic but heavy tax burden. For the new finance minister, Hans Luther, balanced budgets were the key to ending Germany's monetary chaos.

However, the balanced budgets of the stabilization era were relatively short-lived. Political pressures to spend more and at the same time to cut taxes reasserted themselves. Such pressures produced policy responses—in part because the German state had been, at least since Bismarck's 1879 turn to protectionism, highly sensitive to the lobbying of interest groups. At the same time, a tradition of state intervention in industrial and tariff policy encouraged the growth of organizations aiming at influencing policy.

Weimar inherited the old imperial traditions, but it had also generated high expectations as to what it might do to become more of a social and welfare state than the old *Kaiserreich* had been. It was a democracy rather than an autocracy, and its constitution announced that all political power came from the people (and no longer from God). In consequence, the people expected it to do more.

A strong state tradition, with additional hopes raised by the political revolution of 1918–1919, was married to a political process which produced a weak and vulnerable state machinery. Weimar's political situation was precariously balanced. A pure proportional representation system made it unlikely that any party would achieve an overall majority, and Weimar governments depended on the construction of governing coalitions. Some parties represented one economic interest—the SPD labor, or the DVP the business community. However, even these tried to attract other voters, and most parties represented in social terms fairly heterogeneous alliances. The parties came to believe that some pork barrel for their constituents should be a price of their participation in coalitions.

There was a broad range of interests which proved highly effective in lobbying Weimar governments: big business pressure groups, farmers, the civil service, municipal administrations, and organized labor. In addition, the absence of any minimum size for a Reichstag party (of the kind the Bonn Republic has with the 5 percent clause) encouraged the proliferation of smaller parties, representing special interests. In building coalitions on this basis, economic favors were an essential part of the negotiating process.

Weimar was too weak and malleable to resist the demands of coalition building, or to be able to afford the commitment of British politicians of the 1920s to budgetary and monetary orthodoxy. Deflation and the 1925 return to gold hit many vested interests, but British governments were independent and confident enough to risk such a strategy in the belief that the short-term sacrifices would bring a long-term good (the restoration of Britain's pre-1914 international eminence).

By contrast, German businesses successfully demanded tax cuts as an essential preliminary step toward the restoration of profitability. Collecting taxes was difficult for the government, and in August 1925 income and wealth taxes were cut, and the attempt to assess increases in wealth in the years of war and inflation was abandoned. Inheritance taxes were also cut. In 1926 the sales tax (or turnover tax, *Umsatzsteuer*) was lowered to 0.75 percent (it had been 2 percent in the aftermath of the inflation).

These measures were not enough to stem the tide of publications from business interest groups demanding tax cuts.[7] By 1929 there was in Germany a consensus more or less across the political spectrum (and including even the SPD) that taxes were too high, an argument that was supported by sometimes rather dubious international comparative statistics. The tax level was held responsible for the flight of capital out of Germany and for endangering Weimar's fragile economic prosperity. In response, a "tax reduction psychosis" (*Steuersenkungspsychose*) developed.

At the same time, there were pressures on the government to spend more. Industries in nationally sensitive areas—in the Rhineland, with its proximity to France, or in Silesia, near Poland—asked for, and received, subsidies from the central government.

After 1927, agriculture was plunged into a deep crisis of falling prices and indebtedness. In the winter and early spring of 1927–1928 there was a widespread and frequently violent tax revolt. From the perspective of the politicians and the political parties, farmers were a key electoral constituent. The traditional parties—the conservatives (DNVP), the Catholic Center, the Democratic Party (DDP), and even the socialists (SPD)—all tried to cultivate the rural vote. In consequence late Weimar governments were ready to make concessions over farm taxes and on rural debt relief, although these repeated concessions failed to keep farmers voting for Weimar's democratic parties. But again, the Weimar state paid out. By the end of 1932, governments had spent 2 bn RM (or 3 percent of total government spending for the years 1930–1932) on agricultural debt relief.[8]

A powerful civil service lobby within both the Center party and the DVP looked anxiously at public sector pay. In 1927, at the instigation of Finance Minister Heinrich Köhler, a Catholic civil servant, the government granted a pay rise of up to 30 percent.

[7] For instance, Reichsverband der Deutschen Industrie, Deutsche Wirtschafts- und Finanzpolitik (Berlin: RDI, 1925); and Reichsverband der Deutschen Industrie, Aufstieg oder Niedergang (Berlin: RDI, 1929). Oct.–Nov. 1927 Hansabund memorandum in archive of Deutscher Städtetag DST B4472.

[8] Dietmar Petzina, "Staatliche Ausgaben und deren Umverteilungswirkungen: Das Beispiel der Industrie-und Agrarsubvention in der Weimarer Republik," in Fritz Blaich, ed., *Staatliche Umverteilungspolitik in historischer Perspektive* (Berlin: Duncker und Humblot, 1980), p. 102.

At the level of city government, spending on housing, transportation, gas and electricity plants, and urban amenities rose. Most of these municipal projects were valuable, although they incurred a great deal of criticism from conservative circles. But they were often financed by short-term loans, and the investments frequently did not generate sufficient revenue soon enough to allow the repayment of borrowed money. The cities borrowed in part because they believed that conditions on the long-term capital markets would improve, and that they could soon refund their short debt. They also faced the same political constraints as the central government. In consequence, at the same time as their spending increased, they were using tax reductions as an incentive to attract new industries to their locations.

Finally, the right-wing coalition (Bürgerblock) which controlled state politics between 1924 and 1928 implemented a new system of social unemployment insurance (1927), which was inadequately funded and which developed into a major strain on the budget as unemployment increased after 1928.

By 1929–1930, the left-center coalition which had succeeded the Bürgerblock governments was held together almost solely by reparation negotiations, for a very remarkable reason. The parties believed that a successful conclusion to the Hague conferences and a downward revision of Germany's reparations bill would allow more room for a new round of tax cuts, which might help Germany in the emerging world economic crisis. Political eyes were still fixed on ways of being able to make room for expansionary budget policies.

However, the crisis developed too quickly for this calculation to be realistic, and expenditure went up as a product of involuntary mechanisms rather than of conscious political decisions. The central state needed to subsidize the increasingly burdened unemployment insurance scheme. At lower levels of government, there were similar increases in spending as the demand for social assistance grew. Cutbacks in the level of unemployment insurance support (under the insurance scheme) and of municipal relief (once eligibility for insurance payments had ended) did little to stabilize the financial situation.

At the same time, tax revenues were falling because of the Depression, and it was becoming more difficult for all levels of government to borrow as the Depression affected Germany's credit assessments on the world's capital markets. In 1929 the flotation of a reich loan turned into a disaster; and later in the year the attempt to borrow from the U.S. house of Dillon Read prompted a large-scale political crisis which eventually resulted in the resignation of the finance minister and the initiation of austerity policies.

The dramatic policy shift during the Depression era was as much a product of changes on the capital markets, as of the deliberate adoption of a deflationary strategy for its own sake. It is hard to think of a simply political motivation for the highly unpopular deflationary policies which began to be implemented already under Müller (SPD, chancellor 1928–1930), and were then pursued—with much more dramatic belt-tightening—under his successor Heinrich Brüning (Center party), the so-called "Hunger Chancellor." Weimar was still tense and unstable. What politician would want to adopt policies that would hurt every social and economic group, and every political actor—policies that alienated labor (because of unemployment and wage cuts), farmers (who faced big interest bills at the same time as land prices were plummeting), civil servants (whose jobs were disappearing and whose salaries were shrinking), and businessmen (whose order books were becoming ever leaner)?

Brüning was partly concerned to demonstrate how impoverished Germany was in order to convince the Western Allies to cut the reparations bill yet further—a task which was accomplished, but only after Brüning's dismissal, at the Lausanne conference (June–July 1932). But he was also pushed into deflation by a number of high-ranking professional civil servants, the most influential of whom was Hans Schäffer, the state secretary (the highest-ranking career civil servant) in the finance ministry.

These civil servants pointed out again and again to Müller and to Brüning the implications of the strained capital market. Long-term lending to the German government had dried up. What about short-term funding from the money market to tide the government over in the crisis? It is exactly this sort of sovereign borrowing which is recommended by Keynesians such as Hyman Minsky as a stabilizer in financial crises.[9] In this analysis the crisis of confidence is marked by the absence of any secure borrowers: only the state, because of its sovereign power, can be treated as a completely secure borrower.

Schäffer's argument depended on some peculiarities of the German case: public debt could not be monetized at the Central Bank beyond a quite low ceiling (400m RM) set by the terms of the internationally guaranteed reparations (Dawes and Young) plans. Since commercial banks which lent short term to the government thus had no possibility of rediscounting state paper at the Central Bank, they would have to cut their outstanding credits to other debtors, and this might mean that a government funding operation, far from preventing a financial crisis, might turn a panic into a major and general economic disaster.

Schäffer was personally sympathetic to the SPD, and it is difficult to detect any dogmatic or doctrinaire reactionary origins for his viewpoint during the Depression. His theory—which amounted to a peculiarly constraining German version of the British "Treasury view" of the crowding-out effects of public

[9] Hyman P. Minsky, "The Financial Instability Thesis: Capitalist Processes and the Behaviour of the Economy," in Charles P. Kindleberger and Jean-Pierre Laffargue, eds., *Financial Crises: Theory, History and Policy* (Cambridge: Cambridge University Press, 1982), pp. 13–39.

borrowing—was a quite accurate warning of events which actually did take place in the summer of 1931, when a fiscal crisis and a banking crash coincided to make the German depression much more severe. Relatively small budget deficits led to a run on the banks, to foreign panic, and to an exchange crisis. The bank collapse underlined the real limits on the German government's freedom for maneuver.[10]

Even after the disaster of July 1931, the same calculations remained. It was not clear to any of the participants—politicians, civil servants, bankers, and the general public—that the banking run was a unique event. A fear of a renewed wave of bank collapses—of the kind that was taking place repeatedly in the United States at the same time—made the government very cautious in late 1931 and 1932 when it came to reflationary proposals, either for fiscal stimulation or for monetary expansion. The Central Bank did begin to pursue a less restrictive policy from the autumn of 1931,[11] but it made sure that these moves were kept very quiet so as not to provide any further shocks to financial stability.

The key experience in Germany, which the policy makers rightly regarded as a major cause of the worsening of the Depression, was financial panic and collapse. Policies designed simply to overcome deficiencies in demand might, because of their effect on foreign and domestic confidence, undermine the financial structure further, and thus have a counterproductive effect—even on employment levels. This fear of financial collapse was especially strong in Germany and in Central Europe generally because the risks were high there, but it was also an international fear. In 1931 and 1932, at the trough of the Depression and during the wave of financial panics, Keynes was much more hesitant about recommending public works and fiscal expansion than either before (*Can Lloyd George Do It?*) or after (in *The General Theory*).[12]

Despite these concerns about financial confidence, political pressures on German leaders to do something about the economic crisis grew. By 1932 there were almost seven million unemployed. "Doing something" required a public gesture that was to be more dramatic than the silent and slow Central Bank reflation, and Brüning and his ministers began to prepare work creation schemes. Brüning's spending proposals were enough to worry Schäffer into resigning from the fi-

[10] See on this especially Knut Borchardt, "Zwangslagen und Handlungsspielräume in der grossen Wirtschaftskrise der frühen dreissiger Jahre: Zur Revision des überlieferten Geschichtsbildes," in Jahrbuch der Bayerischen Akademie der Wissenschaften, Munich 1979, pp. 85–132. This essay is reprinted, with additional references, in Knut Borchardt, *Wachstum, Krisen, Handlungsspielräume der Wirtschaftspolitik* (Göttingen: Vandenhoeck und Ruprecht, 1982), pp. 165–82.

[11] Harold James, *The Reichsbank and Public Finance in Germany 1924–1933* (Frankfurt: Fritz Knapp, 1985), pp. 326–33.

[12] See the chapter by Bradford Lee in this volume.

nance ministry. But before the proposals could be put into effect, President Hindenburg removed Brüning from the chancellorship.

As a result, it has often seemed to historians that Brüning's successors, Papen and Schleicher, were more adventurous. Their work creation schemes involved (in Papen's case) government subsidies to employers who created new jobs, and with Schleicher, more simply, direct, publicly funded make-work projects. It is impossible to determine how effective Papen's and Schleicher's measures might have been over a longer run: the immediate impact was obviously very limited. Papen ran into the problem that few employers had the confidence to take on additional labor, even if they were given government subsidies. Of the 700m RM set aside under Papen's plan as premiums to reward the creation of new jobs, only 20m RM had in fact been used by the end of November 1932.[13] Schleicher's difficulty lay in the unavailability of sufficient adequately-advanced proposals for work creation. History was as impatient with Papen and Schleicher as she had been with Brüning; and their experiments were not allowed to run to a conclusion. In January 1933 the political scene changed abruptly when Adolf Hitler became chancellor.

Already in the Weimar period, the Nazi political program had given some prominence to work creation. "Doing something" was of great electoral importance. Though the main basis of the Nazi vote lay with farmers and small tradesmen, the party was trying to broaden its social platform. In a number of cities, notably Berlin and Ruhrort-Meiderich, it appealed with skill and success to the unemployed working class. Nazi plans for work creation were most systematically set out in Gregor Strasser's Reichstag speech of May 10, 1932. The program provided for an expenditure of 10 bn RM on roads, agricultural improvements, and the settlement of unemployed workers on the land. Later on in 1932, the plan was scaled down because critics accused Strasser of being too inflationary, but Hitler as chancellor still made the maximum publicity effects out of what he called the "war for work" (*Arbeitsschlacht*).

In fact, considering the amount of publicity devoted to activism, Nazi spending on work creation was relatively low: a total of 5.25 bn RM between 1932 and 1935. It is true that government expenditure on construction and road building (the celebrated Autobahn projects) increased appreciably during the first years of Nazi rule;[14] but levels of investment in housing and transport remained well below Weimar levels. Even roads, which were so important an ideological part of

[13] Bundesarchiv Koblenz (BAK) NL Luther 370, 30 Nov. 1932 meeting.

[14] Ludwig Grebler, "Work-Creation Policy in Germany 1932–1935," *International Labour Review* 35, p. 336; Karl Schiller, *Arbeitsbeschaffung und Finanzordnung in Deutschland* (Berlin: Junker und Dünnhaupt, 1936), p. 63; Richard J. Overy, *The Nazi Economic Recovery 1932–1938* (London: Macmillan, 1982), p. 48.

the Nazi vision of the future, received fewer investment funds in 1934 than in 1927. It was only after 1935 that really enormous sums were put into the Reichsautobahnen.[15] Those commentators who have been so impressed by the scale of Nazi public investment have been the victims of an optical illusion: municipalities, which had spent heavily on construction in the 1920s, were now forced to cut back their expenditure, while central government money flowed into building. But in the recovery phase of Nazi rule (up to 1935–1936) the total amount of government funding did not change very dramatically.

The relatively limited extent of spending on work creation (it amounted to only just over 1 percent of GNP for the years 1932–1935) was matched by a rather cautious and conservative fiscal stance. Taxes were generally kept at the high levels reached during the Depression, though there were some reductions to benefit specific groups (farmers and small businessmen) and tax certificates (future rebates) were given out as an encouragement for house repairs. One of the reasons given for the absence of any far-reaching tax reform or reduction was in fact that such a measure—though desirable—would have to wait for the end of the recovery process.[16] This view—bizarre from a modern viewpoint—shows how far the Nazis were from giving a Keynesian-style fiscal stimulus.

When larger deficits emerged later in the 1930s, they originated in political and not in economic decisions, coming principally from the increased pace of rearmament. Because of the more authoritarian nature of the German state, there was less pressure to subsidize a wide range of interest groups in the style of Weimar politics. Many groups—the farmers and independent retailers and artisans—who had given much support to Nazism before 1933, were very disappointed when they were not better rewarded by the new government. Lobbying politics and coalition building were replaced by a system in which ideology played a much larger part. Hitler's government was profligate not because it was forced to be, but because it wanted to be: at least after 1936, the dictates of rearmament were allowed to override orthodox rules of financial prudence.

In line with the generally conservative fiscal stance of the regime, deficits were conservatively funded through the selling of government securities directly or indirectly through savings banks to the public. Public savings were absorbed to finance state debt, and savings were high during the Third Reich—in part because of the scarcity or unavailability of consumer goods. Only after 1938, when the

[15] *Statistisches Jahrbuch für das Deutsche Reich 1938*, (Berlin, 1938), pp. 564–65; Rene Erbe, *Die nationalsozialistische Wirtschaftspolitik 1933–1939 im Licht der modernen Theorie* (Zürich: Polygraphischer Verlag, 1958), pp. 112–13.

[16] Fritz Blaich, "Die Grundsätze nationalsozialistischer Steuerpolitik und ihre Verwirklichung im Dritten Reich," in Friedrich-Wilhelm Henning, ed., *Probleme der nationalsozialistischen Wirtschaftspolitik* (Berlin: Duncker und Humblot, 1976), pp. 99–100.

government found it difficult to market debt, did it depend on refinancing through banks and on a generally more inflationary strategy of financial management.

There was never any sense in which government deficits were intended to be a fiscal stimulus (which was certainly not needed after 1936 when the economy was in danger of overheating); and critical economists and businessmen warned against the economic perils of growing state spending.

This assessment of the motives behind Nazi policy is borne out by the literature on the economic consequences of that policy. Few historians would now claim that Hitler was a Keynesian, or that "the first country to try demand stimulus and make it work was, sad to say, Germany under the Nazis."[17] Most recent analyses of the Third Reich emphasize not only how much Hitler's approach to economics differed from that of Keynes, but also how it resulted in an aggressively rearming, state-socialist type of economy rather than the demand-led consumer economy usually associated with Keynes' recommendations (in which the state's rôle is to redistribute and to develop higher levels of consumer demand).

The most important objector to this interpretation, Joan Robinson, argues that Hitler was a Keynesian, because she attempts to associate the "real Keynes" more with a kind of state socialist policy. "Hitler had already found how to cure unemployment before Keynes had finished explaining why it occurred. . . . It was a joke in Germany that Hitler was planning to give employment in straightening the Crooked Lake, painting the Black Forest white, and putting down linoleum in the Polish corridor."[18]

However, this is not an opinion widely shared. Rene Erbe concluded the first major scholarly study of Nazi economic policy by saying that Schacht's (economic minister 1934–1937 and Central Bank president 1933–1939) policy was at the most a "distorted reproduction, a bad caricature" of Keynesianism.[19] Richard Overy puts the point well: "Far from pursuing Keynesian policies in the 1930s, the Nazi government controlled the growth of demand, actively intervening to restrain the increasing propensity to consume in the early years of recovery by redistributing income to those with a lower propensity to consume or by deliberately creating savings."[20] He adds that the multiplier in the mid-1930s in Germany was in consequence far lower than that calculated for the British case by Keynes (1.5 rather than 2.5–3.0).

[17] Peter Gourevitch, "Breaking with Orthodoxy: The Politics of Economic Policy Responses to the Depression of the 1930s," *International Organization* 38 (1984), p. 112.

[18] Joan Robinson, "What Has Become of the Keynesian Revolution?" *Challenge* 16/c (1974), p. 7; George Garvy, "Keynes and the Economic Activists of Pre-Hitler Germany," *Journal of Political Economy* 83 (1975), p. 403.

[19] Erbe, *Die Nationalsozialistische Wirtschaftspolitik*, p. 172.

[20] Overy, *Nazi Economic Recovery*, p. 33.

These conclusions had already been hinted at immediately after the Second World War. Costantino Bresciani-Turroni wrote: "German statistics and numerous reliable reports indicate that all in all the effects of public works on private enterprise and the industries producing consumers' goods were very modest, they did not come up to expectations and made themselves felt only very slowly."[21] Arthur Lewis denies the usefulness of the Hitler experiment from the standpoint of Keynesian economics with a characteristic wit:

> Unfortunately the German experiment ceased to be helpful just as it was becoming interesting. What interests economists in this sort of situation is whether, after heavy government expenditure has set recovery in motion in this way, private investment will start to grow cumulatively, and so make it possible for government expenditure to be curtailed without the system collapsing once more. . . . From 1935 the German economy ceases to be an illustration of the methods of "priming the pump."[22]

The Nazi experience then could only really be described as "Keynesian" with the very loose usage of terminology in which Keynesian means simply budget deficits but does not involve the other features associated with post-1945 demand management. There was no systematic use of national accounting in drawing up budgets. The Nazis did not consider the multiplier. There were no discussions with an independent labor movement on how to fix wage levels (the union movement had been destroyed as early as May 1933). It is, then, impossible to transfer any picture of Keynesianism derived from the experience of the post-1945 world to Nazi Germany.

UNKEYNESIAN THEORY

One of the striking features of interwar Germany was how, if policies were pursued that led to budgetary deficits, they were the result of the efforts of practical men, operating in a theoretical vacuum and receiving no encouragement from defunct economists, or even from living scribblers. Theory very often was silent in German policy making, as Keynes himself observed in the preface to the German edition of *The General Theory* (which appeared already in 1936, translated by Fritz Waeger):

[21] Costantino Bresciani-Turroni, *Economic Policy for the Thinking Man* (London: Hodge, 1950), p. 185.

[22] W. Arthur Lewis, *Economic Survey 1919–1939* (London: Allen & Unwin, 1949), pp. 95–96.

But can I hope to overcome Germany's economic agnosticism? Can I persuade German economists that methods of formal analysis have something to contribute to the interpretation of contemporary events and to the moulding of contemporary policy? After all, it is German to like a theory. How hungry and thirsty German economists must feel after having lived all these years without one![23]

Keynes must have expected to have a particular appeal to Germans, initially because of his forthright attack on the Versailles treaty, *The Economic Consequences of the Peace*. This was naturally translated into German, and ensured a response for Keynes' subsequent work. In January 1932 he visited Germany, giving a speech in the prestigious Hamburg Ueberseeclub, and traveling on to Berlin to talk with Chancellor Brüning. According to Brüning's (sometimes unreliable) memoirs, Keynes tried to urge an inflationary course on the German politician;[24] but on his return to Britain, Keynes wrote an article for the *New Statesman and Nation* which made no reference to alternatives to German government policy, and instead blamed the catastrophe on reparations.[25] In February 1932, he seems to have been impressed by arguments about how the first necessity in the crisis was the maintenance of financial confidence.[26]

Once Hitler was in power, Keynes was sceptical of the German course. But, at least in matters of economic policy, he was seen in part as a sympathizer. His *Yale Review* article of 1933 on national self-sufficiency (initially given as a lecture in Dublin on April 19, 1933) was reprinted in German, and its argument that it would be best to "minimize, rather than . . . maximize, economic entanglement between nations" might have been expected to appeal to the new nationalism of National Socialist Germany.[27] In addition, the translator made a substantial concession to German sensibility by omitting Keynes' comments about the limited value of the German example in the light of the fact that Germany was "at the mercy of unchained irresponsibles—though it is too soon to judge her capacity of achievement."[28] Keynes was disturbed by the changes in his article, but eventually agreed: "I confirm that I am quite satisfied that my article should, on your responsibility, appear in the slightly amended form in which the proof reached me."[29]

[23] Keynes, *Collected Writings*, 7:xxvi.

[24] Heinrich Brüning, *Memoiren 1918–1934* (Stuttgart: Deutsche Verlags-Anstalt, 1970), p. 506.

[25] Keynes, *Collected Writings*, 18:366.

[26] See Knut Borchardt, "Das Gewicht der Inflationsangst in den wirtschaftspolitischen Entscheidungsprozessen während der Weltwirtschaftskrise," in Gerald D. Feldman, ed., *Die Nachwirkungen der Inflation auf die deutsche Geschichte 1924–1933* (Munich: Oldenbourg, 1985), p. 246.

[27] Keynes, *Collected Writings*, 21:236.

[28] Keynes, *Collected Writings*, 21:244.

[29] Knut Borchardt, "Keynes' 'Nationale Selbstgenügsamkeit' von 1933. Ein Fall von kooperativer Selbstzensur," in *Zeitschrift für Wirtschafts—und Sozialwissenschaften*, 108 (1988), pp. 271–84.

A similar playing to a German gallery is to be noticed in *The General Theory* itself. The text includes a fundamental statement about political values and expresses a hope for liberal democracy:

> The authoritarian state systems of today seem to solve the problem of employment at the expense of efficiency and of freedom. It is certain that the world will not much longer tolerate the unemployment which, apart from brief intervals of excitement, is associated—and in my opinion inevitably associated—with present-day capitalistic individualism. But it may be possible by a right analysis to cure the disease whilst preserving efficiency and freedom.

But the German preface sounds a rather different note, and looks to a more controlled economy as an ideal experimenting place for management of demand through state policy: "The theory of output as a whole, which is what the following book purports to provide, is much more easily adapted to the conditions of a totalitarian state [*Totaler Staat*], than is the theory of the production and distribution of a given output produced under conditions of free competition and a large measure of laissez-faire. . . . Although I have thus worked it out having the conditions in Anglo-Saxon countries in view—where a great deal of laissez-faire still prevails—it yet remains applicable to situations in which national leadership is more pronounced."[30]

There was even in Germany some parallel development to Keynes' argumentation. In 1937 a work by Carl Föhl was published, which provided a very similar account of the motives behind investment.

The General Theory attracted a great deal of interest in Germany, and some positive reviews (Hans Peter). Most reviews, however, were critical. Many emphasized that Keynes was too much concerned with short-term calculations and that as a consequence of this limited horizon he had derived a stagnationist view that ignored technical change (Alfred Kruse, and the Swiss W. A. Jöhr). Kruse argued in addition that Keynes' diagnosis applied only in the cases of capital-rich countries such as Britain and the United States: in Germany, on the other hand, there was no danger of savings outstripping investment. Gerhard Albrecht wrote articles critical of U.S. deficits and explaining that the New Deal was simply building up problems for the future.[31]

[30] Keynes, *Collected Writings*, 21:xxvi; B. Schefold, "The General Theory for a Totalitarian State? A Note on Keynes' Preface to the German Edition of 1936," *Cambridge Journal of Economics* 4 (1980), pp. 175–76.

[31] In *Jahrbücher für Nationalökonomie* 146 (1937): Hans Peter (pp. 61–72), Alfred Kruse (pp. 72–83), Gerhard Albrecht (pp. 663–86), and Walter A. Jöhr (pp. 641–62).

In *Schmollers Jahrbuch*, Carl Krämer, a former economic journalist and an assistant of Schacht's, who had translated Keynes' *Treatise on Money* in 1930–1931, welcomed Keynes' acceptance that the era of laissez-faire economics had come to an end. But he thought that Keynes' analysis could only be applied to Britain and the United States. In Germany, Russia, and Japan, there was no problem of free capital movements, and there was also no shortage of investment projects. Even for the Western economies, though, there were difficulties: were not armaments rather than more consumption the real key to progress?

> We should recognize that the favourable development between 1895 and 1913 is in part to be explained by the substantial armaments expenditure of almost all Great Powers; whereas in the years 1924–34 there was no especially high spending on weapons. If we set into our calculations for the next decade a higher military budget and a larger demand for loans for the state, is it still necessary or even desirable to follow a policy of raising consumption and limiting savings? . . . Keynes in his new book is in danger of . . . building on the basis of some, but by no means all, the realities of the present a general theory which generalizes partial phenomena of a state of transition.[32]

Thus, despite Keynes' previous popularity in Germany, despite his efforts to harness his theory to the new economic nationalism, and despite the alleged German hunger and thirst for theory, Keynes' seed fell in Germany on barren ground. There are essentially three reasons for this:

1. *Popular fears of inflation.* As a legacy of the German inflation, there was a substantial popular concern about the side-effects of expansionary policies—whether these included budget deficits, changes in the parity of the currency or in banking laws, or alterations of political regime.[33] Any potentially inflationary policy—or any policy which was not inflationary but was reckoned to be so—was in consequence very vulnerable politically.

It was true that there had been in the past—between 1925 and 1930—large government deficits as a result of the combination of pressures to spend and demands to cut taxes. In addition, the small crisis of 1925–1926 had been overcome by something similar to a Keynesian strategy for countercyclical spending programs.[34] However, these deficits had not contributed to long-term growth, and had limited the scope for government activity after 1929, when there was a really severe depression. During the slump, anxiety about government deficits and

[32] Carl Krämer, "J. M. Keynes über die Kapitalbildung," *Schmollers Jahrbuch* 61 (1937), pp. 71–72.

[33] Borchardt, "Das Gewicht der Inflationsangst," p. 235.

[34] See D. Hertz-Eichenrode, *Wirtschaftskrise und Arbeitsbeschaffung: Konjunkturpolitik 1925/6 und die Grundlagen der Krisenpolitik Brünings* (Frankfurt, New York: Campus, 1982).

about inflation increased. In particular, the experience of the 1931 banking crisis heightened German sensitivity about unstable government finance. An example of how the Depression altered the view of deficit finance is the ferocity with which in late 1931, after the bank collapse, Hitler in private rejected a proposal that a future Nazi state could simply print money: "That's exactly what previous governments have done. They pour money for unemployment relief down the drain."[35] Hitler's political antennae were, it seems, finely tuned on this issue.

The British ambassador explained why some of the Reichstag parties were prepared to tolerate—though not openly to support—Brüning's deflationary policy even at the depth of the Depression: "It is particularly this fear of inflation which explains the docility with which the whole country has hitherto blindly accepted Government measures and decrees which have brought business practically to a standstill, have interfered with liberty to travel, practically destroyed the freedom of the press and have set up a sort of inquisition into people's private affairs."[36] The SPD theoretician Rudolf Hilferding in 1931 warned against inflation as "the most terrible indirect tax,"[37] and at the beginning of 1932 the parties of the Left believed that they had discovered a right-wing and industrial conspiracy to launch a new inflation and expropriate the small man.

The SPD faced an acute dilemma: the unemployed and trade union members wanted the party to do something; but at the same time the party shared the general fear of inflationary financing. This is why socialist work creation schemes went off at half-cock. When the SPD at last produced a work creation scheme in 1932, it was trade unionists rather than party politicians who bore the responsibility. This plan (usually called the WTB plan after the initials of its authors: Wladimir Woytinsky, Fritz Tarnow, and Fritz Baade) provided for the spending of an additional 2 bn RM over the course of one year. Woytinsky was interested in Keynes' work, and attempted, without much success, to begin to correspond with the English economist.[38]

The WTB's 2 bn RM were to go for labor-intensive projects such as road building, agricultural improvements, flood protection, the construction of small apartments for lower income families, and infrastructure investment in the post and railways. It represented over one-third of the total Reich (central state) budget for 1932–1933. The proponents of the plan believed that this amount would be sufficient to generate employment for one million men. At an extraordinary congress of the German trade unions in April 1932, the plan was formally adopted—

[35] Henry A. Turner, ed., *Hitler aus nächster Nähe: Aufzeichnungen eines Vertrauten 1929–1932* (Frankfurt: Ullstein, 1978), pp. 332–33.

[36] Turner, *Hitler*, p. 341.

[37] *Vorwärts*, 21 Sept and 4 Oct. 1931.

[38] Garvy, "Keynes and the Economic Activists," p. 401.

although even then only because it was included in a packet with more radical demands. By June the trade unions had moved on to proposals for extensive nationalization, and the work creation scheme was left on one side. Radical rhetoric looked like a more convincing way of wooing back voters and members. The more moderate and reformist work creation scheme might be, its critics said, nothing more than a repeat of 1919–1923, when unions working together with employers had helped to produce an inflation which had in the end only damaged the working class. In consequence, doing something radical had much more appeal than Woytinsky's proposals for additional employment.

Activist parties on the political right faced the same difficulties as would-be activist parties on the left. The NSDAP, with its claim to be a populist party, was very vulnerable to the accusation that it was inflationary: this is the reason why it was obliged to water down the work creation scheme of May 1932 so substantially. There were also more aggressive responses to the accusation. In April 1932 Hitler spoke in Dresden: "Some say today that we would produce an inflation. We cannot do this, even if we wanted to, for the specialists of inflation are sitting in the parties which today rule the state."[39] He threw the Left's accusations of Nazi inflationism back and argued that it was the SPD which had been responsible for destroying the small saver in a cynical move to pauperize and proletarianize the German people.

The fight against inflation remained a theme of Nazi policy after the seizure of power. It is striking how some of the orthodoxies of the Brüning era lingered on in Nazi propaganda. In Hitler's government declaration after the March 1933 elections, he emphasized the need for parsimony in public finance in order to avoid inflationary budget deficits.[40] He constantly opposed the idea of a devaluation of the German mark or of the Danzig gulden: "I have pledged my word. I will not make inflation. The people would not understand it." The sources of this belief in the pernicious effect of inflation came from Hitler's experience of the First World War. Again and again he came back to the frightening story of Germany's military collapse of 1918. Hitler followed the orthodox view of the German Right that the German armies had not been defeated in the field. Rather "the last war was lost because of a limitless lack of understanding for the susceptibilities of the masses of small savers and housewives." Rather than allow such an inflation to occur again, he said, he would prefer to abolish money altogether.[41] In 1933 he believed that it was necessary to appoint a conservative economist such as Schacht to head the Central Bank at least until unemployment had been

[39] *Völkischer Beobachter*, 6 Apr. 1932.

[40] Max Domarus, *Hitler: Reden und Proklamationen 1932–1945: Kommentiert von einem deutschen Zeitgenossen* (Munich: Süddeutscher Verlag, 1965), p. 233.

[41] Hermann Rauschning, *Gespräche mit Hitler* (New York: Europa Verlag, 1940), pp. 195–96.

overcome. Otherwise there would be an international speculative attack on the mark and unemployment would rise again.[42]

In 1935, when police intelligence reports indicated widespread popular fears about inflation, the government had to step in to make a public disavowal of any inflationary intention. In September 1936, when Schacht wanted to follow the French franc off the gold standard, and to devalue the mark, Hitler obstructed the proposal after he had been tipped off by Funk, Schacht's eventual successor as economics minister.[43]

For all German interwar political movements, an open espousal of Keynes' theories, which were frequently and misleadingly identified with inflationism, would have been a severe political handicap. When the Nazis embarked on fiscal deficits and monetary expansion, they were very quiet about what they were doing. Throughout the later 1930s, as deficits grew, the government tried to hide them. One of Central Bank president Schacht's most important functions was to use concealment devices (in particular the Mefo-bills: bills drawn on a front company and used to pay for armaments)—and in general to put a respectable and anti-inflationary front on government policy.

2. *The scepticism of the civil service.* Keynesianism in the sense of demand management requires a sympathetic and economically educated bureaucracy. In many countries, the implementation of Keynesian management depended as much on the intellectual orientation of the civil service as on the more obvious political pressures to spend money and "do something"—pressures which exist, to varying degrees, in all modern societies. Civil servants, of course, may be influenced by their perceptions of what societies demand, but they may also have ideas by themselves.

In Britain, the practical application of Keynes' theories resulted in large measure from an inflow of academic economists into the civil service, and the conversion of leading Treasury officials to Keynesianism during and after World War II.[44] For the Swedish case, it has been argued that willingness to experiment with a socially oriented expansionist policy stemmed from the traditionally etatist character of the civil service.[45]

The leeway that civil servants have in determining policy depends on the effectiveness or lack of effectiveness of politicians in asserting themselves vis-à-vis bureaucracies. Before the First World War, Germany had a tradition of often

[42] Turner, *Hitler*, p. 401.

[43] Institut für Zeitgeschichte Munich (IfZ) ED172/72, 30 Sept. 1936, Goebbels diary entry.

[44] See the contribution to this volume by Donald Winch.

[45] Margaret Weir and Theda Skocpol, "State Structures and the Possibilities for 'Keynesian' Responses to the Great Depression in Sweden, Britain and the United States," in Peter B. Evans, Dieter Rueschemeyer, and Theda Skocpol, eds., *Bringing the State Back In* (Cambridge: Cambridge University Press, 1985), p. 130.

enlightened bureaucratic rule, in which civil servants operated with almost complete independence from parliamentary control, though with occasional interference from the monarch. They were free to make policies—such as the major Prussian tax reform of the 1890s. Late nineteenth-century Prussia appears to be a model for Max Weber's concept of bureaucratic rationality.

In Weimar, politicians made more demands. On the whole, its leading civil servants—unlike the Central Bank, the judiciary, or the military leadership—behaved loyally toward the republic. They did what the politicians instructed, and in the 1920s civil servants in the finance and economics ministries duly supervised the expansion of government budgets and the funding of government deficits. By 1927, and even more by 1929, government funding operations had become extremely difficult; but the high financial civil servants sought out all possible sources of funding and were quite willing to approach U.S. lenders behind the back of the Central Bank.

After 1933, when again there was a clear political direction emanating from the government, civil servants again fell into line. It was between 1930 and 1933, when governments had no support from parliamentary majorities, but ruled instead through emergency decree, that the scope for independent action by the civil service was greatest. Chancellor Brüning in particular was heavily influenced by "experts," particularly by the career civil servants at the heads of ministries (known in Germany as state secretaries—*Staatssekretär*).

It is not simply a coincidence that the period when the German civil servant was most influential in policy determination was also the time when deflationary orthodoxies were strongest. There are two reasons for this. First, those politicians who believed during the Depression that there could be no alternative to deflation felt reluctant to bear the political responsibility for the consequences of deflation, and preferred to let civil servants carry the can. Second and more important, the leading civil servants worked out powerful reasons why high spending and high deficits had failed in the past and would in the future be disastrous.

The German policy-making civil servants were by no means unresponsive to economic theory. But on the whole they were concerned with problems that cannot be easily fitted into a conventional picture of what a Keynesian recipe might offer.

Economic policy was the responsibility of several ministries: finance, economics, agriculture, and labor. In the Third Reich new institutions were added: in 1936 the four-year plan office; while the air ministry and the army ministry's economic section played a major part in the economics of preparation for war. Spending pressure was generated by the agriculture ministry, in Weimar by the labor ministry, and in the Third Reich by the military ministries and offices.

The finance ministry's chief concerns were with taxes and with the frequently very problematic issue of funding government debt. Particularly in the Depression this was the difficulty that obsessed policy makers most.

However, a generally conservative stance did not imply complete theoretical blindness. In August 1931 State Secretary Hans Schäffer produced a multiplier effect argument when he was discussing the hypothetical consequences of spending 3 bn RM on work creation. He tried to tell the president of the Central Bank that the expenditure of such a sum would not really cost the state all that much because of the additional revenue that secondary consumption (by the workers employed in the work creation projects) would generate.[46]

The banking crisis and the continuing financial instability of 1931 proved to be vital constraints in calculating the feasibility of reflationary plans. Schäffer soon retreated from this expansionist stance. The renewed financial instability of September 1931 made him reassess his proposals, and in 1932 he resigned from the finance ministry because he feared new budget deficits. In April 1932, he stated that "work creation can never end the crisis, but only protect men from despair"; and in his letter of resignation he wrote that "the contraction of the German economy, which began in the winter of 1930/1 and then continued with the withdrawal of foreign capital and the subsequent collapse of the banks, was a process which cannot be reversed by domestic means, or even brought to a halt."[47] Schäffer's comments make clear how much German civil servants felt that the international economic framework restricted Germany's policy options.

In the Third Reich, the finance ministry contributed almost nothing to the formulation of policy. From 1932 until 1945 the minister was a former Weimar civil servant from the ministry, Lutz Graf Schwerin von Krosigk, who had been associated with the demand for stable and balanced budgets in the 1920s. In the 1930s, he still talked along these lines. In July 1932, in a meeting of Papen's cabinet, he stated: "Work creation is only a help for an economy that can recover by itself anyway."[48] After 1933, it emerged that he was a much more pliant figure than Schacht, and gave in whenever Hitler demanded that more money be spent. He took the old Prussian stereotype of the obedient civil servant to its logical and extreme end.

The economics ministry (which had evolved out of a section of the old imperial interior office) was, during the Weimar Republic, concerned chiefly with giving subsidies to business, export credits, cartel legislation, and the regulation of competition in general. In the Depression it leaned toward an expansionist policy rather more than did the finance ministry. On the junior staff of the min-

[46] IfZ ED93/31, 31 Aug. 1931 Schäffer diary entry.
[47] IfZ ED93/20, 12 Apr. 1930 Schäffer diary entry, and ED93/20 Schäffer to Brüning.
[48] BAK R431/2045, 21 July 1932 cabinet meeting.

istry was Wilhelm Lautenbach, who was later said to be "deservedly known as the German Keynes."[49]

Lautenbach was intrigued by the desirability of managing overall levels of demand. In June 1930 he had argued, after the iron and steel arbitration award for northwest Germany, that the state should give additional orders to make up for the shortfall in macrodemand caused by wage cuts. This was in 1930 a very radical suggestion: very few economists thought there to be a fundamental problem of demand, and almost all analysis was concerned with the question of industrial costs.[50] Later, in a memorandum of 1932, he claimed that there was no difficulty in creating credit: "the provision of credit is a purely technical and organizational problem: it is child's play to solve it."[51] Credit creation could not, however, solve the problem of deficient demand altogether.

As with Schäffer in the finance ministry, the financial panics of July and September 1931 made him modify his general policy line. Now Lautenbach said that interest reduction would be unwise and that rates should instead be kept high in order to attract new foreign capital. The budget deficit should not be financed by credit creation, since such a step would "damage us in the eyes of foreigners, and for that reason is in practice impossible." Instead, both wages and cartel prices should be cut. In addition to these recommendations, Lautenbach added the comment that the German capital shortage had been caused by excessive public spending crowding out private borrowers.[52] This conclusion, and these policy recommendations, have been described provocatively—but not inaccurately—as blueprints for Brüning's austerity decree of December 8, 1931, the most deflationary of all of Brüning's emergency legislation.[53] When examining policy alternatives, Lautenbach certainly did look over his shoulder at British proposals. His conclusions, however, were ambivalent, and he believed that Keynes' recommendations, intended to create economic and political stability, would in Germany only produce disorder and instability. The experience of both the finance and the economics ministries in the Depression is yet another indication of the centrality of financial collapse in the interwar slump in central Europe.

After 1933, the economics ministry, like the finance ministry, lost part of its

[49] Walter Eucken, *This Unsuccessful Age: Or The Pains of Economic Progress* (Edinburgh: W. Hodge, 1954), p. 59.

[50] BAK NL Lautenbach, 31, 2 June 1930 memorandum.

[51] BAK NL Lautenbach, 31, "Die Arbeitsbeschaffung und ihre Finanzierung kontradiktorisch dargestellt."

[52] BAK NL Lautenbach, 31, 17 Sept. 1931: "Möglichkeiten einer aktiven Konjunkturbelebung durch Investition und Kreditausweitung."

[53] Knut Borchardt, "Zur Aufarbeitung der Vor- und Frühgeschichte des Keynesianismus in Deutschland: Zugleich ein Beitrag zur Position von W. Lautenbach," *Jahrbücher für Nationalökonomie und Statistik* 197 (1982), pp. 359–70.

independence in policy formulation, but until 1937 its ministers were rather more effective defenders of ministerial autonomy than was Schwerin von Krosigk in Finance. Germany cut itself off from world markets, and this gave greater room for maneuvre in making economic policy. But the economics ministry rarely talked about reflationary strategy, and concerned itself more with the mechanisms used to isolate Germany: with the administration of trade and exchange controls. Controls on trade were tightened already from 1931 through a rationing of currency to importers. In 1934 a systematic allocation (the "New Plan") was used to direct trade in accordance with a general policy of bilateralization, and to run down those unnecessary industries which depended heavily on imports. In the administration of controls, for instance, clothing factories using natural fibers were discriminated against. Many of the trades hardest hit by the New Plan—because they were deemed "unnecessary" to Germany's economic development—were consumer industries. The attack on consumer industries was another indication of how Nazi Germany did not intend to take the Keynesian path of higher private consumption levels.

The economics ministry was most important in the power hierarchy of the Third Reich between 1934 and 1937, when the minister was Hjalmar Schacht. Schacht's principal gift lay, however, not in any theoretical innovation but in his ability as Central Bank president (he held the offices simultaneously) to camouflage government spending. After 1937, the ministry became less important as effective power was transferred to Hermann Göring's administrative empire.

When the economics or finance ministries exercised an influence of their own—between 1930 and 1933—it was generally to attempt to restrain political pressures. It was not necessary, the civil servants believed, to teach politicians how to spend money: the difficulty lay in damping spending ardor. Even in the generally deflationary Brüning period, and especially in 1932, there were bitter tussles when figures such as Labor Minister Stegerwald and Finance Minister Dietrich pressed to spend more for electoral and general political reasons. The civil servants felt that they had to say no on the grounds that enthusiastic spending would result not in recovery, or even political successes, but in financial chaos and collapse. In the Third Reich the potential for such arguments was still there as public sector deficits grew—especially later in the 1930s. On the whole, however—with the exception of the relatively politically powerless Schacht in 1938 and 1939 (whose resistance cost him his job in the Central Bank)—civil servants and economic experts had neither the strength nor the courage to say no.

Even when they were theoretically quite sophisticated, Germany's civil servants thought that deficit spending and thus a broadly defined Keynesianism was rather like original sin: it had been around for a long time and no one needed to teach politicians how to do it.

enough. It was fiscal policy that should have the principal contracyclical influence.

The actual policy of Weimar governments—borrowing in the expansion phase and attempting to repay the loans by forcing budget surpluses in the depression—had been exactly the wrong way round. Like many other critics, Röpke thought that terrible mistakes had been made in the upswing, when there was a much greater latitude for maneuver, and he himself had been attacking the instability caused by fiscal policy since the middle of the 1920s. But that was past history.

From 1931 he had argued that a relatively limited state spending program might produce an initial spark (*Initialzündung*) that would halt the secondary depression and allow recovery to take place.[64] But there should only be a small stimulus, and it should be accompanied by a package of additional measures (including wage reductions and the removal of state arbitration in wage disputes) so that the state's contracyclical policy would feed business confidence rather than lead to a further sapping of responsibility. It was also crucial that the *Initialzündung* should be given at the correct point in the economic cycle: it was useful only at the bottom of the depression, when the primary deflation had already played itself out. Otherwise the public stimulus might only delay the necessary process of economic adjustment.

Other advocates of expansionary state policies made similar points. The socialist economist Gerhard Colm thought that if the point of state spending were not to be lost in an open economy, it would need to be coupled with wage cuts and wage controls.[65] Only after the wage reduction of December 8, 1931 did Colm think that Brüning had gone far enough, and that no further government action in cutting wages was required.

For Röpke, it was crucial that restrained monetary policy and the modest domestic recovery achieved by the *Initialzündung* should bring a restoration of foreign confidence in Germany and a renewed inflow of foreign money. He argued that the basis for a lasting recovery would be state encouragement of further capital inflows.[66] This was also the view of the 1931 Brauns Commission on work creation (called into being by Brüning in the hope that the activity of a commission would be regarded as doing something, and of which Röpke was a member). It was an opinion shared too in 1931 by the union economist Wladimir Woytinsky.

Germany's position as an international debtor was to be maintained for the foreseeable future; and Röpke was very suspicious of purely domestic plans for a big expansion (of the type, for instance, proposed by Woytinsky in 1932). The

[64] Wilhelm Röpke, "Ein Weg aus der Krise," *Frankfurter Zeitung* 336 (7 May).

[65] In *Die Arbeit* 1930, pp. 241–47.

[66] Röpke, "Ein Weg aus der Krise."

experience of Nazi policy after 1933 confirmed his belief that such expansion was dangerous. Later, when Röpke read *The General Theory*, he wrote from Switzerland to Gottfried Haberler that "Keynes is saying very important things that need to be taken seriously: but he is playing with dynamite."[67]

If there was to be any possibility of a really dramatic recovery in Germany, it depended on the rest of the world economy, and especially on the resumption of the foreign capital flows that had made possible the German prosperity of the 1920s. Some observers in 1931 and 1932 were still optimistic about the possibility of wooing foreign capital again; but they were a dwindling band of optimists.

There were limits on the extent of a recovery generated by domestic measures alone. In addition, economists such as Hahn or Röpke who basically accepted the existing economic order found it difficult to make very effective and concrete suggestions because they feared that a more radical policy, which might involve fundamental structural alterations, might feed the anticapitalist feeling sweeping depression Germany. Röpke mistrusted the more far-reaching expansionary schemes put forward by Robert Friedländer-Prechtl, because they played into the hands of the Nazis.[68] He was horrified by those who attacked the notion of "a business cycle policy working within the present economic system and relying on its most elementary reactions": what else was possible than to depart from conditions as they actually were? So Röpke attacked those fanatics who believed that "we must abandon the wreck, leaving it to break up, and seek salvation on the shores of the promised land of a planned autarchic economy, with as much agriculture and as little manufacturing as possible."[69]

Röpke is an interesting example of the way in which—before 1933—a sense of political responsibility and of the dangers of altering too much in the political and economic structure stood in the way of a more radical economic program. After 1933, the autarchic and economically interventionist state was so obviously associated with Nazism or Italian fascism that many German economists both in Germany and in exile (most notably Walter Eucken in Freiburg and Wilhelm Röpke in Switzerland) developed a criticism of interventionism. They thus also criticized—by extension—Keynesian management.

Even among those not so critical of interventionism as Eucken—those who were situated in the mainstream of German academic economics—little Keynesian passion developed. One of the attractions in the 1930s Britain of Keynesianism was that it generated a sense of mission among young academics—a cam-

[67] Wilhelm Röpke in Eva Röpke, ed., *Briefe 1934–1966: Der innere Kompass* (Erlenbach-Zürich: Eugen Rentsch, 1976), p. 26.

[68] Robert Friedländer-Prechtl, *Die Wirtschaftswende: Die Arbeitslosigkeit und ihre Bekämpfung* (Leipzig: P. List, 1931).

[69] Röpke, "Trends," p. 428.

paigning zeal against the hidebound orthodoxy of official policy. While precisely such a group had developed in the Brüning years for similar reasons, it is scarcely surprising that after 1933 few economists thought it worth engaging their energies in telling the Nazis to spend more.

The Depression, Keynes, Hitler, and the Postwar World

The association of interventionism and Keynesian management left a legacy for the postwar period. It helps to account for the relatively slow and unenthusiastic adoption of Keynesianism in the German Federal Republic. For the republic's first twenty years, economic policy and much academic theory was neoliberal, emphasizing ethical and social responsibility, embodied in a rational legal and institutional setting, as an essential framework within which market activities might take place. The teachings of the Freiburg school around Eucken had a profound policy impact. Economics Minister Ludwig Erhard's first major work had been a scathing criticism in 1932 of Schacht's economics; and he was an admirer of Eucken.[70] One of Erhard's key advisors was Alfred Müller-Armack, who was in charge of the department of economic policy in the economics ministry between 1952 and 1958: he elaborated a theory of the social market economy which rejected government controls, but argued for social redistribution through taxes and a regulation of the business cycle through monetary policy.[71] Erhard's policy was not orthodox laissez-faire, and provided for substantial state guidance and direction of industry. Yet all this did not take place within a framework of macrodemand management. It was only in the 1960s that governments started to adopt self-consciously Keynesian strategies. The first legislative statement of Keynesian management was the 1967 Law on Stability and Growth.

The reasoning—most systematically expounded by Eucken—behind this long enduring rejection of Keynes went as follows. Keynesianism was a characteristic doctrine of the interwar era, an "age of experiments" in economic doctrine. In the 1930s in Germany, he argued, attempts at a full employment policy had made it necessary to correct what was believed to be a malfunctioning price system, and to replace it by central control. But it is the price mechanism which provides

[70] Volker Berghahn, "Ideas into Politics: The Case of Ludwig Erhard," in Roger J. Bullen, Hartmut Pogge von Strandmann, and Antony B. Polonsky, eds., *Ideas into Politics* (London: Croom Helm, 1984), p. 181. See also Terence Hutchinson, "Notes on the Effects of Economic Ideas on Policy: The Example of the German Social Market Economy," *Zeitschrift für die gesamte Staatswissenschaft* 135 (1979), pp. 426–41.

[71] Anthony Nicholls, "The Other Germany—The 'Neo-Liberals,'" in Bullen, Pogge von Strandmann, and Polonsky, eds., *Ideas into Politics*, p. 173.

the only rational guide for investment: Germany thus embarked on a course of growing economic irrationality.[72]

The problem was that Keynesianism also held that the price system did not necessarily give the right signals, and did not produce full employment, and thus Keynesians argued that interventionist action was required. As a result, "economic policy is faced with a dilemma: on the one hand, mass unemployment necessitates a full employment policy; on the other, the policy of full employment makes for an instability on other markets, which is extremely dangerous, and, in addition, forces economic policy in the direction of central planning. This dilemma is perhaps the most crucial economic and social problem of our time."[73]

The legacy of the 1930s for German economists was that they became "understandably somewhat sceptical about any trade cycle policy [i.e. Keynesian solutions] that lets itself be stampeded by a temporary emergency into impeding or stopping the functioning of the price system—for example, by foreign exchange control, state-fostered expansion of credit, or other measures of the kind."[74]

It took almost a quarter of a century for the generation of economists whose most powerful and most formative memory was that of the 1930s and of totalitarian economics to be replaced by a younger generation who saw Keynesianism working in the United States and Britain without harmful political and apparently without harmful economic effects. It is often said that generals always fight the last war. Politicians and economists react in the same way, so that policy is frequently guided by past situations. Thus, while in the United States and Britain Keynesian economics was the reaction of a generation of economists who grew to maturity in the Depression era, in Germany anti-Keynesian neoliberalism played the same role for the equivalent generation. As a result, Keynesianism had to wait. But perhaps, as Hutchinson observed in 1979, Germany actually benefited economically rather than lost because of this delay, which had been the result of a chance concatenation of events.

Interwar Germany was, and looked like, an economic failure: highly unstable during the 1920s, and in the 1930s only sustaining economic recovery through ever-increasing control. The political process required to manage and control the economy also contributed to the movement for geographic expansion derived from Nazi ideology.

It was perhaps a coincidence that Keynesianism and Nazism developed at the same time, as reactions to the Great Depression, but some German theorists detected a similarity. Both doctrines were, they held, attacks on a market order, and

[72] Walter Eucken, *Grundsätze der Wirtschaftspolitik* (Berne: A. Francke, 1952).

[73] Eucken, *This Unsuccessful Age*, p. 66.

[74] Ibid., p. 94.

on the free determination of prices (this is, of course, a very narrow description of only some aspects of Nazi economic policy). In consequence, men like Eucken and Röpke came to make both an economic and a political argument against Keynesian-style management.

In the case of these economists, as in the case of the influential senior civil servants—but much more powerfully here—Keynesianism represented a kind of sin that should, they believed, be fought rather than encouraged. The British and U.S. view (and certainly Keynes' own), which saw Keynesianism as the only alternative in a modern capitalist order to totalitarian economic and political control, was not shared in Germany. In part this was because of circumstances and historical experiences that had produced a misleading and unscholarly (but widely believed) notion of a link between the economics of Maynard Keynes and those of Adolf Hitler.

Conclusion

Throughout this chapter policy has been described as the outcome of three possible sources of influence: political pressures; the behavior of government officials; and the theories of economists. In interwar Germany, politics mattered most, while economists and civil servants ("the structure of the state") in general stood by on the sidelines. In postwar Germany, economic views being generated already before the war had a great effect on policy formulation, while political pressures could be more easily contained in the new Federal Republic.

There can be no simple explanation for the greater postwar political influence of economists—and especially of neoliberal writers. There was the personality of Erhard himself. After 1948, the U.S. (though not the British) occupation authorities liked market-oriented solutions. The civil service was more enthusiastic about employing academically trained economists. Experiences of the 1930s and 1940s lessened the appeal of the controlled economy. Above all, economic success (generated among other things by the world export boom, the inflows of U.S. capital to Europe, the availability on the labor market of large numbers of refugees) allowed the neoliberal experiment to continue. The policy itself contributed to the fast pace of German recovery.

In the 1950s, growth reduced the urgency of politically transmitted demands for fiscal stimulation, for more controls, and for more redistribution and social justice. Until 1966–1967 there was no economic crisis severe enough to challenge the state to extend its economic armory. Only then, as the rapid postwar recovery phase began to run out of steam, did the political call for action reemerge.

The German experience might suggest that political pressures (and perhaps also administrative demands) for Keynesianism are most likely to occur in low-growth and crisis-prone environments (such as Weimar Germany, or post-1945 Britain).[75] If this deduction is true, it would cast an interesting light on the supposed failure of Keynesian management in the 1970s, and constitute one way of approaching the still fiercely debated question of the usefulness of Keynesian theory.

There is always a strong call from the theoretical side for a new interpretative instrument when existing approaches are no longer capable of grasping current reality. Thus in the interwar years, models which contained market-clearing mechanisms and full employment equilibria clearly were not describing the operation of the contemporary economies. In addition, political calculations and necessities play a role. When a new problem arises and presents a political challenge, it leads to a call for action. In the interwar crisis, the rise in unemployment and the bankruptcy of many farmers endangered Weimar's fragile democracy. In the late 1960s, West Germans again saw unemployment as a threat to political stability. For both theoretical and political reasons, calls for a new style of economic management (and in these historical cases, for the application of Keynesianism) are more likely to occur not in well-operating economies but in imperfect and unstable settings. No one would see a need to disturb a full employment equilibrium if it existed: if it is not broken, there is no need to fix it.

These observations have an important implication regarding the effectiveness of theoretical changes and developments in economics. If the causes of the unsatisfactory economic performance which produces the cry for action are deep seated, it may be that *no* politically viable economic policy can cure the malaise. In the 1930s, there was undoubtedly a widespread wish for a new economics in place of the discredited doctrines of the nineteenth century. Yet it is difficult to see from the historical account that Keynesian economics, or Hitler's economics, actually cured anything in the 1930s.

This argument should be considered in addition to the older and more specific case about the dilemma of Keynesianism broadly defined as deficit finance for the sake of economic stimulation and the promotion of recovery from depression. Here again, the instance of interwar Germany is illuminating: Keynesianism appears there as a response to fundamentally political pressures to spend more and tax less, even in situations in which a Keynesian solution is inappropriate. The

[75] The experience of the United States between 1950 and 1973 appears to contradict this supposition: there Keynesian policies were applied in a highly favorable environment. But was this not an exceptional case, which depended for its success on an international economic order constructed at Bretton Woods and allowing the United States what Jacques Rueff subsequently termed the "exorbitant privilege" of monetizing its deficits?

financial system might be vulnerable to shocks from increased budget deficits (as in the later 1920s); or the economy might be reaching full employment and be in danger of overheating (as in the mid- and later 1930s). But such considerations do not discourage those politicians who see political, and possibly also military, gains from implementing high spending policies; austerity policies on the other hand might bring a loss of political support. In these cases, politicians' preferences, and their dependence on constructing supporting coalitions, override economic logic (including of course Keynes' own recommendations, which saw deficits as pump-priming and not as a permanent solution to any problem).

If the interpretation presented in this chapter is correct, it may be not so much that there is something wrong with Keynesianism, or that Keynesian policies are of themselves ineffective, or damaging, or counterproductive: but rather that they are politically most likely to be introduced in circumstances where, because of grave structural problems, the likelihood is that any policy will fail to bring an economic turnaround. An ostentatious revolution in economic policy is likely to occur at moments when the constraints of the system in which it is applied are such that the chances of the revolution proving effective are small.

10

THE UNDERDEVELOPMENT OF KEYNESIANISM IN THE FEDERAL REPUBLIC OF GERMANY

Christopher S. Allen

IN RECENT years, the West German government has repeatedly been asked by its allies to stimulate the economy in order to improve international patterns of growth and trade, but the Germans have been reluctant to do so. They have consistently resisted international efforts to secure a Keynesian-style reflation, and there are strong domestic precedents for their position. Even during the center-left governments of Helmut Schmidt (1974–1982)—the years of the German model—and the center-right governments of Konrad Adenauer and Ludwig Erhard (1949–1966)—the years of the social market economy (*Sozialemarktwirtschaft*) and the so-called economic miracle—Keynesian ideas and policies were used sparingly in the Federal Republic. In fact, Keynesian policies were popular only for a brief period during the Grand Coalition (1966–1969) and the early years of center-left government (1969–1974) under Willy Brandt.

Therefore, rather than explaining the presence of Keynesian ideas and policies, as do several of the other contributions to this volume, the principal problem in the German case is to explain their absence. We can take our cue for doing so from the 1987 comment of a Canadian summit official on West German economic policy: "They are always saying, 'Watch out for inflation,' but it's more complicated than that. They have a different idea about how economies function."[1] In short, in Germany Keynesianism was effectively preempted by another set of policies, oriented toward the supply side and the social market economy, that was progressively reinforced—both institutionally and ideologically—over suc-

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[1] Peter T. Kilborn, "Kohl's Seizure of Key Economic Role," *New York Times* (The national edition), June 11, 1987, p. 4.

ceeding stages in the postwar period. While Harold James correctly characterizes the interwar period as one in which policy experimentation lacked theoretical foundations,[2] the postwar period was different. Rather than relying on more policy experimentation after World War II—of which Keynesianism was seen as one variant—postwar West German policy makers took a different tack. They returned to an institutional pattern with roots in the late nineteenth century in which the state established a general framework for a powerful and self-regulating private sector. But they ideologically justified these policies with theories emanating from the antistatist Freiburg school of the 1930s and 1940s which arose in direct response to Nazi abuses of central state power.

This alternative economic paradigm became dominant during the Federal Republic's formative stage in the late 1940s and early 1950s when Keynesianism was unable to gain a foothold. Rapid economic growth subsequently reinforced the power of social market views in the minds of German policy makers during the 1950s and 1960s. By 1966, social market views had become so dominant that they even constrained the effects of Keynesian ideas during the brief period (1966–1973) when they had become somewhat more influential in West German policy. Then with the perceived failure of Keynesianism beginning in the latter years of the Schmidt regime, the government of Helmut Kohl reverted to familiar ideas and policies—an updated "social market economy"—during the mid-1980s.

The first part of this chapter offers a structural explanation for the weakness of Keynesian ideas in Germany that finds its roots in the institutional patterns first formed during the late industrialization of the nineteenth century. The second part provides an overview of postwar West German economic policy which sees it as an amalgam of general "framework" policies built around free market competition rather than a more detailed Keynesian "management"; investment-led and export-oriented growth strategies; tight monetary policy; and a paternalistic social welfare system. Collectively, these components comprised the "social market economy" and served to preempt Keynesian ideas and policies. The final part of the chapter examines the three areas within the political economy where economic ideas and policies most often find their gestation and fruition—the economics profession, the civil service, and the political arena—and shows how Keynesianism was either rejected or ignored in favor of this alternative conception of economic policy.

My general argument is that the dominant economic paradigm guiding a nation's policy makers, what Pekkarinen elsewhere in this volume calls their "economic policy model," is built up over a long period of time on the basis of a

[2] See James, this volume.

historical legacy of policy experiences which cumulatively point in certain directions and gradually become institutionalized within the structure and operating procedures of the state.[3] In the West German case, this legacy began with a pattern of late industrialization in the nineteenth century whose effects persisted into the postwar period but were modified by intervening experiences of failure during the Weimar Republic and the Third Reich. Together, these experiences gave rise to an ideational legacy and institutional setting in which it was difficult for Keynesianism to take root.

The Nineteenth-Century Legacy

Although it is generally believed, with some reason, that West German policy made a major break with the past in 1945, that was primarily a break with patterns of policy during the chaotic interwar years and the disastrous Nazi period. To reconstruct the postwar West German economy, policy makers drew on an even older legacy of ideas and approaches dating back to the initial period of German industrialization in the second half of the nineteenth century. In some respects, this is not surprising. The structural problems that Germany faced in 1945 of rebuilding an exhausted economy in the face of stiff international competition were not entirely dissimilar to those the nation had faced in the 1870s. In order to compete in world markets, the West Germans had to reindustrialize rapidly, develop export markets, secure adequate material and financial resources, and push those industries that were most competitive.

In the face of this challenge, it was natural for German policy makers to turn to the same methods that had been used to create an industrial society out of an agricultural one seventy-five to one hundred years earlier.[4] Those methods subordinated domestic demand to the needs of industrial capital and emphasized the importance of supply-side policies for the reconstruction of German industry. The centerpiece was no longer railroad building but exports of other capital goods, and West Germany did not have to contend with the large agrarian sector of the Second Reich. However, the highly successful growth patterns of nineteenth-century Germany left their mark on the thinking of German economists and industrialists alike. It was natural for them to think that supply-side concerns should be at the center of economic policies designed to secure rapid growth.

[3] See Pekkarinen, this volume.

[4] I have elsewhere argued, extending Alexander Gershenkron's late industrialization thesis, that the West German economy has been one of "fragile strength" and that these postwar policies were essential to establish as sound a foundation as possible. See Christopher Allen, "Structural and Technological Change in West Germany: Employer and Trade Union Responses in the Chemical and Automobile Industries" (Ph.D. Diss., Brandeis University, 1983).

Similarly, an extensive program of social insurance—and preemption of the Social Democratic Party—had been central to Bismarck's strategy for securing social peace within the context of rapid industrialization during the Second Reich.[5] His efforts in this direction were the first in Europe and highly successful. This lesson, too, was not lost on postwar German policy makers. Despite the free market emphasis of the social market economics that inspired them, the economic strategy of those policy makers assumed and provided a generous system of social benefits, designed to off-set the social dislocation engendered by industrial adjustment for rapid growth. Although free market economists in other nations often saw welfare state programs as measures that would interfere with the functioning of markets and the achievement of growth, the Germans had a precedent for believing that the two were complementary.

Finally, one of the least understood, but most important, legacies of nineteenth-century industrialization in Germany was a system of "organized capitalism" that still gives the private sector of Germany a distinctive character.[6] The language of social market economics stresses freedom and competition in terms that remind one of laissez-faire or the U.S. system of free enterprise. But, behind this facade, German officials and businessmen take for granted a degree of industrial concentration and interfirm cooperation that seems strange to U.S. eyes and often goes relatively unnoticed.[7] The relatively organized nature of private capital in Germany is important, however, because it lends a degree of stability to the private economy on which the German faith in private enterprise is built. There are some dissenters, but, in general, when German economists think of the private sector, they do not see the same phenomenon that preoccupied Keynes.

Keynes was deeply concerned about the fundamental instability of the private economy. By and large, he saw it as a realm governed by market mechanisms that were not capable of ensuring equilibrium on their own without some external efforts at coordination. By contrast, even when they perceive problems with market mechanisms, the German economists have come to believe that such "framing" coordination can be secured from within the private sector itself, through the coordinating activities of powerful industry and employer associa-

[5] Vernon L. Lidtke, *The Outlawed Party: Social Democracy in Germany, 1878–1890* (Princeton: Princeton University Press, 1966).

[6] The term is often said to have originated with Rudolf Hilferding, *Finance Capital* (London: Routledge & Kegan Paul, 1981), who noted in the early part of the twentieth century the intimate patterns of coordination among big business, the banks, and the state apparatus of the Second Reich.

[7] Volker R. Berghahn, *The Americanisation of West German Industry: 1945–1973* (Cambridge: Cambridge University Press, 1986), underestimates the degree to which this pattern was resumed after World War II. For better and earlier treatment of this phenomenon, see Gerard Braunthal, *The Federation of German Business in Politics* (Cornell: Ithaca, 1965), and Andrew Shonfield, *Modern Capitalism* (New York: Harper, 1965).

tions, as well as the massive universal banks, rather than through the more detailed management of the public sector. The banks are particularly important because they control large amounts of investment capital in the form of loans and proxy control of huge amounts of common stock.[8] Many take these features of organized capitalism for granted, and they see them as an intrinsic part of the competitive economy rather than its antithesis.

Hence, the pattern of late industrialization left three important marks on German thinking that lasted well into the postwar period. First, the success of these early economic policies convinced many economists that supply-side policies—that is, an emphasis on investment over consumption—were a crucial component of any economic strategy. Second, Bismarck's successful social legislation persuaded others that a well-developed welfare state was perfectly compatible with and even conducive to rapid economic growth. And, third, a pattern of industrial organization, whose roots lay in the nineteenth century, also left many German businessmen and economists with a conception of the private economy that cut against some of the most fundamental kinds of Keynesian concerns. All three notions survived the Third Reich and had an important impact on German economic strategy in the postwar period.

These three interrelated points, suggesting a linkage between postwar patterns of economic policy making and those of the late nineteenth century, resonate well with recent historical reassessments of the "exceptional" pattern of German industrial growth.[9] Most of what are now called "standard" accounts of German industrialization have emphasized how a strong, militaristic state was able to preempt the formation of a "normal" Western pattern of bourgeois liberalism, thereby fostering a system of rapid industrial growth within feudal structures.[10] Under these formulations, the imperial period and the Third Reich—though fundamentally different—do have in common a powerful central state.

Blackbourn and Eley[11] have argued, however, that German business was much less the junior partner in its relationship with Bismarck's state than conventional wisdom would have it. These two "revisionist" historians have argued that just because Germany did not use the laissez-faire Anglo-American model did

[8] See Volker Ronge and Peter J. Ronge, *Bankpolitik im Spätkapitalismus* (Frankfurt: Suhrkamp Verlag, 1979); and Shonfield, *Modern Capitalism*. For the historical antecedents to this postwar pattern, see Hilferding, *Finance Capital*.

[9] David Blackbourn and Geoff Eley, *The Peculiarities of German History* (Oxford: Oxford University Press, 1984).

[10] Gordon A. Craig, *The Politics of the Prussian Army* (New York: Oxford University Press, 1965); Ralf Dahrendorf, *Society and Democracy in Germany* (New York: Vintage, 1968); and Barrington Moore, Jr., *Social Origins of Dictatorship and Democracy* (Boston: Beacon, 1966).

[11] See also Eley, *Reshaping the German Right: Radical Change and Political Change After Bismarck* (New Haven: Yale University Press, 1980).

not mean that its industrialization took place under the tutelage of the preindustrial feudal state. They argue that the German pattern of organized, large-scale industrial growth was forward- and not backward-looking in that it was able to create a national market and form the Second Reich in fewer than forty years. *Moreover, moving from disunity and underdevelopment to formidable industrial* might took more than just a strong state. Public sector action was certainly crucial in this growth spurt, but also took a private sector that could raise and allocate capital, mobilize sufficient resources, harness technological innovation, and recruit—if not co-opt—skilled workers. It is in this context, then, that the continuities are visible between the organized private sector in the nineteenth century and its post-World War II counterpart. It also makes more understandable why the weakness and/or absence of the central state as a major actor in shaping economic policy in the Federal Republic did not result in greater demands for laissez-faire, or for Keynesianism. The legacies of these earlier institutional and ideological roots rather than those of the Third Reich are visible in the following two sections of this chapter.

Postwar Economic Policy: Keynesianism Preempted

The two decades after the war in West Germany did not provide a supportive environment for the development of Keynesian policies. This section will show how a number of conditions combined to limit the influence of Keynesian ideas over policy and policy makers. Among the most important of these were:

1. the perception that Keynesianism would intensify inflationary and interventionist tendencies in a country where memories of hyperinflation in the 1920s and the rigidities of Nazi and Allied economic controls were still vivid;
2. a currency reform that was biased in favor of investment and export-led economic growth and was later reinforced by the restrictive monetary policies of a powerful Central Bank (*Bundesbank*);[12]
3. a deeply ingrained acceptance of highly organized industrial structures which assumed a measure of informal cooperation within the private sector that seemed inimical to the reliance that Keynesianism placed on state action and more formal quantitative economic targets; and

[12] While this is not the place for an extensive discussion of the role of the Bundesbank, its power to shape economic policy was considerable. For analysis of the power of this institution in comparative European perspective, see John Goodman, "The Politics of Monetary Policy in France, Italy and Germany." (Ph.D. diss., Harvard University, 1987).

4. the political hegemony of a center-right government that articulated and supported these social market economy goals, including a comprehensive welfare state, over a Social Democratic Party and trade union movement that were weakened by the Cold War and more interested in nationalization and worker control than in Keynesianism.

These factors were mutually reinforcing; they created an economic structure and culture that even limited the impact of Keynesian ideas in the 1960s. The remainder of this section will briefly trace the course of West German economic policy with a view to understanding more precisely how such conditions inhibited the diffusion of Keynesian ideas.

The Period of Allied Controls

For most of the first four postwar years (1945–1949) economic policy in the three Western-occupied zones of Germany was strictly controlled by the Allies.[13] In the face of an extremely harsh winter in 1946–1947, the punitive system of Allied controls on all consumer and industrial goods soon gave rise to massive shortages of essential commodities and a thriving black market. Basic foodstuffs, materials for rebuilding the bombed cities, and housing were all in short supply, and the controls provided few incentives to produce any of these necessities within Germany during the first years of occupation. Moreover, the Allied policies of decentralizing German economic organization dismantled hundreds of viable plants, disrupted supply networks, and broke many of the links between the agricultural and industrial sectors.

Many Germans saw the Allied controls as even more oppressive than those of the Nazis. It is often thought that the free market economists who gained influence in this period did so primarily in reaction to the disastrous experience with state intervention under the Nazis, and this is certainly true. But the hardships that Allied controls imposed on postwar Germany played an important role in reinforcing these views. They contributed to an atmosphere in which enthusiasm for state intervention was quite limited; and this is important here because Keynesianism was initially seen in Germany as a relatively interventionist doctrine.

[13] For accounts of this period, see Gerold Ambrosius, *Die Durchsetzung der Sozialen Marktwirtschaft in Westdeutschaland 1945–49* (Stuttgart: Deutsche Verlags-Anstalt, 1977); Karl Hardach, *The Political Economy of Germany in the Twentieth Century* (Berkeley: University of California Press, 1980), pp. 90–109; Nicholas Balabkins, *Germany Under Direct Controls* (New Brunswick, N.J.: Rutgers University Press, 1964); and Douglas Botting, *From the Ruins of the Reich: Germany 1945–1949* (New York: Crown, 1985).

In this setting, 1948 was a watershed year. It brought two important changes in policy. One was the introduction of Marshall Plan aid which signalled a change in Allied thinking from a stance that stressed punitive measures to one that accepted German economic growth as an important bulwark against communism in Europe.[14] The second important change was a currency reform and partial decontrol of prices which saw the old reichsmark replaced with the deutsche mark (DM). On the surface, such moves might portend an opening for Keynesianism, but this was not the case. German officials saw currency reform primarily as a means to encourage investment. In their view, consumer goods and the satisfaction of demand would have to take second place. Accordingly, the reform rewarded large property holders and, in effect, redistributed wealth and income sharply upward in the western zones. The Allied authorities were generally supportive of these policies, but the determination of (West) German officials to rebuild the private sector was even greater.[15] In fact, they took the Allies by surprise with the next step, which was to lift price controls altogether on all but a few key commodities.[16]

It might seem surprising that German policy makers, highly concerned about inflation in light of the 1920s experience, should move so swiftly to decontrol prices. But Ludwig Erhard and his colleagues were even more concerned about the distortions that an overly active economic policy might provoke in the underlying market system. Decontrol was selective so as to hold down prices on basic consumer necessities, but the principal object was to set loose the forces of competition in line with the view that the market could best send the proper signals about what goods should be produced.[17] This turn toward greater reliance on the market was a deliberate reaction against the unhappy experiences with Allied controls and Nazi economic policies. As a result of the latter, many German economists believed that state intervention and reflation could quickly lead to a system of centralized planning and totalitarian politics. In their eyes, even Keynesianism seemed to lean too far in this direction.[18]

[14] Hardach, *Political Economy*, pp. 94–95.

[15] By the spring of 1948, the Allied Control Council had exhausted its mandate and, while political control did not accrue to the West Germans until the founding of the Federal Republic one year later, increasing numbers of economic decisions were in the hands of the Germans. See Hardach, *Political Economy*, p. 107.

[16] Ludwig Erhard, *Deutsche Wirtschaftspolitik: der Weg der sozialen Marktwirtschaft* (Düsseldorf: Econ, 1962).

[17] Henry C. Wallich, *Mainsprings of the German Revival* (New Haven: Yale University Press, 1955), pp. 113–52.

[18] Dudley Dillard, "The Influence of Keynesian Thought on German Economic Policy," in Harold L. Wattel, ed., *The Policy Consequences of John Maynard Keynes* (Armonk, New York: M. E. Sharpe, 1985).

The Growth of the Social Market Economy

The economic results that followed currency reform, price control, and similar social market policies were highly encouraging. Inflation did rise for the first few months, but the relatively quick transition to the new currency and the arrival of Marshall Plan aid in early 1949 brought inflation under 2 percent by 1952, a figure that it did not exceed for the rest of the decade. Unemployment shot up because, under the system of price decontrol, it was no longer necessary to have a public sector job to get ration coupons and a wave of Eastern European immigrants swelled the ranks of the German labor force as the Cold War intensified. Hence, unemployment averaged 9.4 percent from 1950–1954, but its effects were offset by a level of economic growth that averaged 8 percent during the 1950s, the low cost of such basic necessities as food, utilities, and rent, and the introduction of a basic system of social security, which formed the "social" part of the *Sozialemarktwirtschaft*. It provided a floor under which working-class West Germans would not fall. Together, these policies proved economically viable and politically popular.[19]

This approach, which used public sector policy to shape the framework for market competition, was to become a hallmark of postwar West German economic policy. And its apparent success reflected in low inflation and high rates of economic growth, whether coincidental or not, reinforced the regard in which social market economics was held so strongly as to limit the room for experimentation with Keynesian ideas. The approach was so widely accepted by German economists that Keynesianism was rarely even given serious consideration as an option.[20]

These policies were politically as well as economically successful. The currency reform and price decontrol were ratified in effect by the election of the first West German government at the founding of the Federal Republic in 1949, and the continuing success of the policies generated support for the center-right governments of Konrad Adenauer and Ludwig Erhard for over fifteen years. Germany was initially governed by a center-right coalition of Christian Democrats (CDU/CSU) and Free Democrats (FDP). This coalition won again in 1953; the Christian Democrats won an outright majority in 1957, and the FDP rejoined the CDU/CSU coalition in 1961. In all of these governments Konrad Adenauer was

[19] For a critical view of postwar West German economic policy, one that thought that the high unemployment and the lack of egalitarianism were a sign of failure, see Heinz Abosch, *The Menace of the Miracle* (New York: Monthly Review Press, 1963).

[20] Norbert Kloten, Karl-Heinz Ketterer, and Rainer Vollmer, "West Germany's Stabilization Performance," in Leon Lindberg and Charles S. Maier, eds., *The Politics of Inflation and Economic Stagnation* (Washington: Brookings Institution, 1985), pp. 353–402.

the chancellor and Ludwig Erhard remained as economics minister providing highly consistent economic policy and a stable political setting for private sector development. The government and Germany's leading economists shared a comparable vision regarding the economy. They agreed that government policy should steer a middle course between the unpredictability of complete laissez-faire and the distortions that central planning might introduce into market mechanisms for the allocation of goods.[21]

In short, during the 1950s and early 1960s, German policy makers followed a strategy that relied on exports of capital goods to rejuvenate the economy. In retrospect, it turned out to be an extraordinarily fortuitous choice. The investment-goods sectors were well positioned to serve the growing needs of the industrialized world during the 1950s.[22] The strong export performance of these sectors provided key contributions to the economic infrastructure of other Western European countries. It also took advantage of the demand for such goods as a result of the Korean War boom. In fact, even the tight money policy established in the late 1940s began to seem desirable, as low rates of domestic inflation enhanced the competitiveness of West German exports and generated high profits out of which further growth could be fueled. In all these respects, the policy formed a coherent package whose success reinforced support for each of its elements.

It is well worth asking, however, why the German trade unions and Social Democrats were unable to challenge the hegemony of social market economics and the CDU in this period. After all, this stress on capital goods and exports left many workers without access to consumer goods and somewhat threatened by high levels of unemployment. Why were the German trade union confederation (DGB) and the opposition Social Democrats unable to put Keynesianism on the political agenda? Did they not favor Keynesianism or were they simply not strong enough to secure it? For the 1950s, the answer is the former, and since the 1960s the answer is the latter.[23] To begin with, the great success of social market policies proved a formidable obstacle for any segment in society that wished to challenge them. The influx of refugees from the east during the 1950s weakened the labor market position of the trade unions. The social welfare system provided tangible benefits for the working class, and an 8 to 9 percent annual rate of growth slowly raised wages in West Germany. In addition, the continuing tensions of the Cold War—in which the West Germans were on the frontier—tended to weaken

[21] Werner Kaltefleiter, *Wirtschaft und Politik in Deutschland*, 2d ed. (Köln und Opladen: Westdeutscher Verlag, 1968), pp. 96–176.

[22] Michael Kreile, "West Germany: The Dynamics of Expansion," in Peter J. Katzenstein, *Between Power and Plenty* (Madison: University of Wisconsin Press, 1978), pp. 191–224.

[23] William D. Graf, *The German Left Since 1945* (Cambridge: Oleander Press, 1976); and Andrei S. Markovits and Christopher S. Allen, "West Germany," in Peter A. Gourevitch et al., *Trade Unions and Economic Crisis* (London: Allen & Unwin, 1984).

the Left. The SPD was ghettoized at approximately 30 percent of the vote during the 1950s.

Of even more significance, however, neither the DGB nor the SPD were particularly disposed toward Keynesianism during the 1950s. Like the German Right, the Left also had a long tradition of interest in "supply side" rather than "demand side" policies. Accordingly, both the DGB and the SPD advocated supply-side policies at the macro and micro levels. Their macro policy derived from a straightforward interpretation of Marxism that saw nationalization and planning as the principal national level policy tools of the Left. At the micro level, they pressed for systems of worker participation—both via codetermination (*Mitbestimmung* on company boards of directors and via greater union influence within the legally mandated works councils, *Betriebsräte*) in all plants with at least twenty employees—in line with the longstanding concerns of the guild-based craft workers on whom the union movement was originally based.

The SPD and DGB began to move toward Keynesianism in the 1960s, but even then never completely relinquished their supply-side concerns. In fact, even after Keynesian ideas had become deeply ingrained within the unions, the DGB pushed for policies that they termed *Keynes plus* since they still embodied an important supply-side element.[24] In part, this can be seen as a natural response to the features of organized capitalism that characterize the German private sector. The unions believed that macroeconomic management alone could not deal with problems that might arise from the private sector mechanisms for coordination built into the German economy.

The Brief Rise and Fall of Keynesianism

Between the late 1950s and early 1960s, however, several changes took place that seemed to open the door to Keynesian ideas in the Federal Republic. The initial impetus lay in two exogenous events: the opening of the West German economy to the rest of Europe; and a sharp drop in the available labor supply with the building of the Berlin Wall in 1961. Three other factors in the shift toward Keynesianism during the mid-1960s were endogenous. They were attempts by the SPD and DGB to incorporate demand-stimulus policies into their economic programs; efforts by the CDU/CSU-FDP coalition to stress the "social" part of the social market economy; and the creation of an independent Council of Experts to offer outside analysis on economic matters.

[24] Markovitz and Allen, "Trade Union Response to the Contemporary Economic Problems in Western Europe: The Context of Current Debates and Policies in the Federal Republic of Germany," *Economic and Industrial Democracy*, 2, 1 (1981), pp. 49–85.

Together these developments contributed to a growing feeling that the conditions that had generated German growth in the 1950s had changed and that new policies might be required to deal with the evolving situation. This belief reached a dramatic height in 1965 when the economy experienced its first postwar recession, but it had been gaining force for some time before then.

When the Common Market was created in 1958 and the DM achieved full convertibility, the West Germans had to examine more closely the Keynesian premises of their trading partners' policies.[25] In an economically integrated Western Europe the West Germans had to deal with Keynesianism more explicitly, even if it meant that imports from the more inflation-prone economies of their EEC partners threatened to drive domestic prices higher. The German preference for tight monetary policies came under slight pressure to continue easy access to European markets of the important West German export-oriented industries.

Similarly, the construction of the Berlin Wall in August 1961 had more than political effects. It sharply curtailed the influx of skilled workers from the GDR that had fueled the economic boom of the 1950s by simultaneously raising levels of demand and showing to German workers the concrete improvements in wages and fringe benefits that could be attained. The Social Democrats had done poorly in the 1949, 1953, and 1957 elections which by the late 1950s caused the labor movement and the SPD to question the predominance of their left supply-side policies. Thus, the shortage of labor supply—and the resultant new-found full employment—convinced them that other less exogenous factors favoring demand stimulus (i.e., Keynesianism) might be an effective tool in the future should unemployment return.

Specifically, the unions and the SPD themselves became more open to Keynesianism as a policy option. Until the early 1960s they had tended to give little emphasis to Keynesian policies, although the latter had been a subject of some discussion at least since 1953.[26] The SPD moved toward Keynesianism decisively only in 1959 and the DGB four years later. The SPD seems to have moved on this issue primarily because they were seeking a new programmatic

[25] For a good analysis of the growing internationalization of the deutsche mark during the postwar period, see Norbert Kloten, *Die Deutsche Marks als internationale Anlage- und Reservewährung: Folgen für den Kapitalmarkt* (Frankfurt: Knapp, 1981); and for a treatment of the inflationary threat that then derived from the growing balance-of-payment surpluses, see: Patrick M. Boarman, *Germany's Economic Dilemma* (New Haven: Yale University Press, 1964).

[26] Karl Schiller, *Der Okonom und die Gesellschaft* (Stuttgart: Fischer, 1964); Franz Böhm, "Left Wing and Right Wing Approaches to the Market Economy," in Horst Friedrich Wünche, ed., *Standard Texts on the Social Market Economy* (Stuttgart and New York: Gustav Fischer Verlag, 1982), pp. 361–65. The political economist, Michael Held, has argued that Keynesianism was a part of German social democracy since the Weimar period; however, Keynesianism was never a dominant theme of German social democracy during the 1940s and 1950s. See Michael Held, *Socialdemokratie und Keynesianismus* (Frankfurt: Campus, 1982).

appeal that might bring them the kind of electoral success which had hitherto been elusive. The more straightforward Marxist-oriented approaches of the 1950s—nationalization, planning, and worker control—had been unable to rally enough electoral support to give the party a chance at participating in government, let alone winning a majority.

In roughly the same period as well, the governing center-right coalition began to put more emphasis on the ways in which the social market economy could serve the nation's social needs. In part, this was a response to the growing atmosphere of prosperity in which the old focus on savings and self-sacrifice seemed misplaced, and in part it was a direct response to the challenge of a renewed SPD. Even though the West German economy had grown during the 1950s, wages still followed profits somewhat belatedly, and German social benefits were no longer substantially more generous than those elsewhere in Europe. Alfred Müller-Armack, a prominent Christian Democratic economist and policy maker, suggested that the focus of the social market economy should be redefined in several ways.[27] In particular, he suggested: an increase in spending for university and vocational education; more government support for smaller firms and the self-employed; renewed vigilance with regard to monetary stability (given the tightening labor market); more government spending for health and worker safety; an expanded environmental policy; and an industrial policy based on restraint to deal with a slump in the coal industry. Most of these measures were adopted by the CDU/CSU-FDP coalition government in the early and mid-1960s. In one light, these measures could be seen as stimuli to demand, especially given the higher spending they allocated to education, business subsidies, the environment, and vocational retraining. However, the Christian Democratic-led coalition never viewed them in that context. Rather, they saw these measures as infrastructural aids designed to enhance competitiveness. They did not quite add up to Keynesianism through the back door.

A more important and, to some degree deliberate, step toward Keynesianism was taken with the creation of a Council of Experts (*Sachverständigenrat*), known colloquially as the Five Wise Men, in 1963. The Council was to provide an institutional means for canvassing the opinions of the country's leading economists, in part because recent changes in the German economy were seen as genuinely puzzling by the government and, in part, because the government felt increasing pressure to respond to the new interest that the Left was showing in Keynesianism.[28] That pressure intensified in the 1960s as the annual growth rate

[27] Alfred Müller-Armack, "The Second Phase of the Social Market Economy: An Additional Concept of a Humane Economy," in Wünche, ed., *Standard Tests*, pp. 49–61.

[28] See Henry C. Wallich, "The American Council of Economic Advisors and the German *Sach-*

slowed down to 4.1 percent and 3.5 percent during 1962 and 1963, only to rebound to 6.6 percent and 5.6 percent during 1964 and 1965, before falling off again to 2.9 percent in 1966 and -0.2 percent in 1967.[29] Adenauer and Erhard turned to the academic economists—in Germany, a profession of considerable esteem—in the hope that their expert analyses would lead to policy recommendations that would bolster the position of the government and undercut the critiques of the Left. The center-right government assumed correctly that most private economists would support the policies of the social market economy. But the Council soon became a forum for the articulation of Keynesian ideas and a context that lent a hitherto unattained institutional legitimacy to those ideas. Karl Schiller was the economist on the council most critical of the social market economy. He took advantage of his position to offer explicit Keynesian proposals and had begun to press other members of the council on the appropriateness of Keynesian policies.[30] Schiller had been advising the SPD and the unions to add reflation to their traditional platform since the mid-1950s. By the mid-1960s, both he and they—the SPD and DGB—were well placed to push Keynesianism on the Federal Republic.[31]

During the course of the 1966–1967 recession, the first in the Federal Republic, the center-right coalition collapsed in stages. Konrad Adenauer stepped down as chancellor in 1963 to be replaced by Erhard who proved to be a better economics minister than chancellor. He lasted through the 1965 election in which the CDU/CSU-FDP coalition was returned, but the economic downturn of 1966 marked the end of the era in which social market economics was virtually unquestioned. Erhard was forced out and in December of that year the SPD joined the CDU/CSU in the "Grand Coalition," led by the ineffective CDU chancellor Kurt Kiesinger.

The entry of the SPD into the government finally allowed Keynesians some access to the policy arena, and, as economics minister, Schiller was finally able to secure passage of a Stability and Growth Law in 1967, which officially recognized the government's responsibility for employment and mandated macroeconomic measures to secure the goals of the "magic polygon" (price stability, economic growth, full employment, and balanced trade).[32] However, the first and

verständigenrat: A Study in the Economics of Advice," *Quarterly Journal of Economics*, 82, 3 (August 1968), pp. 349–79.

[29] Hardach, *Political Economy of Germany*, p. 162.

[30] Schiller was able to mobilize some support during the mid-1960s among the more pragmatic non-Keynesians who dominated the council, but Keynesianism was very limited within the council previously or subsequently.

[31] Karl Schiller, "Gesprach," in Leo Brawand, ed., *Wohin steuert die deutsche Wirtschaft?* (Munich: Verlag Kurt Desch, 1971), pp. 25–48.

[32] Much of the following account is drawn from Jeremiah M. Riemer, "Crisis and Intervention in the West German Economy: A Political Analysis of Changes in the Policy Machinery During the

fourth goals outlined in this polygon received much more stress than did the second and third. Debate about this legislation began in 1965, and the lines of battle were quickly drawn. The Social Democrats and the trade unions sought additional macroeconomic measures to safeguard emloyment and growth. The business community, banks, and center-right parties felt that major new measures were superfluous, as the social market economy needed only fine tuning. This alignment suggests that the Keynesian forces faced an uphill battle. Nevertheless, the law was passed.

However, legislation is usually only the beginning of policy. In this case, a number of factors continued to constrain the full implementation of Keynesianism in Germany. The two most important constraints on the Schiller-influenced Social Democratic Party were: first, its coalition partners (the CDU/CSU during the Grand Coalition and the FDP from 1969-1982) since the Social Democrats *never* governed with an absolute majority, and the fiercely independent *Bundesbank*, which exercised great influence over monetary policy. In the face of these constraints, the most that West Germany was able to achieve on this front is what Riemer has called a "qualified Keynesian design." He notes several important constraints on the development of a more full-blown Keynesianism:

1. The Bundesbank placed strict monetary limits on deficit spending. It was able to do so because it never allowed the Finance Ministry and the Economics Ministry to be headed by Keynesians (or Schillerites). It also could claim a quantitative monopoly on economic wisdom since it employed over 1,000 economists while the Economics Ministry employed only 200.[33]
2. Influential conservative forces in the business community used Keynesian ideas to emphasize the need for an incomes policy and to resist reflation in the absence of one.
3. The proposals that were ultimately embodied in the Basic Law on Growth and Stability were actually formulated in 1965, prior to the 1966 recession as a compromise between left and right. Hence, they were always a political artifact based on a tenuous compromise rather than a part of received economic wisdom ready for automatic use in the face of recession.[34]

1960s and 1970s" (Ph.D. diss., Cornell University, 1983); "Alterations in the Design of Model Germany: Critical Innovations in the Policy Machinery for Economic Steering," in Andrei S. Markovits, ed., *The Political Economy of West Germany* (New York: Praeger, 1982), pp. 53–89; and "West German Crisis Management: Stability and Change in the Post-Keynesian Age," in Norman Vig and Stephen Schier, eds., *The Political Economy of Advanced Industrial Societies* (New York: Holmes & Maier, 1985).

[33] Katzenstein, *Policy and Politics in West Germany*.

[34] Riemer, "Crisis and Intervention," p. 86.

Given these conditions, it is not surprising that even this "qualified Keynesian design" proved remarkably short-lived. Its high point was the 1969–1972 period when Social Democrats controlled both the economics and finance ministries (Schiller was forced to give the economics ministry to the FDP as part of a political compromise in 1972). This was a period when:

> Schiller succeeded in installing global guidance—which was under suspicion of being a planned economy—simply by maintaining that state guidance was intended to affect only macro relations, while the freedom and autonomy of those responsible for the allocation process would not be disturbed thereby. . . .[35]

The government successfully survived the "wildcat" strikes for higher wages in 1969, and expanded the welfare state in the "reform euphoria" of the Willy Brandt-led government. It even smoothly handled the upward revaluation of the DM during the early 1970s in the face of a weakening dollar as the Bretton Woods system broke down. Yet, because Keynesianism was subject to the tight money policies of an independent *Bundesbank*, even in the mid-1960s, there was an upper limit to these experiments. And after Schmidt replaced Schiller as the economic leader in the Brandt government, the SPD itself showed increased concern about inflation.

When reflationary policies began to produce an average inflation rate of 5.5 percent in the early 1970s,[36] the *Bundesbank* reined in the Keynesian experiment in order to keep wages in check. But the *Bundesbank* had always moved toward a more restrictive policy in such situations. What really sounded the death knell for Keynesianism in West Germany was the oil crisis-induced recession of 1974–1975 and the replacement of Brandt by Helmut Schmidt as chancellor in 1974. The oil crisis brought "stagflation," the combination of inflation and unemployment that called the venerable Phillips curve, which underpinned contemporary Keynesian thinking, into question. Schmidt's rise in the SPD was important because he generally favored more fiscally conservative policies, which now seemed justified by the appearance of stagflation. Under his aegis, the Keynesian experiment of the late 1960s gradually gave way and—although the Schmidt government did not use the term—the social market economic paradigm was felt once again.[37]

[35] Hans-Peter Spahn, *Die Stabilitätspolitik des Sachverständigenrats* (Frankfurt: Campus Verlag, 1979), p. 53. (Quoted in Riemer, "Crisis and Intervention," p. 113; translation Riemer's.)

[36] Kloten, Ketterer, and Vollmer, "West Germany's Stabilization Performance," p. 360.

[37] For the difficulties in pushing for full employment Keynesianism in West Germany, see Fritz W. Scharpf, "Economic and Institutional Constraints of Full Employment Strategies: Sweden, Austria, and Western Germany, 1973-82," in John H. Goldthorpe, ed., *Order and Conflict in Contemporary Capitalism* (New York: Oxford University Press, 1984), pp. 257–90.

The period from the mid-1970s to the mid-1980s is familiar territory. When the unions pushed for increased spending to alleviate unemployment and President Carter asked the Germans to play the role of economic "locomotive" for the rest of the world in 1977 and 1978, Schmidt reluctantly responded with two packages totalling DM 29.3 billion, but these measures neither revived growth nor completely satisfied the United States.[38] When pressed by the party's rank and file to stimulate the economy further, Schmidt demurred, arguing that his fiscally conservative coalition partner, the FDP, would leave the coalition if he did so. In essence though, Schmidt had partially given in to the locomotive theory after 1978 since the stimulus package did coincide with the second oil crisis. This, of course, was perceived as a "mistake" by the FDP, thereby hardening the junior party's veto stance. As unemployment climbed toward 10 percent in 1982—this time without a subsequent policy response from Schmidt—the FDP then could say "never again" rather than just "never" to demand-stimulus policies. It then left the coalition, becoming the junior partner in a new center-right coalition under Helmut Kohl. Unsympathetic to demand management, the Kohl government argues that Germany's current economic problems are structural rather than cyclical. In fact, this latter distinction is also familiar territory. German economics has always paid a lot of attention to this distinction and has emphasized the structural dimension of Germany. This view is strongly held at the influential economic think tank, the Kiel Institüt für Weltwirtschaft.

To put this account into perspective, we turn in the next section to an analysis of those key locations in the German polity where an economic policy must take root if it is to grow, and where Keynesianism was systematically preempted and/or rejected: the economics profession, the bureaucracy, and the political arena.

Stillborn Keynesianism: Inhospitable Arenas

The three access points from which economic ideas make their way into policy are the economics profession, the civil service, and the political arena. At each of these locations within the Federal Republic, Keynesianism has been viewed with suspicion or apathy. As we have seen, only during the 1966–1973 period did Keynesianism penetrate these arenas, and even then that penetration was never complete. Why were the individuals in these three arenas so resistant to Keynesian ideas and policies?

[38] Robert Putnam and J. Bayne, *Hanging Together* (Cambridge, Mass.: Harvard University Press, 1986).

The Economics Profession

The most important of the three locations—and the one where individuals were most antagonistic to Keynesian ideas and policies—was the economics profession. The first and most significant economists who emerged from the Third Reich untainted by complicity with the Nazi regime were part of the Freiburg school of economics.[39] Few others in the economics profession were so influential just after the war. The autarchic dirigism of Hjalmar Schacht had died with the Third Reich and anything remotely close to it was vilified. Partly for this reason as well as their association with the Cold War, doctrinaire Marxist economists were virtually ignored in the Federal Republic and the more moderate Social Democratic-inclined economists were preoccupied with such issues as worker participation and nationalization.

The members of the Freiburg school were transfixed by concern about the political dangers inherent in interventionist economic policies and by fear of the disorder that might follow from any increase in inflation. They had lived through the centralized planning of Hitler and the Allies' controls, and they had vivid memories of hyperinflation followed by depression in the 1920s. To many such economists, Keynesian ideas seemed to court such dangers.[40] Its attempt to place responsibility on the state for giving global guidance to the economy seemed to resemble the inefficient systems of planning with which Germany already had too much experience, and reflationary policies conjured up images of citizens carrying wheelbarrows full of reichmarks along the streets in 1923. With these experiences in mind, members of the Freiburg school believed that the Depression had been caused, not by a deficiency of aggregate demand, but by the state's experimentation with activist policies that led to a breakdown of the market order. What was needed then, they argued, was not the experimentation of the 1920s and 1930s,[41] but a clear set of policies based on sound economic theory.

Thus, when a market economy was reestablished after World War II, the Freiburg economists wanted to ensure that an effective and "organized framework"

[39] Among the leading members of this school were: Walter Eucken, *The Foundations of Economics* (Chicago: University of Chicago Press, 1951), *Kapitaltheoretische Untersuchungen* (Tübingen: Mohr, 1954), and *This Unsuccessful Age; or the Pain of Economic Progress* (New York: Oxford University Press, 1952); Wilhelm Röpke, *The Solution of the German Problem* (New York: G. P. Putnam & Sons, 1947), *A Humane Economy* (Chicago: Henry Regnery, 1960), and *Economics of the Free Society* (Chicago: Henry Regnery, 1963); and Alexander Rüstow, *Zwischen Politik und Ethik* (Köln: Westdeutscher Verlag, 1968). Others who followed in this tradition were: Wolfgang Müller-Armack, *Auf dem Weg nach Europa: Errinnerungen und Ausblicke* (Tübingen: R. Wunderlich, 1971), Ludwig Erhard, *Prosperity Through Competition* (New York: Praeger, 1958).

[40] Ibid.

[41] See James, this volume.

policy would protect its operation from undue public interference and all inflationary tendencies. They put a premium on policy that was designed to foster a stable set of expectations in the private sector. Public policy was to be aimed at four major goals:

1. The Freiburg economists upheld the primacy of monetary policy, on the grounds that a stable money supply would make anticyclical policy unnecessary. Hence, a strong central bank was to be the guardian against any misuse of power by the political authorities.
2. They sought an open international economic system in reaction to the Nazi policy of autarchy. Hence, these economists supported greater economic contacts with the United States and Western Europe, and they saw exports as the key to German growth.
3. They favored increased market competition, but within the context of an orderly market framework. The latter could be provided by banks and industry associations in conjunction with limited action by the state. In a sense, Freiburg economists like Walter Eucken saw the whole nation as a unit within the setting of international competition. Some cooperation among firms was quite acceptable in that it would lead to a positive sum outcome for the German economy as a whole.
4. They wanted a limited measure of state intervention. The role of the state was to provide a stable legal and social order, including an important measure of social security, as well as infrastructural measures to aid in the establishment of a higher market equilibrium.

Perhaps the best summary of the "framework" philosophy of this school comes from the economist Wilhelm Röpke:

> [Our program] consists of measures and institutions which impart to competition the framework, rules, and machinery of impartial supervision which a competitive system needs as much as any game or match if it is not to degenerate into a vulgar brawl. A genuine, equitable, and smoothly functioning competitive system can not in fact survive without a judicious moral and legal framework and without regular supervision of the conditions under which competition can take place pursuant to real efficiency principles. This presupposes mature economic discernment on the part of all responsible bodies and individuals and a strong impartial state. . . .[42]

[42] Röpke, "Guiding Principles of the Liberal Programme," in Wünche, ed., *Standard Texts*, p. 188.

Rather than the antistatism of traditional Anglo-Saxon laissez-faire, the Freiburg school saw the state performing a crucial and positive role in enhancing investment-led economic growth.

Reinforced by the economic successes of the 1950s, the Freiburg school occupied a dominant position in postwar German economics but it was also internally divided. The major line of cleavage was between the "ordoliberals," who favored the more organized capitalist portion of this program and the "neoliberals," who tended to stress issues such as freedom and individual competition. Politically, the ordoliberals were primarily located within the Christian Democrats (the party of the large business community) while the neoliberals were closer to the Free Democrats (the party of small business).[43] Both groups belonged to a single school of thought, but this tension between its two branches helped to keep a vigorous economic debate alive. To the extent that the West German economy can be characterized as a mix of large firms with networks of smaller suppliers, this tension has allowed both of these segments of the business community to have intellectual representation.

Schiller was the first influential "post-Freiburg" economist on the left in Germany, and, as we have seen, his views did not achieve currency until the 1960s. Yet, with the rise of inflation in 1972, precipitating Schiller's departure from the economics ministry, the leading Keynesian theorist had lost some of his lustre. Increased inflation opened the door for criticism of Keynesian ideas from descendants of the original Freiburg school.[44] How did these economists deal with the revival of Keynesianism in the late 1960s and early 1970s? They attacked both the practice and theory of the 1967 Stability and Growth Law. In general, they were less critical of demand stimulus per se than of the government's failure to apply the brakes when appropriate. Keynesianism was criticized for manipulating rather than diminishing the fluctuations of the business cycle. They argued that macroeconomic equilibrium was simply not attainable and the pretense of aiming at quantifiable targets a dangerous illusion. Finally, they argued that the instruments needed to secure stable outcomes, especially with regard to wages in light of the breakdown of the system of "concerted action" in the late 1960s, were said to be absent.

What happened to Keynesianism after Schiller? During the mid and late 1970s, the primary proponents of Keynesianism were located in the trade unions' research institute, the WSI.[45] But by that time international economic constraints and domestic forces had relegated "Keynes plus" to a position of diminished

[43] Reinhard Blum, *Soziale Marktwirtschaft: Wirtschaftspolitik zwischen Neoliberalismus und Ordoliberalismus* (Tübingen: Mohr, 1969).

[44] Egon Tuchfeldt, "Soziale Marktwirtschaft und Globalsteuerung," in Egon Tuchfeldt, ed., *Soziale Marktwirtschaft im Wandel* (Breisgau: Rombach, 1973), pp. 159–88.

[45] Markovits and Allen, "West Germany," in Gourevitch, et al., *Trade Unions and Economic Crisis*.

importance vis-à-vis the dominant paradigm. The 1980s have not seen any significant resurgence of Keynesianism, although "Keynes plus" remains a part of trade union economic thought. However, since the unions are currently stressing such issues as worktime reduction and "qualitative" collective bargaining, they are not likely to bring full-blown Keynesianism back to the economic table soon.[46] Within the economics profession, the descendants of the Freiburg school—most notably Norbert Walter of the Deutsche Bank—have little competition.

The Civil Service

Elsewhere in this volume, Margaret Weir has characterized the civil service bureaucracy as being either "open" or "closed" depending on how easy or difficult it is for new economic ideas to penetrate state institutions.[47] She argues that the porous U.S. bureaucracy allowed Keynesian ideas to filter in easily but this same inchoate quality made Keynesian policies that much more difficult to implement. It took longer for Keynesianism to "crack" the bureaucratic establishment in Britain, but once "in" Keynesianism went much further.

On this dimension, the West German bureaucracy has generally been more like the British in the sense that it was difficult for weakly articulated Keynesian ideas to gain a hearing.[48] Yet, for a brief time (1969–1972) in the first years of the center-left coalition, a qualified Keynesian design was pursued with limited success.[49] There was clearly little experimentation with Keynesian ideas in the bureaucracy until the 1960s. Even if there had been, the civil service would have been loathe to implement anything short of the dominant conventional wisdom.[50] To those who know their Weber and the hierarchical and paternalistic tradition of the German civil service (*Beamten*), this should come as no surprise. The near monopoly that the Freiburg school had on the policy-making establishment prevented Keynesianism from making any major inroads during the 1950s and early 1960s.

This is not to suggest, however, that there were no conflicts over economic policy or no opportunity for flexibility within the bureaucracy dominated by sup-

[46] Christopher S. Allen, "Worker Participation and the West German Trade Unions: An Unfulfilled Dream?" in Carmen Sirianni, ed., *Worker Participation: The Politics of Reform* (Philadelphia: Temple University Press, 1987).

[47] Margaret Weir, "Ideas and Politics: The Diffusion of Keynesianism in Britain and the United States," this volume.

[48] For an excellent analysis of the West German policy-making process, see Peter J. Katzenstein, *Politics and Policy in West Germany: A Semi-Sovereign State* (Philadelphia: Temple University Press, 1987).

[49] Riemer, "Crisis and Intervention," p. 85.

[50] Renate Mayntz and Fritz W. Scharpf, *Policy-Making in the German Federal Bureaucracy* (Elsevier: Amsterdam, 1975).

porters of the Adenauer and Erhard governments. It is just that Keynesian ideas rarely benefited from any of this conflict. As economics minister in the late 1950s, Erhard was pressed strongly by the United States to revalue the DM upward due to huge surpluses created by the export boom of the 1950s. Both the pressure of export-oriented business and the *Bundesbank* within the bureaucracy undermined the "Atlanticism" of Erhard in favor of a "Gaullism" of going it alone.[51] In the course of the debate over the Cartel Law in 1957, the economics ministry showed great flexibility in watering down a law that could have had a severe impact on the large, oligopolistic export-oriented firms.[52]

With respect to Keynesianism there was considerably less flexibility. During the Keynesian opening of the late 1960s and early 1970s, the Keynesians in the Grand Coalition (1966–1969) government found the bureaucracy, especially at first, quite intractable. Keynesian policies were often sabotaged by the civil service. The only time that Keynesian ideas had any advantage was when Schiller was able to use this intractability to his advantage when the SPD became the majority party after 1969. This same bureaucratic tradition of obediently supporting the government's policies actually facilitated the implementation of the limited Keynesianism of the 1969–1972 period. Unfortunately for the SPD, it had only a few years in which it could confidently press Keynesian policies.

During the broader sweep of the Social Democrats' years in government, there was only a small opportunity to press for Keynesian ideas. For one thing, the economics and finance ministries did not always share a unified view of the economy in the 1966–1973 period. During the Grand Coalition the two portfolios were divided between the Social Democrats and the Christian Democrats, and during the 1969–1972 period Schmidt (at finance) and Schiller (at economics) differed as to how extensively Keynesian policies should be pursued. With the exception of the Council of Advisors and the trade unions (whose economic theories were suspect in the business community), there was little other outside advice that the government could draw upon. In fact, when the center-left government took office in 1969, the Council reversed direction and began to temper its commitment to Keynesianism. When Schiller moved to a government position, he was replaced by an economist who did not have the same commitment to Keynesianism. The net effect was to make the Council slightly less well disposed toward Keynesian ideas precisely at a time (1969) when Keynesian policies were to be given their first real chance in West Germany. The *Bundesbank* also proved to be a greater obstacle to Keynesian policies than the official economic bureau-

[51] Boarman, *Germany's Economic Dilemma*.
[52] Braunthal, *Federation of German Industry*.

cracy itself.[53] The Central Bank—Bank Deutscher Länder from 1948 until 1957, and the Deutsche Bundesbank thereafter—was designed to be extremely independent of political control (in reaction to the Nazi manipulation of the Central Bank). It generally takes conservative positions on monetary, fiscal, and budgetary isues, since its primary mission has been to protect the integrity of the currency. Few other institutions display such an overwhelming concern for the dangers of inflation, and it was Central Bank action that initially cut short the move toward Keynesianism as inflation rose in 1972. As Kreile notes, the *Bundesbank* also played a similarly strong role during the recession of 1965–1966.[54]

The Political Arena

Turning to the political arena, we can see that the particular mix of political issues dominant in postwar Germany and the alternative means at hand for dealing with them structured the way in which Keynesianism was received. In general, non-Keynesian concerns preempted Keynesian ones at almost every turn.

In most nations, the fate of Keynesianism has been linked to the prominence of unemployment on the domestic political agenda. At first glance, then, we might expect West Germany to welcome Keynesian policies during the 1950s when unemployment often ran close to 10 percent a year. However, the unemployment issue can take on different casts in different contexts. In Germany, as we have seen, it was primarily the result of immigration from the east, as millions of East Germans sought greater opportunities in the West. Hence, unemployment was not seen as a failing on the part of the government, but as the result of a special situation whose overall by-products were to be welcomed.[55] It was part of a process whereby native Germans sought freedom through enterprise and, for that reason, unemployment as an issue—and Keynesianism as a response—may have been blunted in the 1950s.[56]

The issue rose on the political agenda in the 1960s, but by then the flow of East German immigrants had been stopped at the Berlin Wall and the Federal Republic began to attain full employment—the result of a timely exogenous factor that again limited the force with which Keynesians could insist on a solution to the unemployment problem. Yet, while it was not a solution to the unemployment problem for the SPD and the unions, the Left at least learned that the tight-

[53] Joachim von Spindler, et al., *Die Deutsche Bundesbank* (Stuttgart: Kohlhammer Verlag, 1957); OECD, *Monetary Policy in Germany*, Monetary Studies Series (Paris: OECD, 1973); and Boarman, *Germany's Economic Dilemma.*

[54] Kreile, "Dynamics of Expansion."

[55] Wilhelm Röpke, *The Economics of Full Employment* (New York: American Enterprise Association, 1952).

[56] Held, *Sozialdemokratie und Keynesianismus.*

ened labor market finally allowed wages to rise and thereby stimulate demand. The SPD in 1959 and the DGB in 1963 realized that Keynesianism might have some potential future use if unemployment returned. In the 1970s, of course, unemployment rose once more, but by this time Germany was making considerable use of temporary laborers (*Gastarbeiter*) from Turkey and the Mediterranean. The problem was thus not solved by full-blown Keynesianism, but by sending the foreign workers home.[57] The *Gastarbeiter* functioned as an important safety valve which, once again, limited the demand for Keynesian policies.

Conversely, Keynesianism was associated with state intervention in Germany—a nation which feared a repetition of the totalitarian experience, but, no less important, one that had also watched a series of inept Weimar administrations fiddle with activist economic policies while the nation moved from hyperinflation to serious depression.[58] Many German commentators seemed hostile to Keynesianism, not because it would lead to central planning, but because it was difficult for them to have faith in the ability of governments to manage efficiently specific and detailed economic affairs. Röpke was as concerned about inflation as he was about collectivism;[59] and, as Riemer notes, these experiences left many German businessmen and officials with the view that the economy could best be managed through a series of informal arrangements, often of a decentralized nature.[60] He refers to this as the qualitative character of neoliberal Ordnungspolitik. Perhaps for this reason, German economists have been particularly critical of Keynesian attempts to quantify economic relations, and economic modeling is not as popular in Germany as it is in the United States or France.

Tax policies can often be used to reinforce Keynesian ideas, but this was not the case in the Federal Republic. Here too the West Germans developed approaches that reinforced social market economics, investment-led growth, and the power of the large banks and not demand stimulus.[61] But unlike the Reagan supply-side policies of the early 1980s that granted tax cuts without encouraging or mandating investment, the tax policies of the Federal Republic have conditioned tax relief on investment actually taking place. This has allowed for firms to quickly plow back profits into productive investment and take advantage of

[57] Andrei S. Markovitz and Samantha Kazarinov, "Class Conflict, Capitalism and Social Democracy: Migrant Workers in the Federal Republic of Germany," *Comparative Politics*, 3 (1978), pp. 373–91.

[58] Anthony Nichols, "The Other Germany—the Neo-liberals," in R. J. Bullen, et al., eds., *Ideas Into Politics* (London: Croom Helm, 1984), pp. 164–77.

[59] Röpke, "Is the German Economic Policy the Right One?" in Wünche, ed., *Standard Texts*, pp. 37–48.

[60] Riemer, "Crisis and Intervention," p. 111.

[61] Malcolm MacLennan, Murray Forsythe, and Geoffrey Denton, *Economic Planning and Policies in Britain, France, and Germany* (New York: Praeger, 1968), pp. 34–79.

and fuel the postwar economic boom. Smaller savers were not left out of this pattern either. During the early 1950s the Federal government established a policy of providing savings subsidies to individuals who contributed to savings accounts at their banks. This, of course, provided the banks with yet another source of investment capital, as well as increasing the domestic savings rate to the detriment of consumption of consumer goods. Compared to the United States where consumer credit card interest has long received tax breaks, credit cards themselves—except for the wealthy—were virtually unknown in West Germany until the 1980s. The West Germans have increased their consumption since the 1950s and 1960s to be sure, but most large purchases today are still financed out of savings and not via the system of installment credit so prevalent in the United States. To the extent that consumer demand reinforces Keynesian policies, this was yet another political obstacle to Keynesianism in West Germany.

It is also often noted that Keynesianism is associated with Social Democracy, and the West German case is no exception in that the Keynesian experiment of the 1960s was undertaken under SPD leadership. However, it should be clear that even the Left in Germany had a long tradition of interest in supply-side policies that overshadowed Keynesianism within party and union circles during the 1950s and reappeared strongly in the 1980s around the programs associated with Keynes plus. This is not the place for a full account of the failure of the SPD to achieve the kind of electoral success in the 1950s that might have put it in a position to implement Keynesian policies earlier.[62] The relatively dogmatic program of the party in that period may have played some role in the outcome; the tensions associated with the Cold War certainly did. But it is worth noting that, like Bismarck, the proponents of the social market economy stole the Keynesians' clothes. In Britain, France, and the United States, Keynesian ideas were closely associated with the social programs of the welfare state, and the combination seems to have been central to the electoral appeal of groups like the British Labour party. In Germany, however, the welfare state became intimately associated with the social market economy; and Keynesian economic policies were never tied to more generous social benefits in such an electorally appealing way.

Conclusion

Keynesianism was not as influential in Germany as one might have expected for many reasons. Some of these have to do with reactions against the interwar experience. There is little doubt, for instance, that German economists took a

[62] For an excellent account of the SPD's years in power, see Gerard Braunthal, *West German Social Democracy, 1969–1982* (Boulder, Colo.: Westview Press, 1983).

more jaundiced view of reflation as a result of experiencing it first under the Third Reich. However, the rejection of Keynesianism and its ultimate weakness in West Germany did not depend simply on the quality of reaction to the interwar period. First, there was more than reaction involved. German policy makers were able to ignore Keynesianism because they had developed a viable alternative of their own. And, second, that alternative was built on a cumulation of historical experiences that stretch back many decades before the Third Reich. These nineteenth-century policies were only reinforced by Freiburg school economic theories that developed in response to the wild experimentation and policy swings of the 1920s and 1930s.[63]

The construction of a national conception of appropriate economic policy is a complex matter. Even in Britain, postwar policy did not flow full-blown from the head of Keynes. It developed in stages according to the ideas that reached fruition at each stage and the experiences Britain had with them. In Germany, social market economics was initially a rather artificial notion, devised in reaction to the disasters of Weimar and refined in light of the Third Reich. Its initial influence in the immediate postwar years owed a good deal to the talents and good fortune of Ludwig Erhard, but social market economics became a powerful set of organizing principles and a political symbol largely because the economic experience of the 1950s, when it was being utilized, was so favorable. Few nations would reject a policy that brought them 8 to 9 percent annual rates of growth. In that respect, it mattered very little whether the policy was responsible for the growth rate. Just as a reaction against Weimar, Hitler and the Allied controls had given some initial impetus to social market concepts, the experience of the 1950s lent real ideological force to them. Within a few years, the concepts had such credibility that few were interested in what Keynesianism could add; and even today, despite the Stability and Growth Law of 1967, German policy making is still founded on social market ideas rather than Keynesianism.

If another set of concepts had been important to policy making during the boom of the 1950s, they might matter more in Germany today. However, the social market ideas also build upon long-standing German notions about how the economy functions. As I have indicated, "social market economy" is not a synonym for laissez-faire. On the one hand, it contains a rationale for the welfare state that Keynesianism appropriated in other nations. That was possible, in part, because the social market economists built upon nineteenth-century notions of governmental responsibility. As Frederick Reuss has observed: "The German government uses incentives for the upper groups and paternalism for the

[63] See James, this volume.

lower."[64] This has long been an important formula in German history. On the other hand, the conception of the private economy implicit in social market concepts is not quite that of the classical economists. As I have noted, it builds upon a long-standing conception of organized capitalism whose pedigree goes back to the German experience of late industrialization. Only when one realizes how many institutional mechanisms for coordination are an accepted part of the private economy in Germany, can one dismiss some of Keynes' concerns about the fundamental instability of markets and the need for state intervention. As the Canadian official quoted at the beginning of this chapter observes, most Germans are working with a conception of the economy that is quite different from the one on which many Keynesians rely.

In sum, if German policy makers were initially predisposed against Keynesian ideas, they were able to ignore those ideas for a long time only because they were constructing an alternative amalgam, whose credibility was firmly established early on in the postwar period. As time passed, the institutional structures for policy making also took on forms that militated in favor of the reigning orthodoxy and against a break toward Keynesianism. In both respects, the development of a prevailing set of economic policies clearly depends a great deal on the accumulation of ideas and institutions and on the sequence in which particular options come to the fore.

[64] Frederick G. Reuss, *Fiscal Policy for Growth Without Inflation* (Baltimore: Johns Hopkins Press, 1963), p. 28.

11

THE DIFFUSION OF KEYNESIAN IDEAS IN JAPAN

Eleanor M. Hadley

IN THE 1930s Japan was a pioneer in the successful use of stimulative fiscal policy and the writings of Keynes had some influence over its adoption. In spite of this distinctive position, however, the diffusion of Keynesian ideas in Japan took a less dramatic form than in many countries where the idea of government "interference" with market forces raised keen emotions. In Japan, the government has been part of the economy from the beginning of its modernization in 1868. Accordingly, the matter of a government role in the economy was close to a nonissue.[1]

In academia the spread of Keynesian ideas was slow notwithstanding a striking beginning. Professor Ichiro Nakayama, who became one of Japan's most influential economists, offered a seminar on *The General Theory* at Hitotsubashi University in the spring of 1936 only two months after its publication, the proceedings of which were published in 1939.[2] One can only wonder how much of the Keynesian ideas was understood given that they had to be absorbed through a

I am deeply indebted to Professor Kazuo Sato for generous assistance on early drafts of this paper. I also wish to thank Professor Koichi Hamada for his great help. Inadequacies are mine alone.

[1] Among a host of sources, see W. W. Lockwood, *The Economic Development of Japan, 1868–1938* (Princeton: Princeton University Press, 1943); W. W. Lockwood, *The State and Economic Enterprise in Japan* (Princeton: Princeton University Press, 1965); G. C. Allen, *A Short Economic History of Japan*, 2d ed. (London: Allen & Unwin, 1962); Takafusa Nakamura, *Economic Growth in Prewar Japan* (New Haven: Yale University Press, 1983); Takafusa Nakamura, *The Postwar Japanese Economy* (Tokyo: University of Tokyo Press, 1981); Yutaka Kosai, *The Era of High Speed Growth* (Tokyo: University of Tokyo Press, 1986).

[2] Koichi Hamada, "The Impact of the General Theory in Japan," *Eastern Economics Journal* 12, 4 (Oct.–Dec. 1986), p. 451. Hamada cites Tadashi Hayasaka, "Wagakuni no Keinzu Keizaigaku Kotohajime" ("The Initiation of the Keynesian Economics in Japan"), *Shukan Toyo Keizai* (Kindai Keizaigaku Shirizu, 42–52, 1977–1980); "Nihon ni Okeru, Keinzu Keizaigaku Donyushi no Shodanmen" ("Historical Facets of the Introduction of Modern Economics: Keynes"), *Keizai Seminar*, (Special Issue on Keynes Centennial, April 1983); Mitsuharu Ito, "Sengo no Kindai Keizaigaku," in Keizai Gakushigakukai, ed., *Nihon no Keizaigaku* (*Economics in Japan*) (Tokyo: Toyo Keizai Press, 1984).

foreign language. Accounts from Harvard indicate that it was a struggle to get aboard.[3] It was not until well into the 1950s that universities generally were offering Keynesian ideas as main fare. The strength of Marxism in Japanese universities is probably the major factor responsible for this slow spread. As late as the early 1960s, the economics faculty of Tokyo University, Japan's most prestigious, was overwhelmingly Marxist.

Keynesian ideas became a subtle part of Japanese public policy without fanfare even though policy for the first two postwar decades was overwhelmingly oriented to supply management. In a few instances in public debate, Keynes' name was marshalled in support of particular positions, but for the most part Keynesian ideas have become part of the Japanese policy framework without attribution. The one organ of the Japanese government avowedly Keynesian was and is the Economic Planning Agency, responsible for developing the basic national income statistics of the economy and for developing the country's economic plans.

The year 1965 represented a turning point in public finance with the government supplementing tax revenue with deficit financing; but it was not until a decade later in 1975 under strong international pressure that deficit financing became a major policy tool. In 1979 deficits even reached 6.1 percent of GNP. Since that time governments have been committed to trying to lower reliance on bonds.

With this brief overview, let us turn in the following pages to the spread of Keynesian ideas in Japan; to the country's pioneering role in the successful use of stimulative fiscal policy; to the Occupation's rejection of what Finance Minister Ishibashi described as a Keynesian approach to inflation; to the diffusion of Keynesian ideas in academia; to the factors that guided the country's high but cyclical growth; and to the role of Keynesianism in the period of deficit financing.

A Pioneering Role

Finance Minister Korekiyo Takahashi's adoption of a stimulative fiscal policy on taking office in December 1931 came in the wake of his predecessor's failed program of returning the country to the gold standard in January 1930. In the 1920s there was widespread support for a return to the gold standard which Japan had left in 1917. Differences were over timing and what the exchange value of

[3] Paul A. Samuelson, "The General Theory," in Seymour E. Harris, ed., *The New Economics* (New York: Alfred A. Knopf, 1947), pp. 145–60.

the yen should be, not over returning per se.[4] Takahashi's predecessor, Junnosuke Inouye, favored an exchange rate of $49.75 per 100 yen which, as Takafusa Nakamura observes was the rate Japan used when it adopted the gold standard in 1897.[5] Since prices were above this level, he initiated a tight monetary policy to force prices down toward such alignment. Needless to say, timing could not have been worse.

Japan suffered an enormous outflow of gold; reserves declined "from Y1,073 million on 10 January 1930 to Y826 million at the end of December 1930 . . . [to] Y521 million on 5 December 1931."[6] As the U.S. economy spiraled downward from the October 1929 stock market crash, its consequences spread to Europe and the world. The following year, 1931, England went off gold in September and that same month the Japanese army began military operations on the continent, the so-called Manchurian Incident. So great was the conviction of orthodoxy that as late as mid-1931 it still seemed to the leadership that the right action had been taken.[7] By the latter part of the year, however, with reserves diminishing, exports continuing to plummet in value, the countryside disastrously hit by the falling U.S. demand for silk and with mounting military expenditures, it was apparent that reorientation of policy was indicated. The cabinet fell in December 1931 and was replaced by one formed by Tsuyoshi Inukai of the Seiyukai party with Takahashi as finance minister.

Hugh Patrick has described the policies that Takahashi instituted as "one of the most successful combinations of fiscal, monetary and foreign exchange rate policies, in an adverse international environment, that the world has ever seen."[8] For five years (1931–1936), the real growth of the economy averaged 4.3 percent per annum, although if the exceptional year of 1934 when growth was 10.8 percent is removed, the other years averaged 2.7 percent.[9] What were Takahashi's policies and what was the background of the man who conceived them?

[4] Kazuo Sato, "Exchange Policy and Economic Stability in Interwar Japan," a paper delivered at the School of Oriental and African Studies, University of London, at a conference on "The economies of Africa and Asia During the Inter-war Depression," December 12–14, 1985, p. 4 of mimeograph.

[5] Takafusa Nakamura, "The Japanese Economy in the Interwar Period: A Brief Summary," in Ronald Dore and Radha Sinha, eds., *Japan and World Depression* (New York: St. Martin's Press, 1987), p. 59.

[6] Tuvia Blumenthal, "Depressions in the 1930s and 1970s," in Dore and Sinha, eds., *Japan and World Depression*, p. 78.

[7] Dick K. Nanto and Shinji Takagi, "Korekiyo Takahashi and Japan's Recovery from the Great Depression," *American Economic Review* (May 1985), p. 370.

[8] Hugh Patrick, "The Economic Muddle of the 1920s," in J. W. Morley, *Dilemmas of Growth in Prewar Japan* (Princeton: Princeton University Press, 1971), p. 256.

[9] Kazushi Ohkawa and Miyohei Shinohara, *Patterns of Japanese Economic Development* (New Haven: Yale University Press, 1979), table A-3.

On taking office in December 1931 Takahashi reimposed the gold embargo, freeing the country to plan its own course of action. He initiated a low interest rate policy, depressed the exchange value of the yen to promote exports, and adopted deficit financing. Under Takahashi's direction, the exchange rate fell from $48.8 per 100 yen to $25.2.[10] Deficit financing for the years 1931–1936 averaged some 30 percent of government expenditures.[11] That increased military expenditure was the major item in the deficit financing made the program widely acceptable. As Kazuo Sato points out, the public works program designed to help farmers began at roughly half of military expenditures and lasted only through 1931–1934.[12]

Takahashi was well qualified for his position, having been finance minister several times before, even prime minister, as well as governor of the Bank of Japan, president of the Yokohama Specie Bank, and a member of the Diet. Notwithstanding this rich political experience, Takahashi took an economic decision in 1935 to restrain the deficits, which cost him his life. Takahashi saw the limit to deficit financing arising "when the effect of the additional funds raised by issuing debt has no value in fostering private industry, and therefore, no stimulus on sound economic development."[13]

Takahashi, along with a number of other leading figures, was assassinated in the February 26, 1936 military uprising of junior officers, and the army continued with expanded operations. The so-called "China Incident" of July 1937 opened the war in north China, which then spread to the rest of China. Japan occupied northern Indo-China in 1940, southern Indo-China in 1941, and in December of that year it took on the United States in a two-front war. The army took the view that there was no such thing as a limit to deficit financing. In the years 1937–1940 deficits amounted to 57.2 percent of expenditures and they were inflationary.[14] In fact, Japan took on the United States when its national income had been declining for two years—although this was not known because techniques for deflating apparent income to get at real income had not yet been mastered.

To what extent was Takahashi's thinking influenced by Keynes? A self-educated man, Takahashi was widely read, not only in Japanese but in English and German as well. In addition, Keynes' ideas had become part of the thinking of liberal circles in the 1920s. Tanzan Ishibashi, then a staff member of *The Oriental Economist* and later its editor—as well as postwar finance minister, MITI minis-

[10] Blumenthal, "Depressions," p. 75.

[11] Ohkawa and Shinohara, *Patterns of Japanese Economic Development*, table A-46.

[12] Sato, "Exchange Policy and Economic Stability," p. 9.

[13] Nanto and Takagi, "Korekiyo Takahashi," p. 373.

[14] Ohkawa and Shinohara, *Patterns of Japanese Economic Development*, tables A-2 and A-44.

ter and prime minister—even organized a Keynes Research Association.[15] Sharon Nolte, in her study of liberalism in modern Japan, writes of the post-World War I period:

> Japanese economic theorists were working more from actual experience than from Keynes' theories; . . . Nevertheless, Keynes was certainly known in Taisho Japan [1912–1926]. . . . Keynes' early works advocated a number of innovations for which a rudimentary institutional basis already existed in Japan: [such as] a floating currency to maintain stable domestic purchasing power rather than fixed exchange rates. . . . As a host of Japanese public figures developed . . . [these] themes during the twenties and thirties, Keynes was seldom their first inspiration. He was, however, . . . a persuasive catalyst of strategies still in flux, and an eminent authority. . . .[16]

Takafusa Nakamura describes Takahashi's policies as "a grand experiment anticipating Keynesian economics. At the time the gold embargo was lifted in 1929, Takahashi published an essay in which he anticipated the theory of investment's multiplier effect. . . ."[17]

Viewing Takahashi in a politicoeconomic framework, G. C. Allen comes out with a different assessment of the initiator of stimulative fiscal policy as does Kazuo Sato. Allen faults him with a lack of political realism and foresight.

> Takahashi . . . had cheerfully acquiesced for four years in a financial policy which made it possible for the militarists to pursue their ambitions. He knew that in them he was dealing with a group which did not easily recognize economic limitations on strategic designs, and that their appetite would grow with any effort to satisfy it. Consequently, when the time came to call a halt on economic grounds, it was to be expected that the militarists would refuse to comply and that they would deal with Takahashi as they had dealt with Inouye. Judged solely from the standpoint of what we should now call a "full employment" policy, Takahashi was amply justified in introducing measures for raising the public expenditure. But since the additional expenditure was of such a nature to promote the strategic plans of the militarists, and since in the last resort policy was determined by them and not by the requirements of sound finance, the outcome was necessarily disastrous.[18]

Kazuo Sato holds that in a longer framework, Takahashi's policies were not only a disaster politically but also in terms of monetary/fiscal tools.

[15] Sharon Nolte, *Liberalism in Prewar Japan* (Berkeley: University of California Press, 1987), p. 224.

[16] Ibid., pp. 233–34.

[17] Nakamura, in Dore and Sinha, eds., *Japan and World Depression*, p. 64.

[18] Allen, *Short Economic History of Japan*, p. 137.

> The Takahashi policy which performed brilliantly in the short run was to turn out a failure in the long run. Externally, Japan was criticized for its beggar-thy-neighbor policy and accused of social dumping. Internally, deficit spending came to be perpetual because of its heavy commitments to military buildup. Fiscal policy thus became impotent. Likewise monetary policy went out of usage because of the country's commitment to low interest rates. The economy boomed in the late 1930s, only to plunge into the catastrophe of World War II.[19]

As is apparent, assessments of Takahashi vary depending whether he is viewed in economic terms alone or political terms as well, whether his policies are viewed in the short run or in the longer run.

The Occupation—Ishibashi and Dodge

In the war years, 1937–1945, inflationary pressures were suppressed by rigid wage and price controls that terminated in the confusion of the war's end thus setting the stage for serious inflation. But, in addition, disastrous actions were taken. Surrender occurred August 15, 1941; MacArthur arrived August 30. In this two-week period and continuing into the first weeks after the arrival of U.S. officials, the Japanese government paid out millions of yen in termination pay to uniformed personnel and in insurance claims, for the government had insured virtually every conceivable risk.[20] To have put such quantities of money into a prostrate economy was an invitation to skyrocketing inflation, which developed at once. Inflation was a stubborn problem for the next five years. Was such action taken in ignorance of the consequences, or was it an effort to confound the policies of the Occupation? Various observers have proposed different answers to this question, but leaving motivation aside, inflation certainly made matters more difficult for Occupation officials.

If it is one thing to adopt anti-inflation policies in an ongoing economy, it is quite another in an economy operating far below capacity and faced with several millions of additional citizens out of repatriation of military personnel and civilians. To get production underway in circumstances of widespread physical destruction and negative savings, the government pursued liberal credit policies. Although this resulted in increased output, it failed to contend with rising prices. In 1946, when Tanzan Ishibashi was finance minister, he strongly supported liberal credit policies and the creation of the Reconstruction Finance Bank, arguing

[19] Sato, "Exchange Policy and Economic Stability," p. 10.

[20] Eleanor M. Hadley, *Antitrust in Japan* (Princeton: Princeton University Press, 1970), pp. 116–17.

in the manner of Keynes, whom he cited, that with much unused production capacity, such policies were not inflationary. General MacArthur's headquarters held otherwise and subsequently purged him. In an address to the lower house, Ishibashi contended:

> The goal of national finance, particularly in situations like that of our country today, is first, more than anything else, to give people jobs, to revive industry, to aim for full employment, and so to propel the national economy forward.
>
> If one were to ask, has our country been under conditions of full employment since the war, one could not say that anything of the kind has been the case. . . .
>
> Monetary expansion and soaring prices under such conditions can be remedied with deflationary policies, but the type of inflation we are experiencing is not inflation in the usual sense. . . .
>
> Starvation prices can only be cured by the production and flow of goods onto the market. . . .
>
> In order to achieve the goal of resuming production, there is no harm if, for example, government deficits occur, or if, as a result, an increased issue of currency is induced.[21]

The U.S. stance toward Ishibashi contrasts with the pro-Keynesian approach of U.S. policy in the European theater at that time. Part of the difference in U.S. policy positions between the German and Japanese occupations may be explained by the fact that in Germany inflation did not grow at an accelerating rate whereas in Japan it did. In Germany the rate of increase in prices stayed almost flat between 1946 and 1949 (which included the 1948 currency conversion). In Japan, by contrast, prices rose almost three times between September 1945 and March 1946, and by April 1949, prices were 186 times higher than prewar.[22]

In the face of increasing Cold War tensions, Washington became more concerned at the lack of progress against inflation. On December 10, 1948, Secretary of the Army Kenneth C. Royall sent a directive to General MacArthur outlining anti-inflationary measures similar to those the headquarters had been attempting but could not effect. On December 11, Truman appointed Joseph M. Dodge, a banker of properly orthodox views, to assist in such matters. Dodge arrived in the theatre February 1, 1949, and proceeded to exercise his almost dictatorial powers. Dodge characterized the Japanese economy as walking on stilts of U.S. aid

[21] Yutaka Kosai, *The Era of High Speed Growth* (Tokyo: University of Tokyo Press, 1986), p. 43.

[22] For Germany, W. S. Woytinsky and E. S. Woytinsky, *World Population and Production* (Twentieth Century Fund, 1953), p. 386, where per capita income figures are cited both in terms of current prices and 1929 prices. The ratio for the years 1946–1949 is virtually constant. For Japan, Cohen, *Japan's Postwar Economy* (Bloomington: Indiana University Press, 1958), p. 84, where for the prewar comparison, the 1934–1936 average is used.

and subsidies.[23] His orders to the Japanese government in effect were, "balance the budget, restrict credit, eliminate subsidies." Dodge decreed that the yen equivalent of U.S. aid be paid into a counterpart fund which basically would be used to retire debt. In place of the multiple exchange rates that GHQ-SCAP had been using depending on the commodity in question, Dodge decreed a single exchange rate set at 360 yen to the dollar. Japanese in all walks of life were aware of his presence.

Many persons find it difficult to believe that the strongly orthodox Dodge[24] could have been such a giant in Japan's Occupation period, but giant he was and so he has remained. Theodore Cohen writes that Dodge "more than any other individual, engineered the historic tacit alliance between American and Japanese conservatives and business elements that endured for the decades that followed."[25] Yutaka Kosai assesses the Dodge contributions in strictly economic terms: "(1) an end to the postwar inflation, (2) a return to world markets, and (3) the revival of a free economy."[26] In 1962, during the premiership of Hayato Ikeda of "national income doubling" fame, Japan decorated Dodge with the highest honor given to foreigners, the Order of the Rising Sun, First Class.[27] (As finance minister in the Occupation Ikeda had worked closely with Dodge and had developed keen respect.) As one of the very few dissenters from the near-adulation in which many hold Dodge, one wonders whether Dodge's stature would have remained so great if the Korean War had not broken out in 1950 with its huge infusion of demand a year after the adoption of his draconian measures.

Earlier we noted Ishibashi's effort to follow Keynesian prescriptions in coping with the inflationary situation of the beginning postwar years. Subsequently, for three months, December 1956 to February 1957, Ishibashi was prime minister

[23] Dick K. Nanto, "Dodge Line," in *Kodansha Encyclopedia of Japan* (Tokyo: Kodansha Press, 1983).

[24] Illustrative of Dodge orthodoxy was an address he made to the Japanese on the occasion of his last official visit in 1951. In it he observed that among the false legends under which Japan was suffering was the notion "that granting progressively larger amounts of commercial bank credit for capital purposes can be substituted for the normal process of capital accumulation, without creating current credit shortages and possibilities of later difficulties" (Cohen, p. 90). This, however, is exactly what Japan did for over twenty years with brilliant results during the high growth period.

In a 1952 address to bankers in New York City, Dodge employed a frequently used observation of the period: "The fundamental problem of the Japanese nation can be expressed in the simple terms of too many people, too little land and too few natural resources" (Cohen, p. 11). By contrast, Takeshi Watanabe, of the finance ministry at that time and Japan's first official postwar visitor to the United States (1950) observed to this writer a few years back that to such assessment his reply was that the same observation could be made about Manhattan Island.

[25] Theodore Cohen, *Remaking Japan* (New York: Free Press, 1987), p. 442.

[26] Kosai, *Era of High Speed Growth*, p. 67.

[27] Kindness of Consul Takao Natsume (in 1986 of Seattle) who checked with foreign ministry officials in Tokyo. My request grew out of the disparity of information in published accounts.

until ill-health cut short his term of office and again he tried to apply Keynesian principles. The press reported him as saying:

> There are people who say inflation is written all over Ishibashi's face. But this does not mean I am going to put an end to positive fiscal policies. If my intention of increasing jobs until unemployment is eliminated and tripling production is thwarted, then I will resign. I became Prime Minister because I wanted to do things my way.[28]

As the foregoing makes apparent in the contest over strategies for dealing with inflation, orthodoxy was the victor.

Keynesianism in Academia

We have noted the interest in *The General Theory* at Hitotsubashi University directly upon its publication. The first translation of *The General Theory* was made by Professor Tsukumo Shionoya, a graduate of Hitotsubashi, teaching at Nagoya University[29] in December 1941. A second edition came out in 1942, but it did not become generally available until reprinted in 1949. Postwar, the American Cultural Centers provided a resource to those who were eager to discover what had been going on in the outside world during the years that Japan had been cut off. There knowledge of Keynes was acquired both from *The General Theory* itself and from the various explications of Keynes by such authors as Alvin Hansen, Paul Samuelson, Seymour Harris, Dudley Dillard, and others. However, the real diffusion of Keynesian thinking in Japan did not happen until well into the 1950s when young economists who had had Fulbrights or other fellowships returned to Japan to take up teaching posts.

Although Marxist thought has been prevalent among Japan's economists, not all universities shared in the strong Marxist tradition. Hitotsubashi University offered classical economics from its beginning while Keio University, which had had a businessman/educator as its founder and a strong tradition in classical economics, found its postwar economics department a mixture of classical and Marxist. Osaka University set up its separate economics department (it previ-

[28] Kosai, *Era of High Speed Growth*, pp. 101–2, where it is shown to be taken from the Nihon Keizai Shimbun, December 15, 1956.

[29] Hamada, "Impact of the General Theory," p. 451; and Kazuo Sato in correspondence. Shionoya's son, Yuichi Shionoya, dean of the economics faculty, Hitotsubashi University, who has translated the *Collected Works of John Maynard Keynes*, kindly answered a number of questions for me.

ously had been part of law and politics) just after World War II specifically for the purpose of having a non-Marxist department and it has so remained.[30]

Economists in Academia and Government

In Japan a dichotomy exists between economists in academia and government.[31] The former are termed *keizaigakusha*, the latter *ekonomisuto*, a transliteration of "economist." Unlike the pattern observed in the United States and Europe where academic economists enter and withdraw from government, academic and government economists in Japan are on quite separate paths. In Japan government service is extremely prestigious. One enters the elite career track only by passing an exceedingly stiff examination in both a particular field and general knowledge. One of the fields in which a candidate may present himself is economics, although most successful candidates have majored in law. Once on board, these career officials are trained as generalists and they operate as generalists moving every two years to different positions within their ministry or agency to gain a better sense of the whole. For those from the economic examination, the ministry may offer a year's internal training in economics and four or five of the strongest performers may be sent abroad for further training, perhaps two to the United States, two to England, one to France.[32] Following their training they move as generalists within the ministry.

The one agency of the Japanese government where economists constitute virtually the entire staff is the Economic Planning Agency which, as we noted earlier, is responsible for producing national income statistics and other key economic statistics as well as developing the country's "economic plans." The plans based on France's system of *planification indicative*, make projections of the economy's growth performance, set goals, and indicate sectors requiring special attention.[33] When performance is not in accordance with the plan, the latter is adjusted. The country is currently on its tenth plan and work is already underway for a new plan for 1988–1992. The agency has had a difficult time asserting its views within the broader circles of Japanese policy making. Only since the late 1970s has an insider been eligible for the top career position in the agency.

[30] Kazuo Sato in correspondence.

[31] Ryutaro Komiya and Kozo Yamamoto, "Japan: The Officer in Charge of Economic Affairs," *History of Political Economy*, 13, 3 (1981), pp. 600–28.

[32] Yoshihiko Morozumi kindly reviewed an early draft as well as sending it over to MITI for comment.

[33] For a discussion and assessment of the Economic Planning Agency's process of making plans, see Yutaka Kosai, "The Politics of Economic Management," in Kozo Yamamura and Yasukichi Yasuba, eds, *The Political Economy of Japan* (Stanford University Press, 1987), esp. pp. 564–68.

Previously this post alternated between representatives from the ministry of finance and the ministry of international trade and industry.

While academic economists do not take positions in government in the Western manner, this is not to say their views do not influence public policy. Not only do they serve as consultants on the innumerable advisory commissions that postwar governments have come to employ, but they also write articles for newspapers and appear on television. In fact, the circle of informed opinion on technical matters in Japan is broader than that found in the United States.

The Role of Keynesianism in Reconstruction and High Growth

Neither academic nor government economists played a major role in Japan's high growth strategy. That strategy was the product of talented bureaucrats and business representatives working together largely on the basis of empirical evidence. The growth performance of the Japanese economy up to the 1974 oil crisis stands out among all nations. It was over two-and-a-half times that of the United States, three-quarters above that of France, and four-fifths above that of Germany.

The Japanese do not speak of "high growth" until after regaining prewar levels of GNP in 1953, but as table 11.1 indicates, real growth rates in the reconstruction period, when the country was experiencing dramatic reforms, were of the same scale as the country experienced up to 1974. Apart from the two periods, 1946–1950 and 1971–1975, inflation was also kept within bounds. However, the most striking feature in table 11.1 is the effect of growth on the labor supply. Oversupply of labor has been the hallmark of Asia. Like the continent, Japan was plagued by this problem from the beginning of its modernization in 1868 up to the 1960s. By the 1960s, however, high growth had even produced labor shortages, a truly historic change.

Japan's high postwar growth rates were marked by cycles. The expansionary phase of each cycle was produced by successive waves of private investment. Until the latter 1960s, the expansionary phase was halted each time by restrictive monetary policy as the economy, with its tendency for imports to exceed exports, bumped against a balance-of-payment ceiling. Under such policy the growth rate would slow to a mere 5 or 6 percent, imports would be brought into alignment with exports, and then with monetary ease, investment would again take off.

Factors in High Growth

In 1945 Japan's dream of a "New Order in Greater East Asia" lay in ashes, foreign troops occupied its soil, and its economy was in ruins. The constitution

TABLE 11.1 Summary of Reconstruction and Growth

	Reconstruction Period		Rapid Growth Period		Adjustment Period		Stable Growth Period	
	1946–50	1951–55	1956–60	1961–65	1966–70	1971–75	1974–80	1981–85
Economic growth rate (%)	9.4	10.9	8.7	9.7	12.2	5.1	5.1	4.4
Rate of price increase (CPI, %)	44.4	6.3	1.5	6.1	5.4	11.5	6.4	2.7
Unemployment rate (%)	1.0	1.7	2.0	1.3	1.2	1.4	2.1	2.5
Balance of payment ($ millions)								
Current balance	634	524	115	−1358	6201	6912	1933	25,222
Trade balance	−939	−1963	468	1955	13,626	26,990	11,268	35,388
Growth conditions	Recon-struction	Inde-pendence	Technological revolution, Modernization		Emergence of superpower	Yen re-valuation, oil crisis	Adjust-ment	Stable growth
Prices	Postwar inflation	Inflation-ary dis-turbances	Stability	Produc-tivity dif-ferential inflation	Import inflation	Hyper-inflation	Effort to stab-ilize	Stability
Labor supply	Over-supply	Over-supply	Over-supply	Short-age	Short-age	Over-supply	Equi-librium	Equi-librium
Balance of payment	Deficit	Deficit	Equi-librium	Equi-librium	Surplus	Fluc-tuating	Fluc-tuating	Surplus

Source: Yutaka Kosai, *The ERA of High Speed Growth* (University of Tokyo Press, 1986), p. 4. Reproduced by permission of the University of Tokyo Press.

drafted by the occupying forces the following year contained the MacArthur-inspired article renouncing war and armaments. Inasmuch as the world ranks nations by the size of their military establishment, how was Japan once again to take its place among nations? Slowly the perception spread that the country might do so by economic performance. As G. C. Allen commented, never was Bacon's aphorism more pertinent: "Men profiteth in that they most intend."[34]

Japan is a goal-setting society, and its virtually unanimously held goal became economic growth. When Japan overtook Germany in 1968 to become the third largest economy in the world (in 1987, it surpassed the Soviet Union), the national excitement was comparable to that found in the United States over the World Series. But in the 1960s, as pollution worsened and congestion became ever more trying, economic growth as the nation's single goal became increasingly questioned. There was more and more talk about the "quality of life." However, growth had remained the single goal for close to two decades, and, as any public administrator knows, single goals are far easier to handle than multiple ones.

Many factors contributed to the country's high growth performance, the most important of which were high private investment and high personal savings. In 1961 private fixed investment reached 24.3 percent of GNP and, if government investment is added, fixed investment was 33.9 percent.[35] Saving was strongly encouraged. In 1960 personal saving as a percent of disposable income reached 17.4 percent.[36] Another factor in the growth performance was Japan's low capital/output ratio.[37] This ratio now resembles that of other countries, but in the high growth years it gave Japan a real advantage.

To produce the high growth, investment was guided into high value-added industries which were income elastic. As Terutomo Ozawa observed in the late 1970s: "No other industrial country . . . is so bent on transforming [its] industrial structure as is Japan."[38] Measured in terms of the value of industrial production, textiles between 1954 and 1977 declined from 18.5 percent to 4.8 percent; machinery rose from 13.6 percent to 23.2 percent; and transportation equipment increased from 6.2 percent to 11 percent.[39] To meet the labor requirement of the huge industrial expansion Japan did not use guest workers. Extra workers came from the primary sector which declined as a percentage of total employment be-

[34] Allen, *Japanese Economy*, p. 22.

[35] Hadley, *Antitrust in Japan*, p. 418.

[36] Kosai, *Era of High Speed Growth*, p. 10.

[37] Ibid., p. 5.

[38] Terutomo Ozawa, *Multinationalism, Japanese Style* (Princeton: Princeton University Press, 1979), p. 234.

[39] Allen, *Japanese Economy*, p. 161.

tween 1950 and 1975 from 48.5 percent to 13.9 percent.[40] Even the latter figure greatly overstated employment in the primary sector because only a fraction of agricultural workers were full-time.

How were specific industries chosen? Selection was through the efforts of business leaders and MITI officials with key support from the Ministry of Finance working together to guess at what would be the most propitious industrial strategy for Japan. Judgments were based on the performance of industries in other economies. MITI's "visions" have been replete with inducements; "shalt nots" have been absent.

The inducements were: (1) access to commercial bank credit; (2) access to government credit; (3) access to foreign exchange; (4) government assistance in negotiating import of privately selected foreign technology; (5) protection in the home market from "cheap" foreign goods through high tariffs, multiple varieties of nontariff barriers (NTBs), and severe restrictions on foreign investment; and (6) ranging tax concessions. In reporting on government measures, one can lose perspective and conclude that government policy was the critical determinant. However, if the Japanese economy had not been so intensely competitive and if labor/management relations had not been satisfactorily resolved, government measures could not have had the impact that they did.

In a market economy it sounds odd to speak of "access" to commercial bank credit or government credit, but only very recently in Japan have interest rates begun to be market determined. During the era of high growth, interest rates were held below market-clearing levels and hence had to be rationed. Similarly, the private sector's desire for foreign exchange considerably exceeded supply so that foreign exchange was also rationed. Under rationing, preference was given to the industries the government was attempting to "grow." As the foregoing account of policies during the period of high growth makes evident, policies were oriented to supply management.

Deficit Financing and Keynesianism

It was only in 1965 that Japan broke with close to twenty years of balanced budgets and resorted to issuance of bonds. That year the growth rate fell to 4.7 percent from 13.7 in 1964 and 10.5 in 1963. As John Creighton Campbell has explained, Japan's guidelines for budgetary policy up to 1965, the principle of "budget balance" as it was called, was that budgets should grow only in accordance with the growth rate of the economy. With an "on average" 10 percent

[40] Kazuo Nukazawa, *Japan's Emerging Service Economy* (Rockefeller Foundation, Working Paper, 1980), pp. 2–3.

per annum growth rate in these years, this gave the government ample opportunity to expand programs and/or cut taxes. If budgets grew faster they would be stimulative, if slower, restrictive. He observes that this implies "either that a larger government sector in the economy increases economic activity, or that, more dynamically, an expansion in the government sector from one level to another will stimulate the economy in the short run no matter how it is financed."[41] Thus it is the expenditure side of the budget to which attention is directed, not the relationship between expenditure and revenue nor the relationship between savings and investment in the economy.

After close to twenty years of balance between expenditure and revenue (i.e., ex post balance since the growth rate was consistently underestimated), why did the government finally depart from this principle? The answer is not altogether clear, but in 1965 Japan found itself facing a new set of international challenges. As the drafter of the Business International Report from the 1965 Tokyo meeting expressed it, the prospect of these challenges was accompanied by "torrents of self pity and forebodings of doom."[42] In 1964 Japan's status at the International Monetary Fund (IMF) changed to that of an "Article VIII" nation. Because the Fund and GATT (General Agreement on Tariffs and Trade) are linked, becoming an Article VIII nation meant that Japan became an Article XI nation in the GATT, losing the right quantitatively to restrict imports (the justification of this article being balance of payments). Furthermore, 1965 followed the year in which Japan became a member of OECD (Organization for Economic Cooperation and Development) when she had been obliged to sign the code for the Liberalization of Capital Movements. While Japan signed the code with an altogether exceptional number of reservations, nevertheless the path ahead was clear.[43] In addition the "Kennedy Round" of GATT negotiations was then in progress (1964–1967) and threatening Japan's high tariffs. For major countries, the Kennedy Round reduced tariffs on industrial products by 35 percent on average.[44] Clearly the government was on a course leading to the loss of its key postwar controls: quantitative restraints on imports, high tariffs, allocation of foreign exchange, and control of capital movements. In this environment it responded to appeals to stimulate the economy. But there was another factor at work as well.

The near-complete consensus on growth among Japan's citizens held to the mid-1960s, but as the scale of pollution and congestion built up, increasing num-

[41] John Creighton Campbell, *Contemporary Japanese Budget Politics* (Berkeley: University of California Press, 1977), p. 80.

[42] Business International, *Japan*, November 28–December 4, 1965, p. 28.

[43] For the tempo employed in carrying out this obligation, see Kosai, *Era of High Speed Growth*, p. 166.

[44] United States Tariff Commission, *Operation of the Trade Agreements Program*, 19th Report, 1967, published 1969, "The Kennedy Round," pp. 236–63, esp. figure 7, p. 257.

bers of Japanese began pressing for cleaner air, streets with sidewalks, more adequate housing, flush toilets, more park space, and adequate social security. The conservative party that ruled postwar Japan (with trivial exception), the LDP (Liberal-Democratic Party), was not immediately responsive, but election results soon persuaded it to think in broader terms. Its strength declined to the point that it needed the support of independents to retain control of the Diet.[45]

T. J. Pempel has described Japan's conservatism as "creative conservatism," by which he means that Japanese conservatives are not ideologically rigid but adapt their positions as the polls dictate.[46] If the party is losing strength to the opposition, it takes over the opposition's position. Thus, the LDP came in the late 1960s and early 1970s to concede that Japan could afford more adequate social security, national health insurance, and funds for housing.

Kozo Yamamura quotes the Economic Planning Agency in its 1964 economic survey of Japan as admitting that "the benefits per capita of social security in Japan, based on studies by the International Labor Organization are still low compared with other countries." For example, in France in 1957 they were $152, in West Germany, $148, and Italy, $58, but in Japan in 1962 merely $26. In 1960 the ratio of transfer payments to national income was 15.7 for France, 14.5 for Italy, but in 1962 only 5 percent for Japan.[47] In the early 1970s, the contributions from the general account to the two trust funds governing social security showed sharp growth—22.5 percent in 1972, 35.4 percent in 1973, and 52.3 percent in 1974.[48]

Thus seemingly it was both in consequence of unsureness as to how the economy would perform in an international environment when losing key controls and in response to the pressure for much greater welfare expenditure that Japan resorted to deficit financing in 1965. As table 11.2 indicates, the experiment was begun cautiously, expanded in 1966 and 1967 in high growth, and reduced in 1968 and 1969 as high growth continued. The deficit program expanded again in 1971–1974 but was kept within moderate proportions even in the face of 1974's negative growth, obviously out of fear of inflationary consequences. It is in 1975 that the reliance on sizeable deficit financing begins. Table 11.2 brings together central government bond issues as a proxy for its deficit financing (other sources

[45] T. J. Pempel, *Japan, Creative Conservatism* (Philadelphia: Temple University Press), 1982.

[46] For statistics on the decline of the LDP's dominance of the Japanese Diet, see Kozo Yamamura, "The Cost of Rapid Growth and Capitalist Democracy in Japan," in Leon N. Lindberg and Charles S. Maier, eds., *The Politics of Inflation and Economic Stagnation* (Washington, D.C.: Brookings Institution, 1985), p. 482.

[47] Yamamura, *Economic Policy in Postwar Japan*, p. 186.

[48] For a table showing budgeted spending by category, 1970–1986, see Edward J. Lincoln, *Japan, Facing Economic Maturity* (Washington, D.C.: Brookings Institution, 1987), pp. 94–95.

TABLE 11.2 Bond Issues, 1965–1975

Year	Bond/Exp.	GNP Growth	WPI	CPI
1965	5.2	5.9	100.0	100.0
1966	14.9	10.9	102.4	105.4
1967	13.8	12.5	104.3	109.2
1968	7.7	14.0	105.1	115.1
1969	5.9	12.2	107.4	121.1
1970	4.9	11.8	111.3	130.3
1971	12.4	5.2	110.4	138.2
1972	16.3	9.5	111.3	144.5
1973	12.0	10.0	129.0	161.6
1974	11.3	−0.5	169.4	200.9
1975	25.3	1.4	174.5	224.7

Sources: Bond issue statistics, OECD, *Japan Economic Survey*, July 1977, p. 44; GNP Growth statistics, Raymond W. Goldsmith, *The Financial Development of Japan, 1868–1977* (Yale University Press, 1983), p. 149; WPI and CPI indexes, ibid. p. 151.

being short-term securities and borrowings), GNP growth rates, and the performance of the wholesale and consumer price indexes.[49]

For the years 1976–1985 deficits as a percent of expenditures in the general account are presented in table 11.3 together with the growth performance of the economy and price movements. From 1976 to 1981 deficits as a percentage of expenditure were above 30 percent and, in 1979, deficits as a proportion of GNP even reached 6.1 percent! Since that year, governments have been attempting to rein in the deficits. Apart from inflation in 1980 following the second oil shock, prices in the Japanese economy have been fairly stable despite budget deficits of such size—a commentary on the scale of saving in the economy.

Finally, a third factor has been important to Japanese deficits. In the years since the 1974 oil shock Japan's growth rate has been reduced to less than half of what it had been—as was that of the other leading countries. Viewing the slowdown in growth as a cyclical phenomenon, the secretariat of the OECD propounded the "locomotive theory" in 1976 according to which the three leading economies—the United States, Japan, and Germany—would be asked to stimulate their economies through monetary and fiscal policies and pull other economies out of the 1974–1975 world recession. Japan was unenthusiastic but, under strong U.S. pressure, went along, as did a reluctant Germany. Leon Hollerman observes that the secretariat argued "that such [stimulative] policies would not be inflationary because of the existence of unutilized productive capacity in the

[49] For central government debts outstanding by type and government debt by type and holder, see ibid., pp. 40, 142–43.

TABLE 11.3 Ratio of Deficit to Expenditure, 1976–1985

Year	Def/Expend.	Def/GNP	GNP Growth	Wholesale p.	Consumer p.
1976	29.4	4.3	4.8	5.0	9.3
1977	32.9	5.2	5.3	1.9	8.1
1978	31.3	5.2	5.2	−2.5	3.8
1979	34.7	6.1	5.3	7.9	3.6
1980	32.6	5.9	4.3	17.8	8.0
1981	27.5	5.0	3.7	1.4	4.9
1982	29.7	5.2	3.1	1.8	2.7
1983	26.6	4.8	3.2	−2.2	1.9
1984	24.8	4.3	5.1	−0.3	2.2
1985			4.7	−1.1	2.1

Sources: Deficit ratios to expenditure and GNP, Edward J. Lincoln, *Japan, Facing Economic Maturity* (Brookings Institution, 1987), p. 93; GNP real growth, ibid., p. 39; wholesale and consumer price movements, Japan Economic Institute, Yearbook of U.S.–Japan Economic Relations. For the years 1976–1980, the 1980 Yearbook; for the years 1981–1985, the 1984–85 Yearbook.

leading countries.''[50] Viewing the policies retrospectively, the Industrial Bank of Japan wrote:

> At that time, our financial position was sound because of little fiscal dependence on national bonds. So in line with President Carter's locomotive theory, fiscal policy was used to stimulate domestic demand, while overseas, America's expansionary economic policy encouraged the recycling of oil money into developing countries to create a development boom, which in turn helped to increase exports of Japanese industrial goods. Thus the Japanese economy was helped tremendously by Carter's ''locomotive theory'' and by the development investment boom in the developing countries.[51]

CONCLUSION

In Japan's case the OPEC shocks occurred at a time when the economy was in the process of fundamental change from an era of high growth to lower, more moderate growth. As outlined above, the conditions making for high growth no longer exist. Yet the pattern of high personal savings, so encouraged in high growth, persists, with the result that, during much of the 1970s and 1980s, savings have been substantially in excess of investment. In such a situation one solution

[50] Leon Hollerman, *Japan Disincorporated* (Stanford: Hoover Institution Press, 1988), p. 158.

[51] Cited by Hollerman, *Japan Disincorporated*, p. 158.

is based on high net exports, which trading partners find difficult. Another solution in combination with the first lies in substantial capital outflows. Still another solution is greater government investment but for stimulative purposes this entails greater deficits. However, an increasing range of voices are calling on the Japanese to enjoy the fruits of their hard-won GNP, not to feel they have to save so heavily.

The 1986 Maekawa report to the prime minister recommended reordering priorities so that growth would rely on the domestic market with much less emphasis on exports. Big changes take time to effect. Given continuing enormous trade surpluses and large capital outflows, it is clear the new priorities have not yet been achieved. Notwithstanding savings in excess of investments, governments continue to try to reduce Japan's very large public deficit.

What does one conclude with respect to the diffusion of Keynesian ideas in Japan? Keynesian analysis is a fundamental part of economics training in Japan, but from this brief review of public policy, both in the high growth era and since the OPEC shocks, it is clear that its impact on public policy has not been strong.

12

KEYNESIANISM AND THE SCANDINAVIAN MODELS OF ECONOMIC POLICY

Jukka Pekkarinen

THE RELATIONS between economic theory, economic policy, and economic development are complex. The most common perception of this triangle of interactions derives from the conventional Keynesian view best represented by Keynes' famous description of politicians as the slaves of some defunct economist. According to this view, economic policy is capable of molding economic development quite strongly. But economic policy makers, in turn, are heavily dependent on the advice of economists when choosing policy moves. Consequently, economic theory assumes a key role. This chapter takes as its starting point this Keynesian view which, in its strong version, sees a unilateral chain of influence from economic theory through economic policy to the economy. We must not deny outright the existence of such a chain of influence, but recognize that it is conditioned by a set of crucial economic-structural, institutional, ideological, and political intervening variables which are too often neglected by economists. A study from an economist's point of view of the role of these intervening variables in the diffusion of economic ideas is the main aim of this chapter.

These intervening variables are investigated in a limited context, that of the Nordic economies. Contrary to what one might suppose, economic policies in the different Nordic countries display clear and systematic differences that call into question the notion of a common Scandinavian model. But at the same time the Nordic countries are similar enough with respect to economic structures, institutions, and ideological and political traditions that the variables that might explain systematic differences in their economic policies can be identified relatively clearly. This chapter will also show that the comparison of economic policies in the Nordic countries is enriched by the inclusion of Finland, usually the least familiar among them. With respect to the topic of this volume, Finland forms an intriguing negative case that to a great extent has resisted Keynesian countercyclical policies. I shall deliberately emphasize the contrast between Finland and Sweden, a country which developed Keynesian economic policies relatively early, treating Norway and Denmark as intermediate cases. I interpret Keynesian policy in a narrow sense to mean countercyclical demand management, not the interventionist stance of economic policies in general. It is from this point of view that differences between the Nordic countries stand out clearly, although they all have been more or less interventionist in their economic policies in a broad sense of the term.

The Conceptual Framework

There is a certain tension, or lack of correspondence, between economic policy debates within an intellectual community of economists on the one hand, and within the broader national policy arena, on the other. These two intellectual communities consist of different types of people. The former is made up of professional economists, while the latter includes a looser group of politicians, civil servants, interest organizations, the press, and the general public (and also some economists in their capacity as members of these groups). These two communities conceive of the scope, targets, constraints, tools, and evaluationary criteria of economic policy in different ways. But the relation between them varies among countries and across time; and we are particularly concerned with the determinants of this relationship.

Tension between economic theory and economic policy has been accentuated by the internationalization of economic theory and especially by the spread of the neoclassical synthesis in the postwar period. The neoclassical synthesis conceives the central task of macroeconomic policy as the stabilization of aggregate demand, utilizing the tools of fiscal and monetary policy. What will concern us is how this message was received in different Nordic countries where Keynesian economics was to some extent imported from abroad and forced to communicate with national policy issues.

To understand the tension between the neoclassical synthesis and traditional domestic policy concerns we shall need some new concepts. We can start with the observation that since the 1930s all industrial societies, in one way or another, have accepted the premise that the national economy has to be managed, that is, that the formulation and implementation of national economic strategy is one of the central tasks of government. This premise has been particularly marked in small, open economies, like the Nordic ones, where the whole existence of a national state is largely based on economic performance. Hence Keynesianism met, in these countries, a relatively established national framework of ideas concerning economic policy. In what follows we refer to this inherited framework of ideas as a national policy model. This policy model defines the broad boundaries of the policy agenda in each country: what types of economic problems are to be solved by economic policy intervention and what tools are to be used. It does not necessarily imply any detailed policy scheme, but rather identifies the main orientation of views on economic policy in each country.

The concept of a policy model is made more concrete in the context of specific Nordic cases below. Here we need only consider some of its general features and a number of factors that tend to affect the character of each national model.

The policy model is tied to the broad economic-structural, cultural, political, and institutional setting of each country. It is not the kind of closely specified conceptual framework that is characteristically developed by economists. Rather, it consists of a more diffuse set of cultural biases that delimit the agenda of economic policy making. Professional economists who rely on international economic theories can meet serious problems of communication with these diffuse, and yet powerful, policy models. If hostile to the policy views implied by an economic theory, the policy model usually does not generate an analytic argument but rather a broad consensus that the economic theory is "unrealistic" or "irrelevant."

The policy model is nationally specific. No matter how similar the actual economic development of different capitalist countries, the style of argumentation about economic policy and the corresponding balance among policy measures still differ remarkably from one country to another.

A national policy model implies some degree of nationwide coherence: to some extent there is a common framework to all parts of the national economic policy debate. However, this does not mean that disagreements never arise. As policy measures affect various groups in different ways, conflicts appear. But even so, the boundaries of the economic policy agenda, that is to say, what can and cannot be accomplished by economic policy, and consequently what are seen as legitimate claims on policy, remain relatively fixed. Different groups tend to rationalize their adherence to the policy model in their own specific way, one they find appealing. The national policy model is consequently sustained by several "satellite models" through which it is communicated to groups with diverse interests.

The national economic policy model is created out of the broad economic-structural, cultural, social, and institutional context of each country. Several factors in this historical legacy seem especially important.

Concerning the economic structure of each country, particular attention will be paid to the industrial structure of the economy, to its stage of development, and to the structure of foreign trade that places an external constraint on economic policy. Small, open economies of the Nordic type generally differ from the kind of economic structure implicitly assumed by an aggregative, demand-oriented Keynesian framework.

Among the ideological factors, we should pay particular attention to the way the role of the state in the economy is perceived. Keynesianism, as incorporated in the neoclassical synthesis, represents a kind of immanent critique of the laissez-faire tradition. However, this tradition has never been particularly strong in the Nordic countries, where the state has traditionally played a more active role on the supply side of the economy.

The economic structure of each country is reflected in the power structure of classes and interest groups. Many political scientists have recently emphasized the importance of this factor to the explanation of economic policy.[1] They claim that the reception of Keynesian ideas, like any national economic strategy, may depend on the relative power of different classes and interest groups. One argument in this vein suggests that a strong working class is necessary for the adoption of Keynesian policies. In this respect, the Nordic countries supply an interesting and varied picture. There are countries, like Sweden, where the Left has been strong and unified, and countries like Finland, where it has generally been weaker and, in particular, internally divided by the struggle between Social Democrats and Communists. A more nuanced view argues that Keynesian policies make possible, and in turn depend on, the achievement of a political coalition between working class interests and the agricultural sector. Without totally denying the value of this approach, I must conclude the claim that agricultural interest groups have generally contributed positively to the adoption of Keynesian policies appears dubious on the basis of evidence from some Nordic countries.

Various institutional features also figure in the creation and evolution of the policy model. Theda Skocpol and Margaret Weir have argued that the structural features of states affect the ability of a government to innovate, implement, and institutionalize different types of economic strategies.[2] In their view Sweden provides an example of a state structure that facilitated the adaptation of a kind of "social Keynesianism" linking macroeconomic management to welfare spend-

[1] See, for example, David R. Cameron, "Social Democracy, Corporatism, Labour Quiescence, and the Representation of Economic Interest in Advanced Capitalist Society," and Fritz W. Scharpf, "Economic and Institutional Constraints of Full-Employment Strategies: Sweden, Austria, and West Germany, 1973–1982," in John H. Goldthorpe, ed., *Order and Conflict in Contemporary Capitalism* (Oxford: Clarendon Press, 1984), cf. Bradford A. Lee, "The Miscarriage of Necessity and Invention: Proto-Keynesianism in the 1930s," this volume.

[2] Margaret Weir and Theda Skocpol, "State Structures and the Possibilities for 'Keynesian' Responses to the Great Depression in Sweden, Britain and the United States," in Peter Evans, Dietrich Rueschemeyer, and Theda Skocpol, eds., *Bringing the State Back In* (Cambridge: Cambridge University Press, 1985), pp. 107–163; and Margaret Weir, "Ideas and Politics: The Diffusion of Keynesianism in Britain and the United States," this volume.

ing and active labor market policies. Particular attention should be given to the status of the government bureaucracy relative to politically representative bodies: a strong bureaucracy may insulate policy from various political pressures, although it may also limit the influence of outside economic theorists over policy. From this point of view, differences in the status of the Central Bank turn out to be particularly interesting.

All of the factors mentioned above condition the influence of economic theory on the policy model. In normal conditions, when these structural factors are changing relatively slowly and the existing course of economic development is not being severely questioned, the policy model is usually relatively stagnant. In particular, it tends to become anchored to its structural determinants and immune to changes in economic theory. This does not imply that the economics profession is without influence on economic policy; but its influence is delimited by the established policy model, that is, the economists rationalize it and seek for solutions to various technical problems in the implementation of the model.

However, there are episodes when the policy model may change substantially and during which the influence of economic theory on the reorientation of economic policy may be very powerful indeed. This is the case when the policy model finds itself in a crisis, that is, the lack of correspondence between it and its structural determinants is generally noticed and economic theory has a credible alternative to offer. In fact the breakthrough of Keynesianism in many countries provides an example of this exceptional episode.

Such a crisis of the policy model can ripen gradually, when it is unable to cope with gradual changes in the economic and social environment. More illuminating, however, may be the crisis that occurs when some sudden and profound change in the environment abruptly outdates the policy model. From this point of view, the Great Depression of the 1930s opened the way to Keynesianism, but still more decisive to its breakthrough may have been the Second World War with an aftermath that meant radical economic, social, and political changes in many countries.[3]

In this chapter, we shall compare the policy models of different Nordic countries, relating the similarities and differences among the models to the economic-

[3] One may notice in the above account of the change of a policy model a certain analogy to Kuhn's well-known propositions on the development of scientific theories. Indeed, one of Kuhn's main accomplishments was to focus more attention on the social determinants of the growth of knowledge. From his point of view, the concept of a policy model directly comprises the social and economic environment that conditions the application of theories to policy. In this way it may make more explicit the external factors that indirectly figure in a Kuhn-type approach. (Naturally there remains the difference that we shall approach the interaction between science and its external environment from the point of view of the practical application of knowledge while the growth of knowledge literature is interested in the development of science itself.)

structural, cultural, political, and institutional context of each nation. In this way it is possible to acquire some information concerning the relative importance of these different background factors for the evolvement of the policy models. To begin with, however, we shall present a more basic model of a typical Nordic economy in order to contrast it with the kind of economy that Keynesian macroeconomics presupposes. We will see that there is a tension between Keynesian ideas and the Nordic environment. The latter sections will then investigate how this tension played itself out in different Nordic countries, involving either the refinement of Keynesianism or its rejection.

The Nordic Countries as Small Open Economies: A Simplified Picture

Keynes' ideas and the neoclassical synthesis they inspired reflect certain economic, ideological, and institutional circumstances that were characteristic of certain "mature" capitalist countries, like Britain and the United States. Keynes' emphasis on effective demand can be legitimized by the fact that these countries had already passed through their industrialization process and possessed a settled production structure relatively undisturbed by the war. These countries were also relatively closed in the sense that domestic demand occupied a decisive share of the markets for most branches of production. This gave demand management something to bite on. Ideologically, these countries had a strong laissez-faire tradition and a weak socialist tradition. The modern industrialized economy had come into being on its own without much perceived involvement by the state. Against this background, Keynesian demand management often seemed more immediately acceptable than direct intervention in production.

The economic, social, and ideological attributes of a typical Nordic economy stand in some contrast with this picture. As far as the economic structure is concerned, the typical Nordic economy is one that may be still in the process of industrialization. The share of investment in GDP is relatively high. Its growth and structural change are typically export-led. The economy is heavily dependent on foreign trade—not only in the sense that the share of exports and imports in GDP is large, but perhaps even more important, exports are heavily concentrated in few branches often consisting of cyclically sensitive industries like raw-materials processing. The concentration ratio for export industries is also high so that the bulk of its exports come from a small number of firms. As these big firms sell only a small share of their output on the home market, the state of domestic demand does not matter greatly to them. What matters are the domestic costs of production as a factor contributing to the profitability of exports.

This caricature forms a polar case to the picture of a mature capitalist economy described above as a suitable case for Keynesian demand management. Concentrated export industries constitute an effective pressure group emphasizing the cost side rather than the demand side of various policy measures. The cyclical sensitivity of their export industries renders the balance-of-payment constraint an effective obstacle to stabilization through the management of domestic demand. Managing changes in external economic circumstances more naturally appears as the dominant issue of national economic strategy and draws attention away from the demand side to the supply side.

This economic structure also contributes to the presence of certain ideological and political constellations in the Nordic countries that differ from those often associated with Keynesianism. As noted above, concentrated export industries usually form an active and coherent interest group. Labor is also well organized; union density is high and decision making in the trade union movement is centralized. Since employer and employee organizations tend to exercise considerable power over policy, neocorporatist forms of collective decision making often play a central role in economic issues. Furthermore, in the Nordic countries laissez-faire doctrine has not played such a prominent role as in the Anglo-Saxon world. Socialist influence has been relatively strong; and, on the bourgeois side, partly as a reflection of ideas similar to those of the German historical school, the state has been conceived and accepted as a more active force inside the economy rather than a body sitting outside the economy.

Taken together, these characteristics move attention from the demand side of the economy, which forms the focus of Keynesianism, to the supply side. People tend to think of the national economy, in a changing international environment, as an entity analogous to an individual firm whose management lies in the hands of the state and the collective organizations of employers and employees that attempt to influence it.

However, this description is only a caricature of the factors that influence Nordic policy models. As we shall see, every Nordic country differs more or less from this simplified picture. Furthermore, the structural characteristics of the Nordic economies have undergone some change. Thus, the description of an undiversified industrializing economy in an export-led growth process applies more to the economic history of the Nordic countries than to the present reality. Finland and Norway may still lie relatively close to it in some respects but Sweden moved away from it in the interwar period, and it is doubtful whether the description has ever applied to Denmark except insofar as her agricultural sector is concerned. Therefore, each Nordic country has to be investigated separately.

The Swedish Model

Social Democrats formed the cabinet in Sweden uninterruptedly from the early 1930s until the late 1970s, at times in coalition with the Agrarian party. Although the economic impact of the stabilization measures taken in the 1930s can be questioned, it is generally agreed that the Swedish government was among the first to implement the idea of countercyclical fiscal policy. It is also generally accepted that the Stockholm school, in the early 1930s, invented ideas that later came to be known as Keynesian and was able to influence the reorientation of the economic policy of the Social Democrats.[4]

In the postwar period, Sweden has been one of the most consistent appliers of countercyclical measures in economic policy. Although policy assessment is not a primary goal of this chapter, calculations based on a full employment budget surplus concept show that, for most of the period 1950–1979, Swedish fiscal policy has mainly been in a countercyclical direction. Interpreting the cyclical reactions of monetary policy by means of changes in credit supply is not as straightforward. Yet it seems that credit flows have also had mainly a countercyclical profile.[5]

Sweden's early application and further development of Keynesianism in economic policy is so well known that it need not be repeated here.[6] But certain remarks on the standard description are in order. In particular, we should note that the Swedish policy model represents the development of a specific form of

[4] The claim that Keynes' *General Theory* was nothing new to the young Swedish economists has been put forward by Myrdal and other representatives of the Stockholm school. See Gunnar Myrdal, *Against the Stream* (New York: Pantheon Books, 1973). On the other hand, Karl-Gustav Landgren has stressed the role of Keynes' writings in the late 1920s as a source of inspiration of the Swedish Social Democrats, *Den "nya ekonomin" i Sverige* (Stockholm, 1960). The debate on the relationship between Keynes and the Swedes still continues. For a recent evaluation, see Don Patinkin, *Anticipations of the General Theory?* (Chicago: University of Chicago Press, 1982).

[5] The calculations concerning the reactions of monetary and fiscal policy in Sweden are available from the author.

[6] See for example, Assar Lindbeck, *Swedish Economic Policy* (London: Macmillan, 1975); and from a somewhat different angle, Andrew Martin, "The Dynamics of Change in a Keynesian Political Economy," in Colin Crouch, ed., *State and Economy in Contemporary Capitalism* (London: Croom Helm, 1979); Rudolf Meidner, *Employee Investment Fund* (London: Allen & Unwin, 1978); W. Higgins and N. Apple-Wright, "Class Mobilization and Economic Policy: The Struggles over Full Employment in Britain and Sweden 1930–1980, *Swedish Center for Working Life, Working Papers* (1981); Gosta Esping-Andersen, *Politics Against Markets* (Princeton: Princeton University Press, 1985).

Keynesianism. First, the Swedish Social Democrats thought of aggregate demand management as a first-stage reform that would maintain full employment and thus enhance working class political power, building resources for the further development of social welfare in subsequent stages. In Sweden, Keynesian policy prescriptions were broadened early on to tackle problems of industrial structure and inflation as well as those of aggregate demand.

Hence, the postwar development of the model, as originally described by Gösta Rehn, contained a vision of the supply side.[7] It stressed rapid structural change, flexibility, and technical progress in industry as the means to maintain its competitiveness in the world market and combat inflation. Hence, the Rehn plan proposed a "solidaristic" policy, whereby all wages would follow the lead of the most successful export sectors, thereby initiating a profit squeeze that would sweep out inefficient enterprises unable to pay wages comparable to the leading branches of the open sector. Active manpower policy, control of credit flows, and taxation were to be used to alleviate employment problems inherent in the profit squeeze and to encourage the creation of new plants to replace the old, inefficient ones.

On the whole, these postwar developments in the Swedish policy model put less emphasis on active demand management; tight fiscal policy was regarded as a means to press industry to rejuvenate. But this emphasis did not exclude the countercyclical fiscal measures discussed above. Furthermore, the countercyclical character of the fiscal system was made more effective by a system of investment funds and the tax arrangements connected with them. It seems that they have succeeded in stabilizing private investment.[8]

The supply-side measures incorporated in the Swedish model were indirect (and we might even say "Keynesian") in the sense that they did not involve direct state intervention in production. In fact, state-owned enterprises have not played a significant role in Sweden except for the quite recent past. However, this kind of policy turns on a potentially fatal ambivalence toward income distribution and profits. Is not the profit squeeze a contractive factor that may lead to deindustrialization? It seems that this possibility was not sufficiently considered in the development of the Swedish model, and in the 1970s, the threat of deindustrialization appeared as an obstacle to the further development of the model. In the face of a dramatic slowdown in international trade, the formerly dynamic Swedish export sector now seemed to consist of many branches in crisis.

Second, in contrast to many forms of Keynesianism and some of Keynes' own

[7] See LO (Landsorganisationen), *Fackföreningsrörelsen och den fulla sysselsättningen* (Stockholm: LO, 1951).

[8] For an evaluation, see John Taylor, "The Swedish Investment Funds System as a Stabilization Rule," *Brookings Paper on Economic Activity*, 1 (1982), pp. 57–99.

views, the new economic policy in Sweden was not meant to be an elitist operation over which an enlightened technocracy of civil servants was to preside. From the beginning, it was conceived as a way of broadening economic democracy and of creating a method to control social conflict through economic policy. In addition to the Social Democratic party, the trade union movement has been actively involved in the development of the Swedish model, suggesting, in fact, the most important revisions concerning anti-inflationary policy and, recently, the workers' investment funds. Thus the Swedish model has been based on a broad political mobilization, and it has left the trade unions relatively free to operate in their members' interests. Consequently, income policy has not become the contentious issue in Sweden that it has in countries where narrow forms of Keynesianism have been applied. Government control over wage negotiations has become less common as methods to control wage inflation have been devised by trade unions and employers' organizations.

Finally, the Swedish policy model continues to be dynamic, partly because it has never been free of contradictions or weak points. Today, for instance, it is not clear how the control of imported inflation based on the Scandinavian model will work with a variable rate of world inflation and unstable exchange rates.[9] In this respect, the experience of the 1970s was not very satisfactory. There is also a potential conflict between the solidaristic wage policy and the need for higher profits from which to fund investment. Wage earners' funds have been suggested as a method to deal with this conflict;[10] so far, however, their role has been negligible.

Similarly, the balance of payment is a potential weak spot in the Swedish policy model. Either by accident or as the result of certain structural characteristics of the Swedish economy, Swedish exports and imports have normally been quite closely synchronized so that serious balance-of-payment problems have been rare. That does not seem to have been attributable to the intrinsic virtues of Swedish economic policy. Indeed, it was during more serious balance-of-payment crises, at the end of the 1940s or 1960s and at the turn of the last decade, that the Swedish model has come under stress. In these conditions the government has been inclined to adopt traditional stop-go measures to maintain the external balance or beggar-thy-neighbor policies to increase its room for maneuver through big devaluations. These have, in turn, strained relations between the So-

[9] In Sweden, the Scandinavian model of inflation is presented in G. Edgren, K. Faxen, and G. Odhner, "Wages, Growth and the Distribution of Income," *Swedish Journal of Economics* 71 (1969).

[10] Meidner, *Employee Investment Fund*.

cial Democratic government and the trade unions, a central pillar of the political consensus which is also a key feature of the Swedish model. By and large, recent changes in the external conditions facing the Swedish economy and in the policy orientation of Swedish governments have been so great that the basic parameters of the old Swedish model may now be called into question.

A given policy model tends to become a nationwide frame of reference. It seems that even in Sweden all the participants in the economic policy debate have been more or less anchored to the same national model, although the model was implemented by the Social Democrats and has been particularly strongly associated with their objectives. The last nonsocialist government in Sweden was not ready to give up the Swedish model; it simply reduced it to more narrow Keynesian lines. In international terms, it was indeed remarkable that the bourgeois government maintained practically full employment despite structural problems in Swedish industry that were far more serious than in many other countries which readily gave up the full employment goal. It was then left to the present Social Democratic government to launch measures, like a large devaluation and a squeeze on real wage costs, that depart from the old Swedish model.

Around the time of the Second World War, the policy model and theoretical developments in economics progressed hand in hand. It is an open question which played the more active role. Some have argued that the new policy directions of the 1930s had a strong political appeal, independent of economists' writings[11] and that later on, as further developments of the Swedish model were proposed by the Social Democrats, economists normally opposed them.[12] On the other hand, Swedish economists were closely involved in the economic policy debate of the 1930s and many of the new proposals were formulated by economists close to the labor movement. This fruitful interaction between economists and politicians, however, gradually disappeared during the postwar period. Economists turned to foreign influences and the theoretical background of the policy model was left stagnant. In fact, by the 1970s it seemed that a majority of Swedish economists had become highly critical of it. Thus the Swedish case broadly conforms to our thesis concerning the relation between theoretical developments and the policy model. Economic crisis opened the way for the former's influence on the latter, which then became more independent over time until the next crisis arose.

[11] See, for example, Myrdal, *Against the Stream*.

[12] This has been forcefully argued by Villy Bergström in "Svenska ekonomer och arbetarrörelsen," in Jan Herin and Lars Werin, eds., *Ekonomisk debatt och ekonomisk politik* (Lund: Liber Förlag, 1977).

The Finnish Model

A major portion of this chapter will be devoted to an analysis of the Finnish case which is little known and particularly interesting from this point of view. The Finnish policy model can be considered an extreme non-Keynesian case, marked by a narrow emphasis on cost and supply factors. As a consequence of this approach to policy and the instability of the raw materials-intensive foreign sector, the Finnish economy has been one of the most unstable among the OECD countries. Yet, at the same time, its long-run growth performance has been good.

The Finnish model also provides a good example of a situation in which the interaction between economic theory and the policy model is almost totally absent. The economic science taught and discussed in Finland has, for the most part, closely followed the mainstream of international developments. As early as the 1930s, the new economic theorizing, later labelled the "Keynesian revolution," was noticed in Finnish economic science. We must emphasize, however, the Swedish and Scandinavian connections. The Stockholm school was read before Keynes, and only after the war did Keynes' name begin to dominate economists' discussions. By the end of the 1950s, Finnish economic theory was already firmly based on Keynesian lines of thought. The special characteristics of the Finnish economy, however, presented obstacles to the implementation of these principles. Thus the policy model was insulated from the theory model.

The Finnish Policy Model

The structural context for Finnish policy—a small and open economy under a process of structural change, and an economic discipline conducted along Stockholmian-Keynesian lines—is not very different from that of the Nordic economies described above. Accordingly, one would expect to find a policy model somewhat similar to that of Sweden or her Scandinavian neighbors, in which Keynesian ideas were prominent but where some attention would also be paid to problems of supply. The traditionally close cultural ties between Sweden and Finland should have made that outcome even more likely. What emerged after the war, however, was a policy model that had little to do with the Keynesian ideas of demand management.

Instead, the Finnish policy model has displayed a rather one-sided emphasis on supply, cost, and competitiveness factors, which relies on some pre-Keynesian elements, such as the quantity theory of money, and never abandoned the principle of sound finance. Thus, the Finnish policy model seems to have drawn little from postwar economic science. Indeed, even the model itself has remained somewhat opaque, never clearly spelled out by economists or policy makers.

Essentially, the model stems from the interwar era, and since then it has been part of the national culture, showing remarkable continuity even during sharp political upheavals.

The continuity of the Finnish policy model in part reflects the strong position of the bureaucracy in Finnish policy making. Cabinets have traditionally been very short-lived, and since they have been constituted either by a minority in parliament or by internally weak coalitions, the role of the bureaucracy has been enhanced. The Finnish policy model has largely been a result of the bureaucracy's daily routines of policy preparation and implementation. Because there are no authoritative documents outlining the Finnish policy model, our interpretation of it has to be built, to a greater extent than would otherwise be desirable, on regularities in actual policy reactions.

Let us look, first, at the historical background of the Finnish model, and then at its actual substance. Before the Second World War, Finnish economic policy was conservative and orthodox. The Depression of the 1930s was seen as a natural adjustment process in which economic policy should remain passive. Financial markets were kept tight and fiscal policy was ruled by sound finance. There were no significant political differences over this basic policy line. The new ideas of the Stockholm school had not yet reached economic policy discussion in Finland. Any critics of the deflationary policy concentrated on monetary policy and made no use of the new theoretical tools.

It is useful to remember that during the interwar period political hegemony in Finland was firmly bourgeois, after the "white" side had defeated the working class in the 1918 civil war. The labor movement was weak, communist action had been banned, and employers used repressive measures against trade unions. At the beginning of the 1930s, there was even some danger of a right-wing coup, but that was crushed. In 1937, a coalition government of the Social Democratic party and the Agrarian Centre was formed. By that time the economy was already recovering.

The two decades following the war were a potentially formative period in which there could have been a break in the conservative economic policy tradition. As noted above, many Finnish economists had by that time assimilated the Keynesian ideas of contracyclical policy. There was also a clear shift in political hegemony. The labor movement had gained new strength, although it was bitterly divided into Social Democrats and communists. The major right-wing party lost most of its influence with the new foreign policy orientation. In the latter half of the 1940s, the Communists, Social Democrats, and Agrarian Centre formed a coalition government. After 1948 the Communists' position was weakened, and since then, the Social Democrats and the Centre have been prominent in Finnish politics.

Furthermore, the war had meant in Finland—as in many other countries—more extensive governmental intervention in the economy. Extensive rationing and planning were applied during the war and, after the war, the state played a strategic role in the resettlement of the Carelian refugees and the organization of production to pay for war reparations to the Soviet Union. The development of the productive structure and the fostering of necessary investment were seen as the main economic policy goals at that time. State-owned companies were established, and the metal industry, which has since become an important export industry, was created mainly through state initiatives designed to cover the war reparations. In this new political context, new welfare programs were also started. All in all, the public sector remained large after the war, and both economic and social policies were interventionist. But, as we shall see, interventionism was not applied to stabilization.

The anti-Keynesian character of the Finnish policy model is most obvious in the trajectory of fiscal policy, the area in which Keynesian initiatives were generally concentrated. Even in the postwar period, Finnish fiscal policy has continuously relied on the principle of sound finance. What is more, the state has run, until recently, a financial surplus, that is, the budget surplus has been positive throughout. This results from attempts to balance the budget without loan financing even though the state's own financial investments are counted like current expenditures. In the same spirit, emphasis has been placed on the need to enhance the competitiveness of industry by curtailing its costs through fiscal measures. Loan financing has been avoided, and the crowding-out effects of fiscal policy have been underlined although the official lines of argumentation have been far from consistent. One can, however, discern a line of argument in accordance with the old British treasury view: every penny loaned by the state diminishes private economic activity by the same amount. Given the target of a balanced budget, only a few selective measures have been employed to deal with cyclical unemployment. Hence, Finnish fiscal policy has tended to reinforce rather than counterbalance the underlying cycles of the economy, especially in the 1950s.[13]

Interestingly enough, this model of fiscal policy has never been systematically articulated, and so the arguments used to defend its elements are often contradictory. Thus, for example, the discussion concerning government borrowing is based on a line of thought very similar to the quantity theory of money, while the effects of taxation have often been described in terms of some kind of cost-push inflation theory. Similarly, the endeavor to balance budgets without borrowing

[13] The procyclical reaction of the Finnish fiscal policy in the postwar period is well borne out by a full employment surplus calculation presented in Jukka Pekkarinen and Juhana Vartiainen, "Keynesianism and National Models of Economic Discussion Policy," University of Helsinki, Department of Economics, Discussion Papers 203 (1983).

has been justified with widely varying lines of reasoning: in some cases, the crowding-out effects of government expenditure or borrowing have been emphasized, while others have been based on a political attempt to limit the growth of the public sector. Flying in the face of principles of demand management, it also seems that in the traditional Finnish analysis of fiscal policy, the structure of the budget has been emphasized rather than its overall balance.

A central institutional feature behind the Finnish policy model is a strong and independent monetary authority, the Bank of Finland. Legally it is subject to parliamentary control, but this is largely retrospective in nature, and the governors of the bank enjoy unlimited tenure in office. In general, legislation stresses the independence of the Central Bank in its relations to the government.

The Bank of Finland has played a major role in maintaining the continuity of the Finnish policy model at a political and institutional level. It has virtually controlled fiscal policy so as to oppose the growth of state expenditure and hamper attempts to implement more countercyclical budgeting. This has been made possible by the fact that, in Finland, facilities for government borrowing from the public have until quite recently remained underdeveloped, and the Central Bank has declined to finance public expenditure directly. As a result, the state has largely been seen as an economic agent comparable to any private one, operating under a borrowing constraint often even more severe than that of other agents. During the past two decades the prominent role of the Bank of Finland has also been enhanced by the control that it exercises over exchange rate policy.

Monetary policy has not been straightforwardly procyclical in Finland, but even here there has been no effective intervention to even out cyclical fluctuations. Traditionally, the regulation of the terms of commercial banks' Central Bank debt has been the most important tool of monetary policy. Since Finland has had no important market for short-term financial assets, open market operations have not been used. The role of the deposit banks as mediators of finance has been crucial, and there have been marked cycles in credit expansion due to fluctuations in currency reserves and consequently in deposits. During the 1950s and the 1960s, the Central Bank tried, to some extent, to offset these swings in reserves by changing the availability of Central Bank debt to the banks, but this policy instrument was far too weak to bear on the credit cycle in an efficient way.[14] During upswings, as export incomes flooded in, the banks were able to expand loans swiftly without using Central Bank debt, and when a downswing came, the Central Bank could not force the banks to expand credit when demand for loans was low. Cash reserve ratio policy would have been a natural addition

[14] Even during periods when the availability of Central Bank credit could have been a binding constraint on banks, the monetary authority was rather shy in using it decisively, partly because it did not want to disrupt depositors' confidence or the profitability of the banks.

to the Central Bank's inadequate tool kit: however, in accordance with the generally anti-interventionist tradition of the Finnish policy model, a proposal to equip the Central Bank with greater authority to control cash reserves was refused, largely on ideological gounds. Thus, there have been no efficient means to offset the largely procyclical fluctuations in the credit market. In the 1970s, monetary policy was quite procyclical and recent statements by the monetary authorities show that external balance has effectively become the major monetary policy objective. In an economy where the business cycle is led by export demand, this results in a procyclical monetary policy.

Exchange rate policy is a policy area that has also been crucial in Finland and one in which the Central Bank has played an active role. The Finnish markka has experienced large devaluations at roughly ten-year intervals, typically toward the end of a deep slump, as in 1957, 1967, and 1977–1978. These devaluations have shifted the distribution of income in favor of profits and, by curtailing private consumption, they may have been contractory in the short run. When exports picked up again on the way to an economic recovery, income policies have been used to depress wages, thus laying the foundation for an investment boom. Over time, however, wage inflation again erodes competitiveness and paves the way for a new devaluation. In this way successive devaluations have contributed to the instability of the economy: during periods when exports were depressed big devaluations have further curtailed domestic consumption, and later their expansionary effects have led to excessive investment during export booms.

In the Finnish discussion these developments are known as a devaluation cycle.[15] Demand management can also be interpreted in its context. Typically the slump preceding a devaluation has been characterized by very tight fiscal and monetary policy. On the other hand the policy has been made more expansive during the consequent boom. There is indeed reason to interpret the Finnish devaluation cycle as a "Kaleckian" political business cycle where periods of deflationary policy have been used to make room for a successful devaluation to squeeze out the required capital accumulation by shifting the distribution of income in favor of profits. This combination of devaluation policy and procyclical monetary and fiscal policies has helped to render the Finnish economy one of the most unstable in the OECD. But over the cycle, it has striven for high rates of investment and growth. In fact, the Finnish economy, while unstable, has grown relatively rapidly and has also undergone very rapid structural change during the

[15] The term can be credited to Sixten Korkman, "The Devaluation Cycle," *Oxford Economic Papers* 30 (1982), pp. 357–66. A short critical analysis of the debate is to be found in Jukka Pekkarinen and Pekka Sauramo, "Devalutions and Employment in the Economic Policy of the Nordic Countries—Some Reflections on the Finnish Experience," *Recherches Economiques de Louvain* 51 (1985), pp. 343–62.

1950s and 1960s. This might suggest that there is a trade-off between stability and growth during the process of industrialization.[16]

Further Explanations

To explain the non-Keynesian Finnish policy model, a variety of factors must be taken into account. The structural aspects of the Finnish economy are discussed below. At the political level, there have been surprisingly few divergences of opinion about the basic policy line. The national policy model seems to possess some degree of hegemony across most lines of political division. In the postwar years the Left did not use its strengthened position to pave the way for a new kind of economic policy, nor did the Left effectively question the authoritative position of the Central Bank, which institutionalized the bourgeois idea that the economic and political spheres of a capitalist society should remain separate. In this respect, the social theory underlying the Finnish policy model is similar to that implicit in classical economics. On the one hand, it envisions an apolitical monetary authority that safeguards the value of the currency as a basis for the functioning of the system, while, on the other hand, it posits a state that operates within the rules dictated by the economy and is unable to threaten the authority of the Central Bank. In this way, the political and the economic spheres remain quite separate.

The narrowness of the Left's scope for interventionist action can be further explained by a general tightness in the political climate after the war. The Right was afraid of the Soviet Union and distrusted all major reforms. On the other side, the parties of the Left did not develop a comprehensive and consistent economic strategy. As already mentioned, they were internally divided into Social Democrats, Communists, and allies roughly of equal strength. What is particularly important is that the Finnish Social Democratic movement never integrated Keynesian stabilization policy into its strategic goals. Starting from a traditional Marxist perspective, the Communists combined some of these ideas into an underconsumption thesis; but this then simply made the Social Democrats even more suspicious of them. Nor did Keynesian ideas find fertile ground in the other main governing party, the Agrarian Centre, both because of the general discrepancy between the agrarian ideology that praises thriftiness and Keynesianism, which, was seen as spendthrift and because many Centre party supporters shared

[16] After all, the above story is not meant to describe the Finnish policy model, while un-Keynesian, as wholly unsuccessful. The pay-offs of the stability-growth trade-off should be assessed in order to make such a judgment. Furthermore, in an open export-dependent economy which is curtailed by the balance of payments constraint, the room for Keynesian policies is in any case restricted. We shall come back to this below.

the cost-oriented interests of the export forest industry. Thus, political criticism of the policy model has been rare and unsystematic, coming mainly from the trade unions and some leftist or populist circles.

The deep rift between academically accepted economic theory, which became Keynesian in the postwar era, and the policy model in Finland remains, to some extent, a mystery. There has been very little dialogue between advocates of the policy model, relying on pre-Keynesian modes of thought and economic theorists working along Keynesian lines. In the 1950s and again during the 1970s, there was some academic criticism of economic policy but to little effect.

In general, advocates of the policy model have been able to gather from theoretical discussions the elements they need to legitimize it. This has become even easier in the current state of economic science. The crisis of Keynesianism has created in the international macrotheoretic discussion new tools for conceptualization and analysis which apologists for the Finnish policy model have been able to utilize for its reproduction and elaboration. The critics of Keynesianism have stressed supply-side factors related to growth and competitiveness that resonate with traditional aspects of the Finnish policy model.

The Finnish policy model becomes more understandable when seen within the general intellectual tradition of Finland. The influence of the German historical school and the openness of the economy created an intellectual climate in which economic growth through good export performance was identified as the preeminent national problem. Hence, economic development has been regarded as being something that is exogenously determined and economic policy as something that must adapt itself to external realities, dictated primarily by the competitiveness and profitability of export industry.

Swedish and Finnish Policy Models: Preliminary Comparisons

In their relation to Keynesianism, the Swedish and Finnish policy models contrast sharply. The former adopted Keynesianism early and later developed it further while the latter has quite consistently resisted it. This contrast has to be explained. The sharp contrast between Swedish and Finnish policy is all the more perplexing, as both countries to begin with had a Nordic type of an open economy in which the economic role of the state was relatively strong from the start. Consequently, the broad ideological background has been similar and intervention did not become such a contentious issue as in countries with a stronger liberal tradition.

What kind of differences are, then, to be found in the background factors? Closer inspection suggests several.

Despite broad similarities, there are important differences in the economic structure of the two countries that may have had a bearing on the reception of Keynesian ideas. Thus the industrial structure, and particularly the export structure, of the Swedish economy has been more diversified than that of Finland. In Sweden, forest and metal industries have long been the two main export sectors, while in Finland the latter has gained importance only in the last two decades. Since the export cycles of these two industries tend to be timed differently, they cancel out each other's fluctuations. Furthermore, the direct import content of the metal industries is large enough that swings in its exports are reflected with a short lag in imports. On the other hand, forest exports, which utilize domestic inputs, have only an indirect effect on imports after a considerable time lag, through the income and capacity effects they generate. Perhaps for this reason, the external account has been much more balanced in Sweden than in Finland, where an export-led boom usually leads to an upswing in imports after a year or two. The export boom has then passed so that the increase in imports leads to a large deficit on the current account. This has contributed to stop-and-go policies in Finnish demand management. In Sweden the external constraint has been more stable and rendered countercyclical policies more flexibility.[17] All in all, this suggests that a soft external constraint is a crucial precondition for adopting Keynesian policies. This conclusion will be strengthened by further Nordic country cases below.

Differences in the influence of the power structures in Sweden and Finland give rise to two comments. First, Sweden has often been cited as a good case for the claim that farmers, along with workers, are generally "the least committed to economic orthodoxy and the most willing to experiment in times of stress"[18] and hence form a crucial partner in the alliance that adopted Keynesian ideas. Reference is usually made to the "Cow Trade" of 1932. The Finnish case, however, inspires some doubts about the general validity of this claim. In Finland, the Agrarian party played a central role in government both in the interwar and the postwar periods, but its overall approach to economic policy has been quite orthodox, notwithstanding its support for broad welfare measures, particularly those reaching the inactive population. During the Great Slump, the Agrarian party defended the orthodox policy then being pursued. In 1937, it formed a cabinet with Social Democrats, but this cabinet did not change the general prin-

[17] But one has to be aware of the possibility of a reverse causation: tightness of the external constraint is not a purely exogenous factor but is partly determined by economic policy itself. Thus in Finland, unstable domestic demand destabilized by economic policy has led to unstable imports and consequently to recurrent balance-of-payment crises, while in Sweden stable domestic demand has contributed to steady external balance. It is likely that both the exogenous and endogenous factors of the external constraint have contributed to its different behavior in Swedish and Finnish cases.

[18] Peter Alexander Gourevitch, "Breaking with Orthodoxy: The Politics of the Depression of the 1930s," *International Organization* 38 (1984), pp. 95–129.

ciples of economic policy. In the postwar period, too, a coalition of Agrarians and Social Democrats has been the most common form of cabinet, and the former have firmly defended the kind of procyclical fiscal policy we described in the Finnish case above.

What might explain this Agrarian stand? Without defending any definitive answer, the following suggestions can be made. First, the traditional doctrines of Agrarian parties generally favor values like thriftiness that Keynesianism attacked. Second, in Finland revenues from forestry form an important share of farmers' income. This has tied their interests closely to the main export sector, the forest industry. And as we have seen, the profitability requirements of this sector have played a key role in the Finnish devaluation cycle and the instability connected with it. It may be the case that in Sweden the representation of interests has been more diversified. On the one hand, foresters have not occupied such a dominant position among farmers; on the other hand, the claims of the export industries have not been equivocal as the interests of the forest industries and metal industries may have differed. Consequently, the conditions for the alliance between farmers and the main export sector may have been more favorable in Finland than in Sweden. Third, in the Finnish left-center coalition cabinets the Agrarian party has traditionally occupied the role of the main representative of the interests of industry in general against claims of the Left. This may also have strenghtened its emphasis on costs and competitiveness at the cost of domestic demand.

The economic policy approach of the Finnish coalition cabinets has, of course, not been determined by the Agrarian party alone. The main coalition partner, the Social Democrats, have had their own influence on it. In fact, it is even more surprising that the Finnish Social Democrats, in contrast to their Swedish comrades, were so deaf to the temptations of Keynesianism. There may be several possible explanations for this difference. First, the Finnish trade unions have been much weaker than those in Sweden, where their role in the design of economic policy strategy has often been decisive. Second, one might point to the internal divisions and weakness of the Finnish Left. In Finland, Communists and Social Democrats have been roughly equal and often bitter competitors for long periods of time. It seems that the Communists, starting from a Marxist underconsumption thesis, had a more positive attitude toward Keynesian prescriptions and this rendered the "responsible" Social Democrats even more suspicious of them. Conversely, the cautious attitude of the Finnish Social Democrats may originate in an ideological inheritance that leaned toward Kautskyism. In its Finnish variant, this doctrine inclined the Social Democrats toward a policy of passive waiting until the time was ripe for socialism. This was not a good starting point for active reformism, the perspective from which the Swedish Social Democrats, for instance, pursued Keynesianism. It seems that the same inheritance paralyzed Social Democrats in the interwar period in other countries as well, such as Germany.

Several pertinent differences in the institutional features of the Swedish and Finnish states have already been mentioned. After the Second World War, Sweden had a long, uninterrupted period of Social Democratic cabinets, while the Finnish cabinets, in general, consisted of weak coalitions and were very short-lived. Combined with the provision in the Finnish constitution that allows even a minority of one-sixth of the parliament to postpone some types of new legislation, this tradition of weak cabinets inhibited purposeful economic strategy.

In comparison to the political authorities, the Central Bank is unusually powerful in Finland,[19] and it has enforced a degree of continuity on Finnish economic policy. Although the bank has not had a particularly "monetarist" orientation, its approach to monetary policy has generally been cautious, giving heavy weight to the state of foreign exchange reserves, while its exchange rate policy has been remarkably growth-oriented and often destabilizing. The bank's influence over economic policy has been broadly conservative in nature in the sense that it has contributed to a kind of "depoliticization of economic policy" that emphasizes the division between economic and political spheres in a society. No doubt this has inhibited the renewal of economic strategy. At the same time, we should remember that the status of the Central Bank is by no means an exogenous factor; it reflects as much as it conditions the persistence of a certain orthodoxy in Finnish economic policy.

The powerful Central Bank is but one aspect of the influential and independent status of the bureaucracy in Finnish politics in general. This results partly from the internal weakness of Finnish cabinets, but also has roots in the nineteenth century when Finland was under Russian rule and relied heavily on her domestic bureaucracy. It seems that the continuity of the Finnish policy model has depended crucially on her bureaucracy. However, one would not want to argue that, compared with other Nordic countries, the Finnish bureaucracy has been completely incapable of adopting new ideas and procedures in economic policy. Immediately after the war, for instance, the civil service took the initiative to manage the heavy war reparations,[20] and it later initiated many supply-side measures designed to modernize the economy. Some other factors are needed to explain why the bureaucracy was so reluctant to adopt countercyclical measures in demand management.

[19] The status of the Bank of Finland is compared with other Nordic Central Banks by Paavo Uusitalo in "Monetarism, Keynesianism and the Institutional Status of Central Banks," *Acta Sociologia* 27 (1984), pp. 31–50.

[20] See Charles Kindleberger, "Finnish War Reparations Revisited," seminar paper presented to WIDER, Helsinki, August 15, 1985.

This finally brings us, as the fourth type of explanation, to the role of professional economists in accounting for differences between Sweden and Finland in the reception of Keynesianism. Sweden provides an example of a country where economists were striving on their own toward Keynesian ideas. The young economists of the Stockholm school also soon realized the policy relevance of their new ideas and began, like Keynes, to look for political forces able and willing to implement them. Gunnar Myrdal, for instance, turned to the Social Democrats and another group of economists subsequently played a prominent role in the new proposals of the trade union movement.

Despite the fact that certain Finnish economists had easy access to decision makers—in the interwar period one professor of economics was prime minister—and that Keynesian ideas were accepted in principle, at least, by the 1950s in Finnish economics, professional economists did not do much to introduce Keynesian ideas into Finnish economic policy. Even criticism of the obvious un-Keynesian features of actual policies was scarce, if not at times nonexistent. It may be that those professional economists with the closest contacts to decision makers took a critical or cautious attitude to Keynesianism. Alternatively, given the structural factors discussed above, they may simply have believed that the assumptions of the theory did not apply to Finnish circumstances.[21] For whatever reason, it seems that, in contrast to the Swedish case, the inability or unwillingness of professional economists to argue in Keynesian terms in a way relevant to Finnish circumstances was a potentially crucial barrier to the adoption of Keynesian policies there.

On the basis of this Swedish-Finnish comparison, certain factors that may have contributed to differences in the evolution of the economic policy models of these two countries since the 1930s have been isolated. To gather more information on the relative importance of the factors behind these policy models we should also consider certain features of the Norwegian and Danish policy models. It appears that the Norwegian case may sharpen certain observations we have made about Sweden, while Denmark may replicate some of the factors associated with the reception of Keynesianism in Finland.

The Norwegian Model

The economic structure of Norway represents a fairly strong version of the Nordic type of open economy described above. First, exports of goods and ser-

[21] This emphasis can already be discerned in the first reactions of influential Finnish economists to the new ideas of the Stockholm school in the 1930s. The writings of Bruno Suviranta, for instance, offer ample evidence for this.

vices have represented more than 40 percent of total output throughout the postwar period—the highest proportion in Scandinavia. Second, Norway, like Finland, has a relatively undiversified set of exports. The bulk of her exports consists of freight services or shipping and exports of processed raw materials, like aluminum, steel and, recently, oil, the processing of which is very capital- (and energy-) intensive. In imports, too, raw materials figure highly, together with various kinds of semimanufactured goods and some capital goods. Consequently, the foreign sector in Norway is cyclically highly sensitive: export prices as well as volumes are volatile; the income elasticity of imports is relatively high, and many import prices are subject to great cyclical changes. These similarities with the Finnish economic structure will raise some intriguing questions of comparison in what follows.

As in Finland, Norwegian industrialization lagged considerably behind that of Sweden until just after the Second World War. Since then, the process of industrialization and structural change has been very rapid. As in Finland, this, together with a high capital-labor ratio in the leading export industries, has led to a high investment ratio.[22] Furthermore, state-owned companies have played a great role in certain capital-intensive industries, partly because Norway, like Finland, was considerably damaged by the war and faced the task of reconstruction.

While Norway bears at least some resemblance to Finland as far as economic structure is concerned, her ideological and intellectual background is more closely comparable to that of Sweden. Bourgeois hegemony in the interwar period was not as substantial as in Finland. The Social Democrats enhanced their position among the Left in the 1920s; in 1935 they formed the cabinet. Collective wage agreements were also launched in the 1930s. After the war the Social Democrats formed the cabinet uninterruptedly until 1965; since then there has been an alternation between Labour and bourgeois cabinets.

Nevertheless, there have been some crucial differences between the policy orientations of the Swedish and Norwegian Social Democrats. The Norwegian Social Democrats focused on the organization of production while the Swedes were more interested in redistribution and the conditions for securing peaceful labor markets.[23] This is connected to the role the trade union movement has played in the strategy of the Left in these two countries. As we have seen, it played a crucial role in the Swedish model, but in Norway, the trade unions have not been so central compared to the parties, the bureaucrats, or the intellectuals (economists included).

[22] The average figure for the ratio of gross investment to GDP for the 1950–1979 period is 29.6 in Norway and 27.8 in Finland.

[23] See J. Björgum, C. Bogefeldt, and J. Kalela, "Krisen och arbeiderbevegelsen," in *Krisen och krispolitik i Norden under mellankrigstiden* (Uppsala), pp. 247–93.

The state of economic science in Norway at the threshold of the Keynesian era was much like that in Sweden. Norwegian economics was renewed by Ragnar Frisch (1895–1973). Like the economists of the Stockholm school, he can claim to have invented in the early 1930s certain central ideas which later came to be known as Keynesian macroeconomics.[24] The 1934 crisis program of the Norwegian Labour party was strongly influenced by his ideas, and as a teacher and supervisor, Frisch created the Oslo school, whose influence has persisted to the present. This school is very policy-oriented; it emphasizes economic planning and the interaction between economists and decision makers in the planning process.

As we shall see, this combination of economic, ideological, and intellectual factors brought in some special features to the Norwegian policy model and its interaction with economic theory in Norway.

The situation after the Second World War offers a natural starting point for any discussion of the economic policy model in Norway. The war had damaged much of Norway's economic infrastructure and institutions. Politically, the position of the Left was enhanced. Since the Social Democrats had taken a reformist stand even before the war, they were ideologically prepared to step into the breach. Furthermore, they had established quite close contacts with the Norwegian economists who were developing new tools for economic management.

Building on the work of Frisch and his students, the Norwegian administration was able to deliver the first national budget as early as 1945, a rudimentary version of the full-blown annual national budgets which started in 1947. Gradually they were enlarged in scope to include even credit flows in a comprehensive survey of the economic outlook and economic policy.

In working out these first national budgets, the Norwegian economists had to confront many new problems connected with national income accounting which Firsch's earlier work helped resolve, and the Norwegian system of national accounts was soon highly developed by international standards. Later on, the Norwegians also became pioneers in developing new tools for economic planning. By the end of the 1950s, Statistical Central Office had produced a quite disaggregated macroeconomic model called MODIS, which then went through several new versions. This model of the real side of the economy was complemented in 1966 by another model (PRIM), which incorporated costs and prices utilizing the famous Scandinavian model of inflation. In his doctoral dissertation, Leif Johansen developed another model called MSG (Multisectoral Study of Economic

[24] Like Gunnar Myrdal and some other Stockholm school economists, Frisch was also of the opinion that there was nothing essentially new in *The General Theory*. For Frischs's role, see T. Bergh and T. J. Hanisch, *Vitenskap och politik. Linjer i norsk socialokonomi gjennom 150 år* (Oslo: Universitetsforlaget, 1984).

Growth) for long-term forecasting. Norwegian economic policy makers have made quite extensive use of all of these models.

What are the most salient features of Norwegian economic policy in comparison with Sweden and Finland, our two polar cases? As in Sweden, the Social Democrats played a key role in the breakthrough to economic policy activism which has been high by Western European standards. The contents of Norwegian intervention differ in some respects from Sweden's. Norway has made greater use of direct intervention in production through state-owned enterprises and the like, while the Swedes have relied on more indirect means like redistribution and wage policy. As noted above, this difference originates in the early views of Swedish and Norwegian Social Democrats and was amplified by the emphasis Norwegian economists gave to the direct planning of production in their work. It may also reflect the fact that, compared to Sweden, the manufacturing sectors of Norway and Finland (where intervention is also often direct) have been undiversified and hence likely to inspire state initiatives to promote investment and restructuring.[25]

This brings us to the intriguing comparison between Norway and Finland. We have already noted that the external sectors are highly unstable in both Norway and Finland and both have been subject to recurrent cyclical shocks emitted by the foreign sector. Yet the cyclical development of the Finnish economy in the postwar period has been very unstable while Norway has succeeded in being one of the most stable OECD economies, largely because domestic demand has dampened the effects of changes in exports. What explains this difference?

Two possible explanations offer themselves. First, it may be that the foreign sectors of the Norwegian and Finnish economies are not as similar as we imagine so that the structure of each economy transmits foreign cyclical impulses in different ways. For instance, certain "automatic stabilizers" seem to cushion the effects of foreign shocks on the Norwegian economy.[26] Changes in Norwegian exports originate to a large extent from the shipping sector, and it has a rather

[25] The fact that the contents of intervention are different in the Swedish and the Norwegian models is also reflected in differences in the public sector. The growth of the public sector has been rapid in both countries. In 1955, the share of taxes of GDP was 26 percent in Sweden and 28 percent in Norway against the OECD average of 24 percent, while in 1980 the figures were 50 percent, 47 percent, and 36 percent, respectively. Traditionally, however, public consumption has been much higher in Sweden than in Norway. In 1980, its share of GDP was 18.8 percent in Norway against 28.9 percent in Sweden. In Norway, on the other hand, transfers and subsidies have been much more important than in Sweden. In 1974–1976, the average share of GDP of transfers to producers was 6.3 percent in Norway, 2.3 percent in Sweden; since then, during the economic crisis, this difference has been blurred by the fact that the growth of transfers and subsidies has been particularly rapid in Sweden.

[26] On this, see Palle Schelde Andersen and Johnny Åkerholm, "Scandinavia," in Andrea Boltho, ed., *The European Economy: Growth and Crisis* (Oxford: Oxford University Press, 1982), p. 614.

small influence on the domestic economy because it is a capital-intensive branch that relies on foreign sources of credit. Similarly, fluctuations in exports of raw materials and semimanufactured goods are often cushioned by corresponding changes in inventories; and the import content of Norwegian exports is relatively high so that changes in exports are reflected in corresponding changes in imports. In general, the Norwegian economy (at least before the discovery of North Sea oil) can be said to have an export enclave: the domestic sector is protected by various means from fluctuations in exports.

By contrast, the import content of the traditional export sector in Finland, forestry, is relatively low, and the cushioning role of inventories has been virtually absent. This has resulted in a close correlation between changes in exports and changes in domestic income. Moreover, as we have seen, the Finnish credit mechanism has been highly sensitive to changes in foreign reserves. Hence, any change in the level of exports has produced corresponding changes in domestic demand. These, in turn, have led to intensified fluctuations in imports so that the balance of payment typically begins to deteriorate badly following an export-led boom.

The second possible explanation is that economic policy has off-set the cyclical effects of the foreign sector in Norway in a Keynesian fashion while Finnish economic policy has not done so. This may be because the credit system seems to operate differently in the two countries. However, the evidence also suggests that the reactions of fiscal and monetary policy have been rather countercyclical in Norway, whereas they are highly procyclical in the Finnish case. These two explanations do not exclude one another. But we cannot fully evaluate their relative importance here.

To conclude this discussion of the Norwegian case, we shall make some points concerning the relation between economic theory and the policy model.

It has often been pointed out that the Second World War was important for the breakthrough to Keynesian types of interventionism. When theoretical ideas that had been developed in the 1930s were applied to the management of the war economy, their usefulness was demonstrated, and the task of reconstruction that many countries faced after the war gave renewed impetus to Keynesians and planners. However, the Scandinavian countries we have examined might lead us to qualify this view slightly. It seems that the war alone was not sufficient to change long-standing habits of thought. Finnish economy and society were greatly changed by the war, yet the principles of fiscal and monetary policy remained unchanged. Keynesian policies were more often pursued after the war in countries that had developed an indigenous strain of proto-Keynesian economic thought in the 1930s. In Norway, the task of reconstruction gave added impetus to such policies, while Sweden continued to pursue such policies despite a less devastating wartime experience. The Second World War may only have accelerated changes that were taking place independently of it.

We have noted that the interaction between economic theory and the policy model in Finland has been virtually nonexistent. On the other hand, Swedish economists had a powerful influence on the reorientation of economic policy in the 1930s, even if their positive influence has gradually deteriorated since then, as a majority of the Swedish economists known for their scientific work have become highly critical of the Swedish model. By comparison, in Norway economic theory has been most influential and closely linked to the policy model. One may refer to the sequence of models that Norwegian economists have built for policy purposes and, like Sweden, Norway has an extensive system of governmental committees that utilize the expert knowledge of economists. Compared with their Swedish colleagues, however, Norwegian economists have preserved a positive attitude toward the domestic policy model to the present day. If anything, the Norwegian economists have occasionally been dissatisfied with the seemingly half-hearted way in which the policy model has been implemented. In their view, decision makers can be distracted from making full use of the powerful means the policy model offers by spurious "political necessities." Indeed, Norwegian economists have consistently defended the autonomy of specialists in economic policy making.[27]

In summary, the discussion of the Norwegian policy model in comparison to the Swedish and Finnish models points to the importance of the following three factors to the reception of Keynesianism:

1. The structure of foreign trade, particularly as reflected in the synchronization of changes in exports and imports and the consequent balance-of-payment constraint, seems to have had some impact on the degree to which a national policy model was open to Keynesian ideas and a considerable effect on its ability to implement Keynesian policies successfully.

[27] In the 1950s Ragnar Frisch, for instance, became critical of the cautious attitude decision makers had toward economic policy. Indeed, it has been said that in the conditions of postwar reconstruction it was the Norwegian Labour party which put itself to economists' service, not the other way around (Berg & Hanisch, *Vitenskap och Politik*, p. 127). When it later appeared that decision makers were not willing to go as far in intervention as Frisch wanted, frustration was a natural outcome. Later on economists in Norway seem to have been worried by the threat of the "bargaining economy" with its pressure groups for the autonomy of authorities. In a way this is reflected in Leif Johansen's work on game theory. As a further example, one may refer to the long struggle many of the Norwegian economists, Ragnar Frisch and Leif Johansen among them, have had against the process of economic integration. They have maintained that integration is highly detrimental to the autonomy of domestic economic policy.

2. Innovative domestic economists discovered Keynesian-type ideas on their own and were capable of communicating their new ideas to decision makers.
3. The political strength and ideological stance of the Social Democratic Party and a strong Labour party with a settled reformist stance were favorable to the diffusion of Keynesianism, as was the readiness of economists to cooperate with the Labour movement.

In general, the Norwegian model corroborates the importance of background factors which already appeared salient in the Swedish case. In particular, it is precisely these factors which differentiate Norway from Finland, two countries which otherwise seem to have a quite similar economic and social structure.

THE DANISH MODEL

Denmark's industrialization has been slow but it began earlier than in the other Scandinavian countries. As strong commercial farmers prospered, Danish industrialization took place without major proletarianization.[28] Agriculture was export-oriented from a very early stage and it provided the backbone of Danish exports throughout the period from the first half of the nineteenth century until the mid-1950s. Between 1955 and 1965, output and investment in manufacturing industry grew rapidly, while agriculture declined. However, this growth was very capital-intensive so that employment in industry and manufacturing increased at a considerably slower pace. Industrial development since this period has been heavily export-oriented, matching the decline in agricultural exports so that the share of exports in GDP has remained around 30 percent throughout the postwar period. In contrast to the other countries, Denmark's exports have leaned heavily toward foodstuffs and the products of small or medium-sized, highly specialized firms so that the income elasticity of export demand has been lower than in Finland or Sweden. This has provided a partial shelter from international fluctuations.[29] However, Denmark has still suffered from terms of trade changes and current account disturbances since it has traditionally been totally dependent on imports for many price-sensitive raw materials and the elasticity of imports with respect to domestic demand has been rather high.

Political mobilization in Denmark has been marked by perennial conflict between strong liberal-bourgeois forces and the Social Democratic party. In Sweden and Norway, the Social Democrats were able to build a large wage earners' coalition, but the Danish Social Democrats' attempts to implement their ideas

[28] See Esping-Andersen, *Politics Against Markets*, chap. 2.

[29] See Andersen and Åkerholm, "Scandinavia."

have often been thwarted by the bourgeois parties. Thus Danish politics displays a kind of liberal hegemony, in which farmers and industrialists have been able to form an effective counterblock to Social Democratic aspirations.

Although the Social Democrats were interested in more comprehensive economic planning and industrial democracy even before the German occupation, their political weakness compelled them, at an early stage, to adopt a rather pragmatic attitude toward day-to-day economic management. The Danish trade union movement has also been organized in a way that has made it more difficult to build a united alliance representing wage earners' interest. Although the rate of unionization has been high, many Danish unions have been organized on a professional basis that perpetuates a marked distinction between skilled and unskilled workers. Hence, real wages have often been more rigid downward than employment, and the Social Democrats have been confronted with a left-wing opposition both at the political level and in the trade union movement.

The state of economic science in Denmark was originally not very different from that in Sweden and Norway. Although many Danish economists seemed to think that little in Keynes' writing was genuinely new compared to the ideas of the Stockholm school, these ideas gained widespread attention in the Danish press during the 1930s, and the new line of thought became a major influence on Danish economists. There were even some interesting Danish contributions to Keynesian theory—mostly associated with Jörgen Pedersen.

At the political level, Keynesian ideas were received most favorably by the Social Democrats, who adopted Keynesian principles even before the occupation and reexpressed them in their influential 1945 program *Fremtidens Danmark* (Denmark in the Future). The thinking of many influential policy makers was solidly Keynesian during the 1950s and the 1960s.[30] The overall political attitude toward Keynesianism in Denmark, however, has not been free of reservations. While the major liberal party, the Venstre, also adopted Keynesianism in principle after the war, at the same time it endorsed some older lines of policy stressing the need to balance the budget and ensure firms' competitiveness. As in Finland, officials often emphasized various economic constraints on activist fiscal policies.[31] Compared to the Swedish Social Democrats, even the Danish Social Democrats' attitude toward activist fiscal policy was a little half-hearted. For instance, they did not conceive of active fiscal policy as the first stage in a grander strategy to change the balance of forces in society to the advantage of wage earn-

[30] This is the argument put forward by Henry Grünbaum, "Hvilken rolle har keynesiansk teori spillet ved tilrettelæggelsen af den okonomiske politik siden den 2. verdenskrig?" *Nationalokonomisk tidsskrift* 121 (1983), pp. 395–99.

[31] See Niels-Henrik Topp, *Udviklingen i de finanspolitiske ideer i Danmark 1930–1945* (Copenhagen: Kopenhavns universitets okonomiske institut, 1983).

ers; and the legacy of the 1920s and 1930s, when Social Democrats, according to Esping-Andersen, "hovered between a Marxian underconsumptionist analysis and an odd loyalty to orthodox liberal principles of balanced budgets,"[32] was not completely without influence during the postwar period either. This is very similar to the Finnish case.

Turning to the actual course of economic policy, we find that policy during the Great Depression was predominantly conservative and orthodox. Although Keynesian ideas of activist fiscal policy were acknowledged, the crisis was—rightly, to some extent—seen as an export downswing that could be cured by wage-price adjustments. The main elements of the 1933 crisis package were devaluation and a wage freeze.

Since the wartime occupation, there have been periodic attempts to utilize countercyclical policies, but the balance-of-payment constraint and fear of inflation have been major obstacles to the successful pursuit of such a strategy. Thus, especially during the 1950s, the outcome was a series of stop-and-go-measures. *Expansionist policies were attempted in 1949, 1954–1955, and 1957–1960, but* they were usually reversed, as the external constraint and the fear of inflation became binding obstacles. Given the nature of the labor market organization, wage restraint has not been easy to implement, and governments have often had to intervene. Throughout the 1950s, the opposition between the Social Democrats and the Venstre party continued to provide the basic political setting for policy compromises. Although employment was made a goal of policy and Keynesian ideas were accepted in principle, there was no dramatic change in actual policies. Denmark's dependence on agricultural exports was almost complete during the 1950s, and farmers' organizations blocked more active Keynesian full employment plans. Public expenditure growth was usually not permitted to exceed GDP growth and Danish Keynesianism did not loose its Myrdalian overtones with the result that the principle of balanced budgets was not abandoned even if it was not implemented on as strict a basis as in the 1930s.

On the monetary side the discount rate was lowered several times to boost construction, but this policy also ran into balance-of-payment problems. As Niels Thygesen observes, prior to 1957–1958 the task of defending the country's international reserves was dominant; and this policy objective was even explicitly incorporated into a written agreement between the government and the Central Bank, which allowed any external deficit or surplus to be reflected fully in the monetary base.[33] Thus, on the whole, austerity policies prevailed and unemployment was often high.

[32] Esping-Andersen, *Politics Against Markets*, p. 192.

[33] See Niels Thygesen, "Praktisk relevans at keynesiansk teori i dag," *Nationalokonomisk Tidsskrift* 121 (1983), pp. 332–44.

Basically the same tensions determined the course of economic policy in the 1960s, although there was some expansion during 1957–1962, due to a strengthening of the Social Democrats' position and the weakening of the farmers' political base. This rapid expansion induced a wage-price spiral and a deterioration in the balance of payment, which again led to a more restrictive policy stance. More liberal monetary policies were attempted, but for external reasons again interest rates remained high most of the time. Thus, like Finland but in contrast to Sweden and Norway, the Danish economy has been cyclically volatile. It has suffered from a chronic balance-of-payment deficit and the external constraint has been the major obstacle to stabilization policy.

To conclude, the Danish model can be located rather nearer to the Finnish model than to the Swedish one. One may call attention to the following background factors as possible explanations for this.

First, as far as economic structure is concerned, it seems that the Danish case underlines the importance of the elasticities of foreign trade. These determine how the trade balance reacts to foreign shocks and to domestic demand changes. Unsynchronized changes in exports and imports make the balance-of-payment constraint more severe and attempts at Keynesian policy therefore tend to degenerate into a series of stop-and-go measures. It seems that Denmark is the clearest example of a case where the idea of stabilization by means of domestic demand management was in principle widely accepted, especially among the Social Democrats, but the success of policies was frequently frustrated by the external constraint. In Finland, there has been more basic opposition to Keynesian ideas. But this difference between Denmark and Finland is a matter of degree, as the balance-of-payment constraint has played a crucial role also in Finland.

Second, both in Finland and Denmark, Social Democrats have had only limited success in working out and implementing a coherent strategy. They have frequently found themselves in outright opposition or as minority partners in governmental coalitions dominated by bourgeois parties. Their trade union movements have also been rather weak by Scandinavian standards. In Denmark the Social Democrats have accepted Keynesian ideas in principle more readily than in Finland but they have been too weak to implement them in practice.

Third, the Danish agricultural sector (and the main export sector until the 1950s) is comparable to forestry in Finland. It formed a strong political pressure group whose interests have been closely associated with the cost competitiveness of exports. It seems that in both Finland and Denmark farmers' interest groups have often allied with the main export industry to oppose Keynesian measures.

Finally, Denmark forms an intermediate case as far as the role of the economics profession in the diffusion of Keynesianism is concerned. Danish economists accepted Keynesianism rather early and propagated it more eagerly than the economics profession in Finland, but, on the other hand, they did not provide an indigenous school as in Oslo or Stockholm of a sort that could exercise special influence over policy makers.

Conclusion

In this examination of Keynesianism in the Nordic countries, we have attempted to develop a framework that can be used to study the interaction between economic theory and economic policy. While economic theory is quite universal and has become increasingly so over the course of time, actual economic policy makers still conceive of the targets, constraints, and instruments of economic policy in different ways in different countries. We used the term *policy model* to refer to the specific ways in which the economic policy agenda is conceived in each country. Thus our task was to analyze the role of various intervening factors in the transmission of Keynesian ideas to the policy models of different Nordic countries.

Our choice of factors on which to concentrate was based partly on the previous literature, which offers a rich menu of factors to explain the differences in the economic strategies of different countries. More consideration than is usual was given to the specific economic-structural conditions of the Nordic countries, in particular, the structure of foreign trade in these countries and the degree of diversification in their production structures. These factors formed specific Nordic conditions Keynesianism had to overcome.

Seen in a comparative perspective, the Nordic countries display an interesting variety of experiences whose analysis may contribute to our understanding of the diffusion of economic ideas more generally. First, the reception given to the Keynesian ideas of stabilization policy clearly varied from one Nordic country to another. At one extreme, Keynesian ideas were widely accepted in Sweden even before the Second World War and were later developed into a more comprehensive economic strategy attacking problems of supply and inflation as well as those of aggregate demand stabilization. At the other extreme there is Finland, which has consistently resisted the Keynesian ideas of demand management right up to the present time. This negative case, which is often neglected in the Nordic context, has been very helpful for analyzing the factors that affect the diffusion of Keynesian ideas. Finally, the Nordic countries include two intermediate cases. Norway comes rather near to the Swedish case, while Denmark has displayed a much more hesitant adherence to Keynesianism and thus bears some resemblance to Finland.

How are these differences to be explained? It turns out that, despite strong similarities in the broad outlines of policy and economic development, there are some interesting differences between these nations that may have a bearing on the reception of Keynesianism. See table 12.1. Horizontally, it ranks the Nordic countries in relation to their adherence to Keynesian economic policies. Vertically, various characteristics that may constitute possible explanations for these differences are arrayed. Positive and negative signs suggest, with due allowances for the simplified nature of this presentation, the degree to which these characteristics are, or are not, to be found in different Nordic countries.

The investigations made in this chapter have indicated that the "independent variables" of table 12.1 may in fact interact with one another in each country. Furthermore, they may not be exogenous in the sense of being totally independent of the actual economic policies followed. It can also be maintained that some of the factors are necessary for any consistent policy strategy to be followed without necessarily implying that it should be Keynesian in its contents. With these reservations, the following comments on table 12.1 are in order.

We have stressed the role of the trade balance that has been subject to violent changes in Finland and Denmark where attempts at Keynesian policies have degenerated into a kind of stop-and-go cycle. In Sweden and Norway, a healthy external balance over long periods of time has left room for stabilization mea-

TABLE 12.1 Keynesianism and the Nordic Economies: An Overview

	Adherence to Keynesianism (incr. to the right)			
Independent Variables of Potential Importance	Finland	Denmark	Norway	Sweden
Economic Structure				
—Early industrialization (in Nordic Comparisons)	− −	+	−	+ +
—Diversified export sector	− −	+	−	+
—Steady external equilibrium	− −	−	+	+
Power Structure				
—Strong and unified Left and trade unions	− −	−	+	+ +
—"Cow deal" (workers-farmers coalition) in the interwar period	+	+	+	+
Institutional Feature of the States				
—Strong (one-party) government	− −	−	+	+ +
—Dependent Central Bank	− −	−	+	+
—Bureaucracy under political control	−	+	+	+
Economics Profession				
—Strong domestic tradition of economics, especially	−	+	+	+
—Domestic origins of Keynesian ideas	−	+	+ +	+ +

sures. Notwithstanding the fact that it remains open to what extent the balance itself is a result of determined stabilization, it seems that the chronic tendency to trade deficit is a major explanation for the fact that Denmark has not succeeded in the application of Keynesian measures.

Unstable external balance has played an important inhibitive role in Finland as well. But besides this, the rejection of Keyngsianism has been more fundamental there. In the postwar period the Finnish economy has found herself undergoing the process of industrialization and rapid structural change. Shortage of saving has been the main motivation behind economic policies in Finland. The cyclical volatility of the economy may in fact have served a function in the sense that it has helped to make room for profits, saving, and investment. There may have existed a trade-off between instability and growth. But the Norwegian case on the other hand clearly demonstrates that high levels of investment and rapid structural change can be attained without casting away Keynesian ideas. Some further explanations have to be found.

The Nordic comparisons clearly indicate that the strength and unity of the political Left have been important to the adoption of Keynesian economic policy. The relevance of this factor seems striking when one contrasts Sweden and Finland. On the other hand, it does not appear that the formation of an alliance between the Agricultural party and the Social Democrats in a coalition cabinet during the 1930s was, by itself, the most crucial factor paving the way for Keynesianism. Farmer-worker alliances were agreed upon in all Nordic countries during the interwar period, yet some of them firmly resisted Keynesianism. Indeed the Finnish and Danish cases suggest that the nature of the agricultural sector itself may be important. Where the farmers' interests closely coincide with the main export industry, as in the cases of forestry in Finland or foodstuffs in Denmark, agricultural interest groups may remain hostile to Keynesian ideas, which also conflict in many ways with traditional rural ideology.

Comparing Finland on the one hand and Sweden and Norway on the other, we see that Keynesian ideas were received more readily in the latter countries where the official bureaucracies, including the Central Bank, were structured so as to be generally responsive to political initiatives and outside advice. Sweden and Norway exemplify powerful legislatures with detailed committees and much use of commissions and outside testimony. In these countries, the initiative over the adaptation of Keynesianism was placed at the political level, where it was open to outside pressures. In Finland, on the other hand, the maintenance of a non-Keynesian model seems related to the existence of a strong and independent central bureaucracy (especially the Central Bank) in relation to which governments have normally been weak. The implementation of economic policy was kept in the hands of closed bureaucracy averting Keynesian ideas. The role of these institutional differences forms an interesting subject for further study. Let it only be noted that it is not the general administrative creativity and efficiency of the bureaucracy which is at stake here, but rather its sensitivity to Keynesian-type approaches in a specific historical context. Thus the attitudes of the bureaucracy may in turn reflect some deeper structural features of the society.

On the basis of this Nordic comparison, we cannot escape the conclusion that the quality of the domestic economics profession and its attitude toward Keynesianism have been important to the passage of Keynesian ideas into economic policy. Sweden and Norway are countries in which domestic economists developed their own version of Keynesian ideas in the 1930s and were eager to persuade political parties to adopt them. Finland, on the other hand, exemplifies the case of a peripheral economics profession that passively accepted Keynesian ideas from abroad and was unable to communicate them to politicians. Hence, the gap between the policy model and academic economics persisted for an unusually long time.

The Finnish case indicates that a national policy model often stubbornly resists change. It can survive relatively intact over great economic, political, and cultural upheavals. But, sooner or later, fundamental changes in the economic, social, and cultural factors behind the policy models begin to alter it. Economic theory is most likely to influence the policy model when the latter finds itself in crisis, that is to say when its results are generally regarded as unsatisfactory and the economics profession has a promising new approach to offer. Such a crisis can ripen as a result of a growing dissonance between the policy model and its environment or when some dramatic change in the latter suddenly overwhelms the model. It has often been suggested that the Second World War and its aftermath provided the dramatic change which legitimated Keynesian policies. But our Nordic comparisons qualify this theme. Norway seems to conform to such an interpretation. However, Sweden and Finland deviate from it. In the former case, the reorientation of economic policy was largely accomplished before the war which did not generally initiate such a sharp social and economic reordering in Sweden as in many other countries. In Finland, on the other hand, the war changed the economic and political constellations abruptly, yet the policy model remained largely unchanged.

To conclude, it seems that the economic, political, institutional, and cultural factors we have singled out may account relatively well for differences in the Nordic countries' response to Keynesianism. However, this is a preliminary analysis. It does not exclude the possibility that some other factors may be relevant as well, nor does it imply that exactly the same factors have been central in other countries. We have made considerable progress, but in this area of comparative research, much work remains to be done.

13

HOW THE KEYNESIAN REVOLUTION WAS EXPORTED FROM THE UNITED STATES, AND OTHER COMMENTS

Albert O. Hirschman

THE RISE AND DECLINE OF FREE TRADE AND KEYNESIANISM COMPARED

"We are all post-Keynesians now"—to paraphrase and bring up to date a famous pronouncement. As such, we are now able to perceive the remarkable parallelism between the fate of the Free Trade Doctrine in the nineteenth century and the rise and decline of Keynesianism in the twentieth. In 1846 Free Trade won its major domestic victory in Great Britain, then the dominant world power, with the abolition of the Corn Laws. The doctrine soon acquired a considerable degree of international hegemony, which was manifested and further propelled by the Cobden-Chevalier Treaty of 1860. But it suffered reverses with the coming of the depression of the 1870s and was superseded by neomercantilist and imperialist policies that were adopted not only by the major Continental powers and the United States, but eventually also won politically powerful converts in the original protagonist, the United Kingdom.

Keynesianism, the economic doctrine fashioned by Keynes in *The General Theory* (1936), gained its first success in acquiring major influence over the economic policy of a great power in the United States in the course of the 1938 recession. This influence was substantially strengthened during World War II. Through the war's outcome the United States was then propelled to superpower status, and proceeded to promote Keynesian-type policies not only because of its new position in the world, but also because it acquired, through its postwar aid programs, considerable direct influence on the economic policies of other major countries. In spite of many resistances, described in the present volume, Keynesianism curiously acquired a good measure of intellectual hegemony for just about as long as the Free Trade Doctrine, and during the identical decades of

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"its" century—thirty years, from the 1940s to the 1970s. It went into decline with the oil crisis of the 1970s and the concomitant unsettling experience of "stagflation." Increasingly, the theoretical predominance Keynesianism had long exercised was contested by neomonetarist and supply-side doctrines that largely originated in the very country—the United States—that had originally been spreading the Keynesian message.

The purpose of delineating this historical parallel is not to insinuate that influential economic doctrines come and go at regular intervals, like schools of painting such as Impressionism or Abstract Expressionism, nor to ponder the curiosum that they achieved hegemony during the middle decades of succeeding centuries. Rather it is to bring out the common elements of both episodes.

First, a newly arisen economic doctrine came to acquire dominant influence *within* a very special country: one that is outstandingly endowed both with military power and with the prestige that comes from being a principal beacon of economic progress.

Second, this country then became eager to export the doctrine to others and initially achieved a measure of international hegemony for it.

Third, in spite of the seemingly invincible combination of a persuasive body of thought with its sponsorship by the most "modern" country and a leading world power, the doctrines soon met with resistance and their reigns turned out to be unexpectedly short-lived. Moreover, they came to be contested within the very countries which had originally spread them.

Unique Factors in the Spread of Keynesian Policy Making

A comparative look at the spread of Free Trade and of Keynesianism also calls attention to an important difference between the two stories. The Free Trade Doctrine arose in England, became that country's official policy, and was "exported" from it, along with its prized manufactures, to the rest of the world. Keynesianism also arose in England, but won its most significant battle for influence over domestic policy making in the United States during the 1930s and the Second World War, and then was spread primarily from that country after the war's end. It is perhaps not of overwhelming interest that the originating and the missionary country were identical in the Free Trade story, whereas in the case of Keynesianism two different countries assumed successively the function of "invention" and that of worldwide diffusion. The arresting features lie rather in some specific aspects of "How Keynes Came to and Was Spread from America," to expand on the title of Galbraith's well-known article.[1]

[1] "How Keynes Came to America," in his collection *Economics, Peace and Laughter* (Boston: Houghton Mifflin, 1971), pp. 43–59.

Galbraith and others (such as Salant in this volume) have told how Keynesian ideas came to a key university (Harvard) and to some key Washington agencies (Federal Reserve Board, Treasury, Bureau of the Budget) in the wake of the protracted Depression of the 1930s, particularly the steep and troubling 1938 recession. Seldom in history were the basic propositions of an economic theory so strikingly confirmed by events as during the 1938–1945 period in the United States. The new and heterodox Keynesian concept of underemployment equilibrium illuminated the continuing difficulties of the late 1930s that were particularly evident in the United States. Shortly thereafter, the ability of government spending to energize the economy and to drive it to full employment (with wartime controls restraining the inflationary impulses) was taken as another, more positive demonstration of the correctness of Keynesian analysis. These striking experimental verifications of the theory—so uncharacteristic for social science propositions—might have been sufficient to cause many economists to take Keynes' ideas seriously, but, as has often been remarked, the rhetoric of *The General Theory* also contributed to forming a band of sectlike initiates and devotees on the one hand, as well as a group of out-and-out opponents on the other.

It is useful to dwell briefly on the latter point. As Salant points out in his contribution to this volume, Keynes showed how, in an underemployment situation, numerous commonsense intuitions about economic relationships are by no means fallacious, as had long been believed and taught by the economics profession. Contrary to Say's Law, general overproduction *can* exist; deficit spending by the government *can* activate the economy; and, horror of horrors, the "mercantilist" imposition of import duties and export subsidies *can* improve the trade balance and domestic employment. In propounding these popular and populist heresies, Keynes threatened traditional economists, not just in their beliefs, but in their hard-won status as high priests of an arcane science that owed its prestige in good part to its claim that much of commonsense understanding of economic relationships was pitifully wrong. Here is one reason for the undying hostility of some important members of the profession to the Keynesian system.

But while rehabilitating common sense, Keynes hardly presented his own theory in commonsensical terms. Rather, his message was delivered in a book whose text was uncommonly difficult. Moreover, he frequently presented his propositions as counterintuitive rather than as confirming common sense: for example, instead of telling his readers that converging individual decisions to cut consumption can set off an economic decline (common sense), he dwelt on the equivalent but counterintuitive proposition that a spurt of individual decisions to save more will fail to increase aggregate savings. In this manner, he managed to present common sense in paradox's clothing and in fact made his theory doubly attractive: it satisfied at the same time the intellectuals' craving for populism and their taste for difficulty and paradox.

The Keynesian system thus attracted a group of extraordinarily devoted followers. It gave them the exhilarating feeling of possessing the key to truth while being beleaguered by a coalition of ignoramuses and sinister interests. Moreover, the 1930s were a highly ideological or "creedal" period and Keynesianism, with its reevaluation of the proper roles of the state, the world of business, and the intellectuals (the economists in particular), supplied an attractive "third way" that could compete with the various fascist and Marxist creeds of the time.

It was in the United States that these various factors converged most effectively to create an energetic and influential group of Keynesians, during the years just prior to and during World War II. Then comes the peculiar "exogenous" twist of the story: the outcome of the war. With the United States suddenly propelled to military and political world leadership, its group of devoted and inspired Keynesians could now fan out to the far corners of the U.S.-controlled portion of the globe to preach their gospel to a variety of as yet unconverted natives. And this is what they did, backed up by U.S. power and prestige, first by occupying positions with the military governments established in Germany and Japan and then by providing much of the qualified manpower needed for the administration of Marshall Plan aid. As is shown in the individual chapters of this volume, their success in implanting Keynesian policies abroad varied greatly, a matter on which I comment below.

By flocking to the newly opening and highly attractive opportunities to spread the message and exert power overseas, the U.S. Keynesians, who were after all still a rather small group, left the domestic front dangerously unprotected. The retreats that were imposed on the Keynesian cause in the United States in the immediate postwar period (with the emasculation of the Full Employment Bill, for example) may in part be explained by this factor which complements the domestic considerations discussed by Margaret Weir in this volume. On the other hand, the difficulties of maintaining their grasp on domestic policy in the more contentious and conservative climate of the Truman era may have convinced many prominent and gifted U.S. Keynesians that they would have a far easier and more profitable time applying their skills in the newly opened overseas theaters of operation. Such are the dialectics of empire, especially when it is of the instant variety.

In sum, what spread of Keynesianism occurred after World War II was due to an extraordinary constellation of circumstances: first the formation of a core group of Keynesians in the United States, a function of domestic economic problems, then the military victory of that country, and then the attempt at "colonization" of the rest of the "free world" with Keynesian ideas. The peculiar shape of the story is perhaps better understood by invoking a seemingly odd historical parallel. In the fifteenth century the "Catholic kings" of Spain completed, after centuries of fighting, the Reconquest of that country from the Muslims. In the course of this epochal event, the "ruling circles" of the kingdom became imbued with an extraordinary spirit of fervor, missionary zeal, and power. With the discovery of the New World in America (the "exogenous" event in this story), that ardent spirit then found a ready-made outlet and inspired both the soon-to-be-staged military conquest of the new continent and the intensive subsequent proselytizing efforts by the Spanish state and church. One significant difference between the two stories is that, unlike the United States, Spain did not switch to spreading a wholly different faith after some thirty years.

But this exotic parallel only serves to underline the nonreplicable character of the story I have chosen to tell. It certainly does not yield anything like a usable "model" of the process through which economic ideas gain political influence. Or, if it does, it is in the nature of the old advice "Get yourself a rich grandfather" to a young man who wishes to know the secret of how to become rich. It would seem that, to achieve worldwide influence, an economic idea must first win over the elite in a single country; that this country must exert or subsequently chance to acquire a measure of world leadership; and that the country's elites be motivated and find an opportunity to spread the new economic message. The account is clearly different from the model Peter Hall delineates in his conclusion, with its array of economic, political, and administrative determinants. From the diverse country experiences Hall attempts to extract some generalizable lessons about the conditions under which economic ideas are likely to acquire political influence. A determined analytical effort of this kind should obviously be made, for whatever understanding of the past and guidance to the future it may provide. My approach has been along a different road: I have dwelt on the unique features of the spread of Keynesianism and the account does not lend itself, therefore, to deriving any stable set of "preconditions" for the diffusion of ideas. My story may, nevertheless, have another kind of utility: it intimates and puts us on guard that, next time around, we may have to look for a very different combination of circumstances to explain (or promote) the acquisition of political influence by an economic idea.

Something remains to be said, from the perspective here adopted, about the highly different degrees of influence wielded by Keynesianism in the various countries that, immediately after World War II, were all exposed to considerable U.S. influence, and along with that, to Keynesian ideas. The specific historical factors that are peculiar to each country, and explain much of the variance, are well brought out in the country-specific chapters of this volume: the revulsion against state interference in the economy, inherited from the Fascist and Nazi experiences in Italy and Germany, as opposed to the openness to economic policy innovation in France which had stagnated lamentably in the 1930s, largely under the dictates of "orthodox" economic management (resistance to devaluation and insistence on deflation). There remains nevertheless a puzzle: if U.S. influence meant exposure to Keynesian ideas as a result of the fanning out of U.S. Keynesians as described, why was it that in Germany and Japan, which were under U.S. military occupation and government and where U.S. power was therefore strongest, the influence of Keynesian ideas on policy making was far weaker than in France and Italy, countries that were merely subject to U.S. advice as recipients of substantial U.S. aid? To help explain this paradox, I wish to propose a hypothesis which needs to be confirmed by archival research, but which, as an active participant in those events, I sense to be correct.

At the end of World War II the U.S. Keynesians formed a cohesive, combative, and influential, yet, as already noted, also a multiply beleaguered group. It was based in various government agencies in Washington and in a still quite small number of the major universities. In government, these Keynesian economists had mostly influential advisory, rather than outright managerial positions, in line with the Washington quip that economists should be "on tap, but not on top." When the U.S. government was suddenly called upon to improvise an apparatus of military government in Germany and Japan, the top positions were given to military officers and to experienced businessmen, bankers, lawyers, and other managerial types. These groups had by no means been converted to Keynesianism and tended in fact to be hostile to it to the extent they had an opinion on the matter. (In the militarily occupied countries, Germany in particular, there was often conflict between the top administrators and the Keynesian advisors within the U.S. military government.) To the contrary, in the other countries the top jobs available to Americans were those of economic advisors to Allied governments, and they largely went to the U.S. Keynesians, who therefore had virtually the last word on the economic policy that was being urged on the local government by the United States. Hence the U.S. Keynesians were *more* influential in those countries where the United States had *less* power and exercised it indirectly via advisors rather than directly, via outright administrators.

The Failure to Follow Keynesian Policies in the 1930s

In the postwar period during which Keynesian ideas about appropriate contracyclical policy were widely accepted, the depth and length of the Depression of the 1930s, particularly in such countries as the United States, Germany, France, and Italy, were attributed to the stubborn and retrograde refusal of unenlightened policy makers to apply vigorous Keynesian remedies, such as deficit spending on public works. It is hardly a coincidence that the recent questioning of the

Keynesian system should have witnessed the rise of an alternative explanation. As now argued by Skidelsky and others (an interesting variant is proposed by Bradford Lee in this volume), Keynesian policies would have been unavailing as a stimulus of renewed economic activity as long as public opinion in the affected countries was not broadly aware of how recovery was expected to be engineered through Keynesian remedies.[2] If not only the government, but the public in general was convinced that large-scale deficit spending was a disastrous policy, capital flight and further declines in private investment might have followed upon the Keynesian "remedies," thus thwarting the upward spiral in consumption and investment, supposed to be impelled by the mechanics of the celebrated multiplier. Put more broadly, at any one time there is a general understanding, an unwritten "social contract," about the rules which make an economy work and about the boundaries assigned to the state's economic role. The harm caused by breaching these rules and boundaries is likely to outweigh the benefits that are calculated to accrue from the purely "mechanical" effects of state action.

There is an easy reply to this kind of argument. One of the functions of government is to inform public opinion, and if the mindsets and reactions of the public were in fact likely in the 1930s to neutralize (or worsen) any Keynesian stimuli, then it would have been up to the governments to instruct their publics in the elements of Keynesianism before applying the doctrine in practice. So the governments must still be considered to have been at fault. Nevertheless, their failure to educate the public in the mechanics of the Keynesian system would probably be judged less blameworthy than the sheer ignorance and reactionary stubbornness with which they were charged in the earlier interpretations.

Actually the new interpretation or justification of non-Keynesian, orthodox policy making in the 1930s raises a fundamental question which should be briefly spelled out here: If the success of a newly proposed economic policy depends on the understanding, on the part of the public, of how the policy is expected to work, how is it ever possible for the established economic policy, that is familiar and well understood, to be superseded by another? For it seems that the revisionist view proposes a typical vicious circle: On the one hand, we are being told that the newly proposed policy can work only provided people are already convinced that it will do so; on the other hand, it stands to reason that this conviction arises most typically among the economic operators once they have lived through a positive experience with that policy. The success of the new policy depends on reshaping attitudes and proper attitudes depend in turn on prior experience with the policy. This vicious circle formulation is actually helpful: it reveals the for-

[2] See Roger Middleton, *Towards the Managed Economy: Keynes, the Treasury and the Fiscal Policy Debate of the 1930s* (London: Methuen, 1986), pp. 172, 183; also Skidelsky's review of Middleton's book in the *Times Literary Supplement*, June 20, 1986, p. 684.

midable difficulties standing in the way of the adoption of new economic (and other) ideas. That process is indeed far more problematic than is usually suspected. It is not enough for even so brilliant a mind as Keynes to formulate a new system of economic relationships and for his ideas, with the help of some friends and students, to gain a foothold in the government. Rather, the vicious circle just described must be broken and this can be achieved only if the traditional reactions of dismay and disbelief that would make Keynesian policies inoperative are suspended by some exogenous happening—in the event, the 1938 recession and, above all, the Second World War played this crucial role of first suspending traditional expectations and then, as Keynesian policies proved successful, of reshaping them.

The process as sketched here has something in common with cognitive dissonance theory in social psychology which deals precisely with the difficult relation between the acquisition of new attitudes (say, of racial tolerance) and actions in accordance with such attitudes. Here again, there is a problem in visualizing how such an action could be undertaken unless the appropriate attitudes have first been acquired, and yet how can this happen unless an action and its positive sequel have first provided the experiential basis for the attitude change? One solution proposed by the theory was precisely for actors to "stumble" more or less accidentally on an action that will then give rise to the new attitude.

Actually, by arguing along such lines, the revisionist historians of the economic policy in the 1930s have themselves stumbled on a complex problem area. They argue that the successful pursuit of a new economic policy may require some minimal comprehension, on the part of the public, of how the policy is expected to work. This proposition certainly holds for some policies. Yet we also know of very different ways of thinking about the relation between the effectiveness of an economic policy and its understanding by the public. The relation was in fact stood on its head by recent critics of Keynesian macroeconomic policy who argue that such a policy will become ever *less* effective the more the public "catches on" and renders the policy ineffective through anticipatory reactions.

These apparently quite contradictory views can be accommodated in two very different ways. In the first place, there may well be one set of economic policies which require some minimal understanding on the part of the public, and a very different set of policies whose effectiveness, from the point of view of the government, depends on some sort of surprise effect. Here the policy necessarily loses in effectiveness once increasing numbers of victimized citizens get "wise" to them and refuse to be "caught twice." We all know of such usually spoliative (or, to use a less loaded term, *redistributive*) policies, from inflation to the sudden imposition of exchange controls.

But there is another possible reconciliation of the two views, a reconciliation that turns out to be rather worrisome. With regard to certain economic policies, both views could conceivably be applicable, in succession. To work at all, a policy must first be at least minimally understood, but it becomes unsustainable if it is understood too well, in the sense that the operators will neutralize it by anticipating its effects. In other words, the public's understanding of the policy must be neither inadequate nor excessive, but since that understanding presumably passes from the former of these negative conditions to the latter, the viability of any policy is necessarily limited in time. Recent experience suggests that this is not an entirely unrealistic interpretation of macroeconomic policy making in a decentralized economy.

Political Influence of Keynesian Ideas

The discussion around the political influence of ideas—as opposed to, say, the influence of state structure or of organized interests—runs the risk of becoming as dogmatic, ritualized, and inconclusive as the hoary disputes about the influence of great men in history or about the comparative roles of nature and nurture in human development. The most obvious model of how economic ideas become politically influential—a new economic idea wins recruits among the economics profession, some members of which then obtain influential positions in government—is also the most unsatisfactory one as is convincingly, if politely, argued by Peter Hall in his introductory comments on what he calls the "economist-centered approach." The interplay between economic ideas, state power, administrative structures, and interest groups is far more intricate, as is pointed out in his concluding chapter and in a number of the contributions here assembled. Three forms of this interplay demand our attention.

The Reshaping of Political Alignments

In her contribution to this volume, Margaret Weir shows how in postwar Britain Keynesian doctrine played an important role in allowing the Labour government to shift its course without losing either its soul or its face. After some unsuccessful experimentation with detailed industrial planning and physical controls, Sir Stafford Cripps, as Chancellor of the Exchequer, chose to place the emphasis on Keynesian macroeconomic demand management. At the same time, the Conservative opposition had come around to endorsing the principles of Keynesian economic management, although it was violently opposed to the "coercive features of Labour's economic controls."[3] A postwar consensus on economic policy had thus emerged. Here is an excellent example of how a new economic idea can affect political history: it can supply an entirely new common ground for positions between which there existed previously no middle ground whatever. Prior to Keynes there simply was no respectable theoretical position between centralized planning, on the one hand, and, on the other, the traditional laissez-faire policies, with their denial of any governmental responsibility for economic stability and growth.

As shown in Rosanvallon's chapter, the postwar French recovery furnishes another excellent illustration of how Keynesian ideas provided support for a new conception of the economic role of the state. The celebrated and pivotal concept of "indicative planning" is unthinkable without the Keynesian reformulation of that role.

In his contribution to this volume, Peter Gourevitch views different interest groups as drawing on various extant systems of ideas to articulate their programs, stake their claims on resources, and manifest their proclivity to coalition with other groups. With the example of Keynesianism's role in the postwar policy of Great Britain and France, it is possible to see new ideas in a more activist role: apparently they can become leading actors in the political process as they shape new policies and political arrangements.

An Infusion of Civic Spirit

Margaret Weir also shows how Keynesianism was much less successful at durably reshaping attitudes and coalitions in the United States than in Britain. It is a convincing account even though the peculiar time at which she wrote—the zenith of Reagan's power—may quite understandably have led her to be a bit too negative. In fact, the United States was the theater of another important political impact of Keynesianism—one that has gone largely unnoticed.

As I have noted elsewhere, new ideas have two principal intellectual effects: the persuasion effect and the recruitment effect.[4] The persuasion effect is the obvious one of attracting followers from among the specialists already laboring

[3] See p. 81 above. In his famous last article, "The Balance of Payments of the United States," *Economic Journal*, June 1946 (vol. 56, pp. 172–87), Keynes aligned himself with this understanding of his doctrine by excoriating the hankering of some of his followers for physical controls as "modernist stuff gone wrong and turned sour and silly." Here Keynes sounded very much like Lenin denouncing certain excesses committed in his name as "infantile maladies."

[4] "A Dissenter's Confession: *The Strategy of Economic Development* Revisited," in Albert O. Hirschman, *Rival Views of Market Society and Other Recent Essays* (New York: Viking, 1986), p. 34.

in the particular discipline where the idea makes its appearance. The recruitment effect is more important and more ambiguous. As a result of the excitement generated by the new idea and the ensuing debates, intellectually able and ambitious recruits are newly attracted toward the field where the discovery has been made, where its scientific merits remain to be evaluated, and where its ramifications are yet to be worked out. This phenomenon was extremely conspicuous in the United States, with its vast university system. Moreover, Keynesianism inspired and energized even the opposition, from Milton Friedman to James Buchanan, in accordance with Burke's dictum, "our antagonist is our helper. This amicable conflict with difficulty obliges us to an intimate acquaintance with our object. . . ."

The political repercussions of the powerful recruitment effect of Keynesianism were notable. Large numbers of recruits were eventually drawn to Washington or were able and eager to spend varying periods of time there. They came to their tasks often naively and arrogantly confident that they would solve the economic and social problems of their time, but at the same time they infused into many areas of government, from Social Security to foreign aid, a spirit of energetic dedication to public service and accomplishment.

One of the major unsolved problems of democratic political theory and practice is how to maintain a minimal degree of public-spiritedness among the citizenry in general and the bureaucracy in particular, of how to prevent what Machiavelli called *corruzione*, by which he meant not corruption or graft, but the loss of public spirit, the exclusive concentration of individual effort on personal or sectional interests.[5] Due to the decline of pluralist theory and to the rising impact of the Prisoner's Dilemma Theorem, we are now aware that in the public arena there is no invisible hand that will mysteriously produce the public good out of the clash of various types of self-seeking. The solution of the minimal state is utopian under modern conditions. Pure exhortation in the name of morality or love of country is likely to fail. Hence we are reduced to looking around for sundry devices that can serve as occasional and temporary boosters of that precious public spirit. Via their recruitment effect, new ideas in economics and social science provide us with just such boosters. Keynesianism's most important political effect in the United States may well have been to have raised public-spiritedness in a crucial period of its recent history—the transition to superpower status.

[5] See Quentin Skinner, "The Paradoxes of Political Liberty," in *The Tanner Lectures on Human Values* (Cambridge, Mass.: Harvard University Press, 1984); some fresh ideas on the problem are in Steven Kelman, *Making Public Policy* (New York: Basic Books, 1987).

Keynesianism Gives Rise to New Economic Ideas

It is hardly news that one of the principal consequences of an idea is to give rise to further new ideas, most of which were not visualized by those who formulated the original one. The second-generation ideas will then in turn have political effects along the lines sketched in the preceding pages or in other ways. Now Keynesianism has been particularly blessed with a rich and diverse progeny of second-generation ideas and a survey of the political effects of Keynesianism would be seriously incomplete if those attributable to that progeny were wholly left out of account. This is a vast subject, but it may be helpful to mention a few major lines along which an inquiry into this matter might proceed.

First of all, as already noted, Keynes' work had the gift of seriously upsetting and antagonizing a large and important segment of the economics profession. Stung by the ridicule that was poured on them by the newly enlightened coterie of Keynesians, the traditionalists reformulated the "classical" position more rigorously, forcefully, *and* uncompromisingly. When circumstances became favorable in the 1970s, they counterattacked, with the well-known enormous political effect.

It may be a bit farfetched to consider this revanche of the anti-Keynesians as a consequence of Keynesianism, even though it seems incontrovertible that a theory must be held accountable for the *kind* of reaction it provokes. But there are of course several important intellectual currents that have their origin in Keynesianism along more obvious lines. One is the economics of growth, particularly its first Harrod-Domar phase. This major development in post-World War II economics is unthinkable without the Keynesian tools of the multiplier, the marginal efficiency of capital, and the propensity to save. The political importance of the claim that economics had unlocked the secrets of the growth process is too well known to require extended treatment here. But one point might be made: the substantial change in social and political attitudes toward capitalism and market society during the postwar period is connected less with Keynesianism than with one of its intellectual progenies, the economics of growth. Although the economics of growth is greatly indebted to Keynes, it was by no means fashioned by him. If Keynes is sometimes acknowledged as the "savior of capitalism," it is more because of his influence on the economics of growth than through his own theory.

My final example of political effects stemming from one of the ideational ramifications of Keynesianism is the economics of development. Keynesian doctrine drew a sharp distinction between the economic mechanisms ruling in a fully employed economy and those applying in an economy where manpower, capital, and other resources are underemployed. This intellectual posture made it respectable to construct yet another special economics, this one applying to "underdeveloped areas."[6] While the emergence of the anticolonial struggle after World War II stimulated thinking about the conditions of economic progress in the former colonies, as well as in Latin America, the conviction, among an influential group of development economists, that they had identified and understood what one of them called the "mechanics of economic development" contributed a great deal to the launching of a determined effort to get those "mechanics" going.[7] The effort was conceived as a task that should be undertaken jointly by the West and the countries of the "periphery." Its enormous difficulties and pitfalls would only reveal themselves as time unfolded. But the process, with all its political disasters, wild gyrations, and yet enormous promise, might never have been started as a joint enterprise of rich and poor nations had not the economics of development, that other progeny of Keynesianism, held out the promise, right or wrong, that it was indeed manageable.

These filial connections of Keynesian ideas with the economics of growth and development had a remarkable consequence: a body of thought that was conceived in the Depression and was designed to deal with the problems of unemployment and stagnation has come to be intimately and deservedly associated with *les trente glorieuses*—the glorious thirty post-World War II years—that is, with the most sustained and dynamic period of economic expansion in human history, both in the economically advanced and in many of the less developed countries.

[6] "The Rise and Decline of Development Economics," in Albert O. Hirschman, *Essays in Trespassing* (New York: Cambridge University Press, 1981).

[7] Hans W. Singer, "The Mechanics of Economic Development: A Quantitative Model Approach," *Indian Economic Review* 1 (Aug. 1952), pp. 1–18.

14

CONCLUSION: THE POLITICS OF KEYNESIAN IDEAS

Peter A. Hall

IN THE WORLD of economics, where material interests and monetary flows so often predominate, a book about the role of ideas may seem somewhat unorthodox. Ideas are commonly seen as part of the superstructure rather than the base of political economy or portrayed as so much froth on the long waves of economic development. Even the study of politics has recently moved away from an emphasis on ideas, as structuralist accounts of public policy and political change have superseded more traditional lines of analysis.[1]

To neglect the role of ideas in political economy, however, is to miss an important component of the economic and political worlds. It is ideas, in the form of economic theories and the policies developed from them, that enable national leaders to chart a course through turbulent economic times, and ideas about what is efficient, expedient, and just that motivate the movement from one line of policy to another.[2] Structural accounts can tell us a great deal about the constraints facing policy makers, but policy making is based on creation as well as

Although this conclusion draws on the preceding chapters, it is presented not as the collective opinion of the authors but as a considered judgment inspired by their work. I am grateful to the German Marshall Fund for financial support, and to Rosemary Taylor, Harvey Rishikof, Peter Lange, Andrew Martin, Robert Keohane, Albert Hirschman, Chris Allen, Bradford Lee, S. M. Miller, Margaret Weir, Stephan Haggard, Carol Mershon, Richard Rose, Rogers Smith, Leon Lindberg, and Hans-Peter Müller for comments on earlier drafts of this chapter.

[1] For representative works, see Theda Skocpol, *States and Social Revolutions* (Cambridge: Cambridge University Press, 1979); Morris Fiorina, *Retrospective Voting in American National Elections* (New Haven: Yale University Press, 1981); Peter A. Hall, "Patterns of Economic Policy: An Organizational Approach," in Stephen Bornstein, et al., eds., *The State in Capitalist Europe* (London: Allen & Unwin, 1982); James March and Johan Olsen, "The New Institutionalism: Organizational Factors in Political Life," *American Political Science Review* 78 (September 1984), pp. 734–49.

[2] See Stephen Krasner, *Defending the National Interest* (Princeton: Princeton University Press, 1980); Eric Nordlinger, *On the Autonomy of the Democratic State* (Cambridge: Harvard University Press, 1981); and Peter Evans, et al., *Bringing the State Back In* (New York: Cambridge University Press, 1985).

constraint.[3] If we want to explain innovation as well as the underlying continuities in policy, we must recognize that "the knowledge basis of state action, as well as the processes by which the state itself influences the development and application of social knowledge, are indeed research issues of central importance."[4]

Simply recognizing that ideas are important to the development of policy is not enough, however. All too often ideas are treated as a purely exogenous variable in accounts of policy making, imported into such accounts to explain one outcome or another, without much attention to why those specific ideas mattered. But if we cannot say why one set of ideas has more force than another in a given case, we do not gain much explanatory power simply by citing ideas. In short, if we want to accord ideas an explanatory role in analyses of policy making, we need to know much more about the conditions that lend force to one set of ideas rather than another in a particular historical setting.[5] It is all very well to say that policy makers are influenced by the lessons drawn from past policy experiences, but the lessons that history provides us with are always ambiguous.[6] Why are some lessons learned from a given policy experience, rather than others? Why is one set of ideas influential in some times and places but not in others? What are the processes whereby new ideas acquire influence over policy making?

This chapter uses the case of Keynesian ideas to address such questions. Its purpose is to develop a broad view of the factors that conditioned the progress of Keynesian ideas from theoretical expression to implementation as policy and to identify the historical elements that rendered Keynesianism more influential in some nations than others. The analysis proceeds in three stages. In the section that follows, I distinguish three dimensions of Keynesian thought: Keynes' reformulation of fundamental economic concepts, his contribution to a new view of the activist state, and his specific proposals for countercyclical demand manage-

[3] See Judith Goldstein, "Ideas, Institutions and U.S. Trade Policy," *International Organization* (Winter 1988); and Peter A. Hall, *Governing the Economy: The Politics of State Intervention in Britain and France* (New York: Oxford University Press, 1986), chap. 10.

[4] Peter Evans, Dietrich Rueschemeyer, and Theda Skocpol, "On the Road to a More Adequate Understanding of the State," in Peter Evans, et al., eds., *Bringing the State Back In* (Cambridge: Cambridge University Press, 1985), pp. 357–58; cf. John Odell, *U.S. International Monetary Policy* (Princeton: Princeton University Press, 1982).

[5] For work that makes an important contribution to the resolution of these questions, see Hugh Heclo, *Modern Social Politics in Britain and Sweden* (New Haven: Yale University Press, 1974), chap. 7; Margaret Weir and Theda Skocpol, "State Structures and the Possibilities for 'Keynesian' Responses to the Great Depression in Sweden, Britain, and the United States," in Evans, et al, *Bringing the State Back In*, pp. 107–68; and Samuel H. Beer, *Modern British Politics* (New York: Norton, 1982).

[6] Cf. Charles Murray, *Losing Ground* (New York: Basic Books, 1984); and Henry Aaron, *Politics and the Professors* (Washington: Brookings Institution, 1979).

ment. I argue that each dimension of Keynesian thought became influential in a different way. We can learn much from this case about the multiple roles that ideas play in the political world. Next, I present an overview of the considerations influencing policy makers' judgments about Keynesian ideas. This overview is designed to summarize some of the most important points made in preceding chapters in this book. The policy makers' response to Keynesian ideas seems to have been conditioned not only by the economic viability of those ideas, but by their administrative and political viability as well. Finally, I turn to the problem of explaining why Keynesian ideas about demand management acquired influence over policy in some national settings but not in others. Four kinds of factors seem to have affected the influence of Keynesian proposals: the orientation of the governing party, the structure of the state and state-society relations, the nature of national political discourse, and the events associated with World War II.

The Influence of Keynesian Ideas

John Maynard Keynes was one of the most imaginative thinkers of our century. Even the ideas associated with *The General Theory*, on which this book focuses, were multifaceted; and, like many doctrines, his did not have to be accepted in toto to be accepted at all. Moreover, there were many dimensions to Keynesian thought and each became influential in a different way. At the risk of some oversimplification, we can say that there were at least three dimensions to Keynesian doctrine.[7]

First, Keynes introduced a new set of concepts into macroeconomic analysis based on the balance between aggregate demand and supply. These were the ideas later integrated by John Hicks and others into what is usually termed the "neoclassical synthesis."[8] They ultimately revised the very terms through which economists saw the macroeconomy.

Second, Keynes also provided a rationale for more active government management of the economy. Keynes broke with classical views of the polity and economy as separate spheres and with the related view that the market economy was fundamentally stable or likely to function best when free from state intervention. By arguing that private markets were inherently unstable but susceptible to correction through discretionary government action, Keynes provided a powerful

[7] This is not meant to be an exhaustive summary of Keynes' ideas. It is simply a typology of the factors in *The General Theory* most relevant to the influence of that work.

[8] For a basic introduction to the neoclassical synthesis, see D. E. Moggridge, *Keynes* (London: Fontana, 1976); and for its elaboration see Donald Patinkin, *Money, Interest and Prices*, 2d ed. (New York: Harper & Row, 1964); as well as chapter 1 of this book.

justification for increased state intervention in the economy and contributed to a redefinition of the accepted boundaries between the public and private spheres in society.

Finally, Keynes also argued for a particular set of policy prescriptions commonly termed "countercyclical demand management." In periods of recession, Keynesians advocated an active fiscal policy, based on injections of public spending, tax reductions, or public works to be financed by budgetary deficits, in order to revive investment and demand in the private sector. In periods of excess demand or military necessity, Keynes called for precisely the reverse: deflationary policies designed to reduce consumer demand and thwart inflationary pressures.

The Keynesian Terms of Economic Analysis

In the long run, Keynesian ideas have had their most lasting impact on the terms of economic discourse. After John Hicks and Alvin Hansen formalized an IS-LM curve analysis based on *The General Theory*, Keynes' approach to economic analysis became widely influential in Britain and the United States. From there, the terms of the neoclassical synthesis spread to economists around the world. Its popularity was best symbolized by Paul Samuelson's famous text, which made Keynesianism the centerpiece of economic education for millions of students.[9] Less obvious, but no less important at a national level, was the impact of Keynesian ideas on national income accounting. Along with Colin Clark and Simon Kuznets, Keynes laid the groundwork for a new kind of national income analysis that became influential in the Anglo-American nations during the war and was generalized to many other countries shortly thereafter, partly as a result of the statistical conventions developed by international agencies like the United Nations and the Organization for European Economic Cooperation. By the late 1950s, econometricians had also built Keynesian concepts into sophisticated statistical models of the economy, and, as these became more central components of policy making, they carried Keynesian modes of analysis into the macroeconomic management of many countries.[10]

Here we see one of the many ways in which a new set of ideas can secure a

[9] Paul Samuelson, *Economics*, 12th edition (Boston: Little, Brown, 1985); and on the discrepancies between Keynes' own thought and some of the refinements introduced by his followers, see Axel Leijonhufvud, *On Keynesian Economics and the Economics of Keynes* (Oxford: Oxford University Press, 1968).

[10] See Nicholas Kaldor, "Reflections of an Economist," *Banca Nazionale del Lavoro Quarterly Review* 156 (March 1986), pp. 14–15; Francois Fourquet, *Les Comptes de la Puissance* (Paris: Recherchés, 1980), pp. 66ff.; and Donald Patinkin, "Keynes and Econometrics: On the Interaction Between the Macroeconomic Revolutions of the Interwar Period," *Econometrica* 44, 6 (November 1976), pp. 1091–1123.

niche in the world. The economy itself is really just a complicated conception employed to describe a subset of human activities, and Keynesian ideas altered the terms of that conception in significant ways. New ideas are most powerful when they change the basic categories through which we see reality, and, after Keynes, the economic world never looked quite the same as it did before.

Equally notable is the process whereby this kind of influence was achieved. The Keynesian conception of the economy was initially spread by diffusion among the members of the economics profession and required only intermittent endorsement from political authorities. This may be one reason why that diffusion was so rapid and complete. Once the new terms gained currency among economic experts, the growing role of these experts in contemporary governance carried them into the heart of the policy process.

Within the economics profession itself, however, the acceptance of Keynesian ideas was by no means foreordained. In many respects, the process of professional persuasion was as much sociological as it was epistemic; and several of the case studies in this volume show how the organization and ideological inclinations of the economics profession affected the speed with which Keynesian concepts were assimilated into conventional thinking in various countries.[11] Not surprisingly, the new concepts spread more slowly in nations where the economics profession was small and peripheral to the university system, as in France, or hierarchical and dominated by a few professors with deep commitments to classical economics, as in Italy. They made the earliest inroads in Britain, where Keynes himself was a powerful presence, and in the United States, where a large and diverse set of institutions taught economics and substantial numbers of graduate students were seeking a new research program on which to cut their teeth.

The Rise of the Keynesian State

In the political sphere, the second dimension of Keynesian thought had its greatest impact. Keynes' arguments about the instability of the private economy and the usefulness of state intervention became an important ideological pillar of the social consensus endorsing a managerial state and the mixed economy in the postwar world. The role of the state in the economy increased for many reasons that had little to do with Keynes: the legacy of the war economy, the demands of reconstruction, and the expansion of universal social benefits. However,

[11] See Thomas Kuhn, *The Structure of Scientific Revolutions* (Chicago: University of Chicago Press, 1970); Harry Johnson, "The Keynesian Revolution and the Monetarist Counter-Revolution," in Harry and Elizabeth Johnson, *In the Shadow of Keynes* (Oxford: Basil Blackwell, 1978), pp. 183–202; and the chapters in this volume by Walter Salant, Marcello de Cecco, and Pierre Rosanvallon, in particular.

Keynesian ideas were a potent weapon in the hands of those who sought to justify a new role for the state against the arguments of the old laissez faire.

By articulating an image of the managerial state that endorsed a measure of state intervention but preserved the capitalist organization of production, Keynes reinforced the belief that a middle way could be found between the complete socialization of the means of production and the excesses of unbridled capitalism. As Pierre Rosanvallon demonstrates, Keynesian ideas contributed to a change in the very terms of political discourse after the Second World War. They provided a new language that diverse groups of political actors could use to forge a common purpose, and a conception of the state's role in the economy that appealed to forward-looking conservatives and Social Democrats alike. This, in turn, made new kinds of political coalitions possible; and some of these coalitions became powerful enough to alter the economic arrangements of their nations.[12]

As a number of commentators have pointed out, Keynesian ideas also contributed to the class compromise that is widely associated with the postwar settlement in Europe and the United States.[13] Class conflict had appeared in many forms during the interwar period, and many observers expected renewed conflict after 1945, as the terrible experiences of depression, fascism, and war fueled support for militant labor organizations and left-wing political parties seeking a break with the old order. Up to that point, the programs of labor and capital had seemed in direct conflict. Labor leaders argued that the only way to secure full employment was to nationalize the means of production, while the spokesmen for capital insisted that private ownership of production be maintained.

In the years following the war, however, Keynesian ideas seemed to provide a formula for compromise. Keynes argued that full employment and sustained economic growth could be achieved within a capitalist economy through the judicious use of macroeconomic management, without any need to interfere with the managerial prerogatives of private capital. With effective demand management, labor could be guaranteed full employment, while capital retained control over investment. As a result, Keynesian ideas were taken up by a wide range of centrist politicians who hoped to build cross-class coalitions and national frameworks of regulation to sustain them.[14] In some cases, direct bargaining took place between the representatives of labor and capital on the basis of Keynesian ideas. In others, the adoption and success of Keynesian programs gradually undermined

[12] See the chapter in this volume by Pierre Rosanvallon.

[13] On this point, see Adam Przeworski, *Capitalism and Social Democracy* (Cambridge: Cambridge University Press, 1985); and Robert Skidelsky, "The Decline of Keynesian Politics," in Colin Crouch, ed., *State and Economy in Contemporary Capitalism* (London: Croom Helm, 1979), pp. 55–87.

[14] Cf. Robert Boyer and Jacques Mistral, *Accumulation, Inflation, Crises* (Paris: Presses Universitaires de France, 1983).

support for more radical measures. Both cases suggest that Keynesian ideas contributed to an implicit class compromise that is widely associated with the postwar settlement and the achievement of domestic stability in the industrialized nations.

Accordingly, Keynesian ideas were often used to justify a range of practices associated with the "mixed economy."[15] To be Keynesian bespoke a general posture rather than a specific creed. Indeed, the very ambiguity of Keynesian ideas enhanced their power in the political sphere. By reading slightly different emphases into those ideas, an otherwise disparate set of groups could unite under the same banner. This tells us a good deal about the kind of role that ideas play in politics. When an evocative set of ideas are introduced into the political arena, they do not simply rest on top of the other factors already there. Rather, they can alter the composition of other elements in the political sphere, like a catalyst or binding agent that allows existing ingredients to combine in new ways.

Some of these effects are unintended. Politicians take up a new set of economic ideas to wield like a weapon in political conflict. But, like the magical weapons of wizards, new ideas have the capacity to change the very perceptions of those who wield them as well as the world itself in ways that their advocates often do not fully anticipate or desire. Thus, the British Treasury officials who adopted Keynesian concepts to justify deflation in the context of a war economy found to their surprise that the same concepts could also be used to cut a powerful swathe through the problems of postwar demand management; and many of the leftist politicians who embraced Keynesianism as a contemporary creed for socialism later found that the pursuit of such policies often drew them into a costly series of incomes policies that threatened the allegiance of their own working class constituency.

Keynes' Policy Prescriptions

There is a central paradox in the history of Keynesianism. On the one hand, Keynes' influence over the conceptual apparatus of economics and postwar images of the contemporary state was widespread and profound, as the preceding discussion indicates. On the other hand, his specific policy proposals for countercyclical demand management, on which the rest of this chapter concentrates, had a much less consistent impact on the industrialized world. One of the most striking findings of this study is the degree to which Keynes' ideas about demand management were resisted or ignored in many nations.

[15] For one influential expression of this view, see Andrew Shonfield, *Modern Capitalism* (New York: Oxford University Press, 1965).

Keynes' own ideas had virtually no impact during the interwar period. Most nations, including his own, rejected the policies of deficit spending that Keynes proposed in response to the Depression of the 1930s. In the few countries where such policies were pursued during this period—Sweden, Japan, the United States, and Germany—policy makers acted with virtually no reference to Keynes' own ideas.

Even in the period after World War II, conventionally known as "the Keynesian era," countercyclical demand management was rarely taken up as quickly or practiced as consistently as Keynes had envisaged.[16] Finland passed up Keynesian practices in favor of balanced budgets throughout the postwar years. The Federal Republic of Germany and Japan made little use of fiscal policy for countercyclical purposes until the late 1960s. Even then, after a brief burst of enthusiasm for Keynesianism, the Germans became very cautious about reflation; and the Japanese continued to let other goals guide their macroeconomic policy. After initial hostility, Italian governments made increasing use of countercyclical policy in the 1960s, but patronage politics continued to hinder the effective implementation of fiscal policy. Keynesian ideas were used with more effect to justify policies of pragmatic mercantilism toward the industrial sector and the *Mezzogiorno*.[17]

Sweden endorsed aggregate demand management in the 1930s, but deliberately restricted countercyclical measures in the postwar period in favor of an emphasis on active manpower measures to deal with unemployment. Similarly, France and Norway have taken a broad Keynesian approach to aggregate demand, but more prominence has been given in both nations to supply-side measures and industrial planning. The willingness of U.S. governments to utilize fiscal tools for economic stabilization has been sporadic at best; and, even in Britain and Denmark, where Keynesian ideas had considerable influence, macroeconomic management has been dominated by balance-of-payment concerns to a degree that Keynes did not anticipate.[18]

The highly varied impact of Keynesian policy proposals leaves us with a puzzle. Why were Keynesian ideas about countercyclical demand management influ-

[16] For broad reviews, see Andrea Boltho, ed., *The European Economy: Growth and Crisis* (London: Oxford University Press, 1982); and Bent Hansen, *Fiscal Policy in Seven Countries 1955–1965* (Paris: Organization for Economic Cooperation and Development, 1969).

[17] See Guido M. Rey, "Italy," in Boltho, *European Economy*, p. 516.

[18] In addition to the chapters in this volume, see Andrew Martin, "The Dynamics of Change in a Keynesian Political Economy: The Swedish Case and Its Implications," in Crouch, ed., *State and Economy*, pp. 88–121; Jim Tomlinson, *British Macroeconomic Policy Since 1940* (London: Croom Helm, 1985); Lars Mjoset, "Nordic Economic Policies in the 1970s and 1980s," *International Organization* 41, 3 (Summer 1987), pp. 403–56; and Herbert Stein, *The Fiscal Revolution in America* (Chicago: University of Chicago Press, 1969).

ential in some times and places but not in others? There are two components to this problem. First, there is a disjunction between the interwar and postwar periods. Why did doctrines that became influential after World War II meet with so much resistance before then? Second, there is wide variation across nations in the degree to which Keynesian ideas were implemented as policy. Why were Keynesian ideas readily incorporated into the economic policies of some countries but not of others?

These are complex explanatory problems. As the preceding chapters indicate, historically specific combinations of factors seem to have affected the reception given to Keynesian ideas in each nation. As Albert Hirschman points out, events that are unlikely to be repeated played a key role in the diffusion of Keynesian ideas. Nevertheless, behind the complex unfolding of events, it is often possible to discern more general factors at work and to draw some conclusions about the sort of variables that might condition the progress of any new set of economic ideas.[19]

To do so, of course, also entails making some judgments about the relationship between ideas and material circumstances.[20] Any attempt to explain the influence of ideas teeters on the brink of reductionism. However, the Keynesian case is robust enough to capture the double-sided nature of this relationship. On the one hand, it confirms that ideas have an existence and force of their own that cannot be reduced to complete dependence on some set of material circumstances. As we have seen, Keynesian ideas did not simply reflect group interests or material conditions. They had the power to change the perceptions a group had of its own interests, and they made possible new courses of action that changed the material world itself. In these respects, Keynesian ideas had a good deal of independent force over circumstances.

On the other hand, the Keynesian case also suggests that the ultimate influence of a new set of ideas does not depend entirely on the innate qualities of those ideas alone.[21] There are at least three respects in which external circumstances can affect the influence that a new set of economic ideas acquires over policy.

First, the persuasiveness of economic ideas depends, in part at least, on the way those ideas relate to the economic and political problems of the day. In other

[19] Cf. Peter D. McLelland, *Causal Explanation and Model Building in History, Economics and the New Economic History* (Ithaca: Cornell University Press, 1975).

[20] For some of the few attempts to tackle this kind of problem, see Odell, *U.S. International Monetary Policy*; and the references in footnote 1 of Bradford Lee's chapter in this volume.

[21] For arguments that go even farther in this direction to suggest that the course of the French Revolution was largely determined by the structural logic of Jacobin ideas, see Francois Furet, *Interpreting the French Revolution* (Cambridge: Cambridge University Press, 1981), esp. pp. 48–65; and William H. Sewell, Jr., "Ideologies and Social Revolutions: Reflections on the French Case," *Journal of Modern History* (1985), pp. 57–85.

words, persuasiveness is an inherently relational concept, determined as much by the shape of current economic and political circumstances as by the shape of the ideas themselves. It is congruence between the ideas and the circumstances that matters here, and changes in material circumstances can affect the pertinence and appeal of certain ideas.

Second, many complex sets of ideas are ambiguous and far from immediately comprehensible. In these cases, interpretation is a necessary prerequisite to understanding; and to make such interpretations, individuals tend to refer to an existing stock of knowledge that is generally conditioned by prior historical experience. Hence, the same set of ideas can be interpreted quite differently in settings where the relevant historical experiences diverge.

Finally, if it is to influence policy, an idea must come to the attention of those who make policy, generally with a favorable endorsement from the relevant authorities. However, the organization of decision making in each state can affect the flow of information within it, including the access that policy makers have to particular ideas and the kind of authorities they consult about them.

For all of these reasons, the influence of a new set of economic ideas is likely to depend, at least in part, on political and economic circumstances. In this respect, the case of Keynesian ideas is somewhat like the case of new technology in the industrial revolution. In each instance, it is not the invention of the new knowledge that must be explained, but its dissemination and implementation; and, if the former is peculiarly resistant to explanation, the latter depends much more directly on a concrete set of economic and political conditions.[22]

How Keynesian Ideas Were Judged

To provide an overview of the kind of conditions that affected the progress of Keynesian ideas, it may be useful to outline the factors that seem to have been most central to policy makers' judgments about those ideas. These are the kind of considerations that figure prominently in the case studies covered by this volume; and the results are quite interesting.

It is conventional to assume that Keynesian ideas were judged primarily by reference to their ability to resolve the economic problems at hand; and, indeed, there is no question that the apparent economic viability of Keynesian ideas had an important effect on how they were received. However, the cases that we have examined suggest that policy makers also tended to judge Keynesian ideas in other terms as well. In particular, their receptiveness to the new ideas also de-

[22] See David Landes, *The Unbound Prometheus: Technological Change and Industrial Development in Western Europe from 1750 to the Present* (Cambridge: Cambridge University Press, 1969).

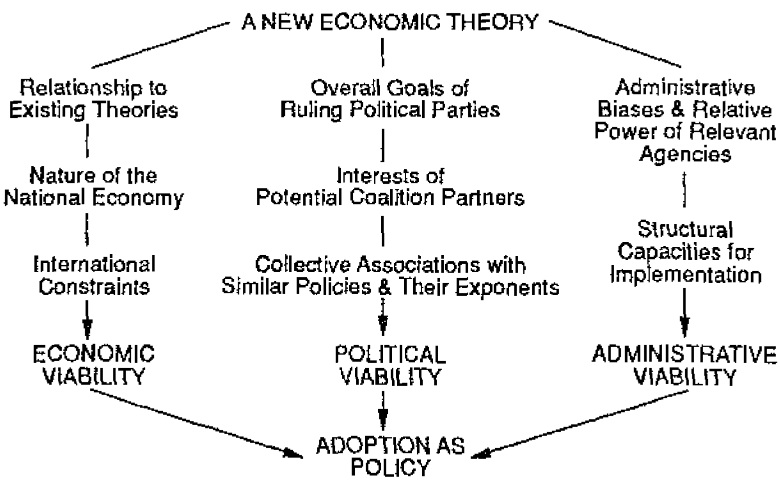
pended on what we might call the "administrative viability" of those ideas, namely on the degree to which the new ideas fit the long-standing administrative biases of the relevant decision makers and the existing capacities of the state to implement them. Similarly, the reception accorded Keynesian ideas depended on their political viability as well, judged, in this case, by the fit between the new ideas and the existing goals and interests of the dominant political parties and by the sort of associations that Keynesian ideas acquired in the political arena.

In other words, in order to become an accepted component of policy, Keynesian ideas had to achieve a measure of administrative and political viability, as well as viability in economic terms. Each criterion brought a slightly different range of considerations to bear on the outcome. These are summarized in figure 14.1 and are described in further detail below.

Economic Viability

The economic viability of economic ideas refers to their apparent capacity to resolve a relevant set of economic problems. Therefore, it is closely tied to the nature of current economic problems. Keynesian proposals have generally been taken more seriously in settings where unemployment is the preeminent problem on the economic agenda because they speak directly to that problem. Where inflation was an overriding concern, as in Japan and Germany just after the war, Keynesian ideas received somewhat less attention.

FIGURE 14.1 Factors Affecting the Reception of Keynesian Ideas



However, a variety of other factors can also affect the economic viability of a new theory. These include the qualities of the new doctrine *qua* economic theory. Any doctrine is more likely to be accepted by professional economists if it is theoretically appealing, and that will turn on its relationship to existing theory. Indeed, the relationship of Keynesian theory to classical doctrine itself helps explain the worldly trajectory of Keynesian ideas: they were not widely accepted when first propounded in the 1930s but became highly influential twenty years later. This may be attributable in part to the way Keynes formulated *The General Theory*. He went out of his way to couch it in terms that would force his readers to forsake their traditional concepts and learn a new language in order to appreciate his insights. Therefore, *The General Theory* was likely to meet initial resistance until younger scholars seeking a new research program could take it up and eventually press the new view on the economics profession as a whole. That is precisely what happened.[23]

Equally important to the way Keynesian ideas were received in each nation were the structure of its national economy and the kind of international constraints that it faced. All too often it is assumed that Keynesian prescriptions would have cured the economic ills of the 1930s or the postwar world. But the proposals outlined in *The General Theory* were best suited to a closed industrial economy with rigidities in the labor market and a well-developed financial system. Such measures did not seem so appropriate to small open economies, where a demand stimulus might suck in imports or drive up export costs and generate a balance-of-payment crisis.[24] And they seemed less likely to work in agrarian societies with a limited banking structure. This is one reason why Keynes' proposals were initially received rather coolly in Italy and parts of Scandinavia.

Similarly, a nation's position within international economic regimes could limit the viability of Keynesian policies. The desire to remain faithful to the pre-

[23] See Johnson, *In the Shadow of Keynes*; cf. Michelle Lamont, "How to Become a Famous Philosopher: The Case of Jacques Derrida," *American Journal of Sociology* 93, 3 (November 1987), pp. 584–622.

[24] It could even be argued that Britain's manifest problems in implementing Keynesian demand management during the postwar era stem from the failure of her policy makers to recognize that what had once been a large, imperial power was now more like a small, open economy. See J.C.R. Dow, *The Management of the British Economy 1945–1960* (Cambridge: Cambridge University Press, 1964); and Kerry Schott, "The Rise of Keynesian Economics in Britain 1940-1964," *Economy and Society* 11, 3 (1982), pp. 292–316. There is also recent evidence to suggest that devaluation may have been a more effective response to the 1930s Depression than any demand stimulus conceivable at the time. See Barry Eichengreen and Jeffrey Sachs, "Exchange Rates and Economic Recovery in the 1930s," *Journal of Economic History* (December 1985), pp. 925–46; Bradford Lee, "Paths to Recovery, Pitfalls of Reform: Economic Policy and Performance in Britain, France and the United States in the 1930s," paper presented to the American Historical Association, December 1983; and the essay by Bradford Lee in this volume.

vailing gold standard was one reason why Britain and France resisted reflationary policies in the 1920s, for instance, and Chancellor Heinrich Brüning himself told Keynes that Weimar Germany could not reflate until the reparations clauses of the Young Plan were modified.[25] These kinds of constraints, like some of the others cited in figure 14.1, are often seen as factors affecting the implementation of economic ideas; but they also play a role in the process of policy formulation being considered here precisely because policy makers tend to judge new proposals at least partly in terms of the existing constraints on their implementation. Jukka Pekkarinen puts the point well when he suggests that such considerations are usually internalized into the "economic policy model" that national officials habitually employ when making policy or judging the viability of a new set of economic ideas.

Administrative Viability

To say that the influence of Keynesian ideas was also affected by the administrative viability of those ideas means that Keynesianism was more likely to be accepted if it accorded with the long-standing administrative biases of the officials responsible for approving it and seemed feasible in light of the existing implementational capacities of the state.

This is a point that has received considerable attention in Britain as historians review archival evidence from the economic debates of the 1930s. Until recently, it was generally believed that the fate of Keynesian ideas in interwar Britain turned on a largely theoretical clash between the classical doctrines of the Treasury and the innovative concepts of Keynes. However, internal government documents now suggest that British policy makers were just as concerned about the structural difficulties of implementing Keynesian proposals, given the organization of the British state, as they were about the theoretical validity of his views. As the guardians of public expenditure, Treasury officials also had a long-standing bias against policies that entailed further spending.

The essays in this volume indicate that similar considerations also affected the

[25] See Stephen Krasner, ed., *International Regimes* (Ithaca: Cornell University Press, 1983); and Robert Keohane, *After Hegemony* (Princeton: Princeton University Press, 1985). Even Keynes, who had earlier advised devaluation, counselled Ramsey MacDonald to deflate so as to avert an exchange rate crisis in 1932. See Philip Williamson, "A Bankers' Ramp? Financiers and the British Political Crisis of August 1931," *English Historical Review* (1984), p. 787. For instance, when Blum finally devalued the franc in 1936, he did so only after negotiating a rearrangement of exchange rates with British and U.S. officials that put constraints on French policy, primarily in his agreement not to impose exchange controls. See Patrick Fridenson and André Straus, eds., *Le Capitalisme Français* (Paris: Fayard, 1987). On Germany, see Charles P. Kindleberger, *The World in Depression 1929–32* (Berkeley: University of California Press, 1973), pp. 174ff.; Heinrich Brüning, *Memoiren 1918–1934* (Stuttgart: Deutsche Verlag, 1970), p. 506.

reception accorded Keynesian ideas elsewhere. In the United States, for instance, interwar politicians were hesitant about Keynesian ideas in part because they seemed to demand a fiscal stimulus well beyond the current capacities of the U.S. state. Lauchlin Currie himself calculated in 1935 that to prime the pump sufficiently would require an annual federal deficit of $5 billion at a time when total federal expenditure was barely $2 billion a year.[26]

Similarly, resistance to Keynesian policies during the postwar period has been particularly strong in nations like Finland and West Germany, where the Central Bank plays a prominent role in economic policy making. Central bankers tend to develop institutional concerns about inflation and the balance of payments that bias them against a fiscal stimulus. Such biases are not immutable, but they seem to have had an important effect on official judgments about the viability of a new set of economic ideas. Hence, the official reception given to a new economic theory can be conditioned by the way in which power over economic policy making inside the state itself is distributed among agencies with different biases, and by prevailing perceptions of the capacity of the state to implement the new policy.

Political Viability

Finally, like any new theory, Keynesianism was more likely to become policy if it also had some appeal in the broader political arena, to which the politicians who ultimately made policy were oriented.

Like many economic ideas, Keynesianism had significant political implications. When first presented, it spoke directly to the interest of working people in full employment and against the deepest prejudices of the financial sector. It was a politically polarizing doctrine. Not surprisingly, it was initially embraced by many trade unionists, while policy makers with public financial responsibilities hesitated. Some socialists, wedded to the notion that capitalism itself must be destroyed, were also ambivalent. As we have seen, however, Keynesianism could be used to forge new political coalitions among groups that had previously seen their interests in antagonistic terms. Although it took politicians some time

[26] See Alan Booth and Melvyn Pack, *Employment, Capital and Economic Policy in Great Britain 1918–1939* (Oxford: Basil Blackwell, 1985), p. 1; Roger Middleton, *Towards the Managed Economy: Keynes, the Treasury and the Fiscal Policy Debate of the 1930s* (London: Methuen, 1985); G. C. Peden, "The 'Treasury View' on Public Works and Employment in the Inter-war Period," *Economic History Review*, 2d ser., 37 (2), pp. 167–81; S. Glyn and A. Booth, "Unemployment in Inter-war Britain: A Case for Relearning the Lessons of the 1930s?" *Economic History Review*, 2d ser., 36 (3), pp. 329–48; and the related works referred to in these pieces. For a slightly different view, see the essay by Donald Winch in this volume. See also Lauchlin Currie, "Comment," *American Economic Review* (May 1972), p. 140.

to respond to the political advantages and drawbacks of Keynesianism, there is no doubt that they evaluated it in political as well as economic terms.

The outcome of that evaluation seems to have depended on such factors as the overall goals of the ruling political parties, the presence and perceived interests of groups who might have been potential partners in a Keynesian coalition, the implications of Keynesian ideas for other issues high on the political agenda at the time, and the general reputation which the national exponents of Keynesianism and related policies had acquired in that nation. In Italy, for instance, Keynesian ideas were tainted for a time by association with the social corporatists who first embraced them. Similarly, Keynesianism was more appealing in Britain and the United States just after the war, where the unemployment issue was high on the political agenda, than in Germany or Italy where recovery from defeat loomed larger in the public mind. In all nations, however, the fate of Keynesian ideas ultimately depended on their ability to speak to the interests of the political entrepreneurs who would have to put them into action.

In sum, this analysis suggests that a new set of economic ideas must be seen to have a minimum level of viability on all three of these dimensions—economic, administrative, and political—in order to be incorporated into policy. It also implies that each of the three explanatory approaches reviewed in the introduction to this volume captures some aspects of the overall policy dynamic. In some cases, attractiveness on one dimension can offset weakness on the others; the political appeal of supply-side economics, for instance, was apparently great enough to offset the many doubts that economists expressed about it.[27] However, it is still difficult to specify the conditions under which one form of viability will matter more than the others. It stands to reason that administrative considerations will carry greater weight in nations where a permanent civil service exercises considerable control over policy and that political considerations may become more important in periods of crisis and realignment when the initiative passes to the political arena. But this is a matter on which more research needs to be done.

Explaining the Adoption of Keynesian Policies

The considerations associated with economic, administrative, and political viability had a wide bearing on the reception accorded Keynesian ideas, and there is good reason to think that they would affect the reception given to any new set of economic ideas. However, these considerations cover a wide range of issues. In order to explain why Keynesian policies were adopted in some times and

[27] See David Stockman, *The Triumph of Politics* (New York: Avon, 1986); and Paul Roberts, *The Supply Side Revolution* (Cambridge, Mass.: Harvard University Press, 1984).

places but not others, we need to focus on the Keynesian case itself and attempt to specify a more restricted set of factors that tipped the balance in favor of or against Keynesian proposals for countercyclical demand management.[28]

With this in mind, we can single out four factors for particular attention. Each had an important bearing on the Keynesian case, and together they constitute the kind of factors likely to be important to the adoption of economic policy more generally.

The Orientation of the Governing Party

Prosaic as it might seem, the orientation of the governing party appears to have been the single most important factor affecting the likelihood that a nation would pursue Keynesian policies. Keynesian policies were much more commonly initiated by parties with particularly strong ties to the working class than by their conservative or bourgeois rivals.[29] In large measure, this can be attributed to the special concern that such parties have for the effects of unemployment on the working class.[30]

During the 1930s, two of the most prominent Keynesian experiments were initiated by the Swedish Social Democrats and the U.S. Democratic party, as they consolidated worker-farmer coalitions. With a similar orientation, the French Popular Front also attempted an abortive Keynesian initiative. Of the five main cases of Keynesian or proto-Keynesian experimentation between the wars, the only ones not directly associated with attempts to mobilize a working class constituency were those associated with military mobilization in Germany and Japan.

During the postwar period, a Labour Government (1945–1951) spearheaded the drive toward Keynesianism in Britain, and Democratic administrations spon-

[28] In some cases, the initial impetus for a change in policy came from proto-Keynesians rather than Keynes himself, but their ideas were broadly similar and all are described here as Keynesian. In general, I take these ideas to have been most influential where countercyclical policies were pursued, except in cases like that of Nazi Germany where similar policies were attempted without apparent reference to Keynesian ideas.

[29] It is important to underline this finding since many of those who survey the contemporary scene doubt that the complexion of the governing party has much impact on economic policy. See Richard Rose, *Do Parties Make a Difference?* (New York: Chatham House, 1979); David Cameron, "Social Democracy, Corporatism, Labour Quiescence, and the Representation of Economic Interest in Advanced Capitalist Society," in John Goldthorpe, ed., *Order and Conflict in Contemporary Capitalism* (New York: Oxford University Press), pp. 143–78; and Manfred Schmidt, "The Role of Parties in Shaping Macroeconomic Policy," in Francis Castles, ed., *The Impact of Parties* (London: Sage, 1982).

[30] See Douglas A. Hibbs, Jr., "Political Parties and Macroeconomic Policy," *American Political Science Review* 71 (December 1977), pp. 1467–87. Peter Gourevitch adds the observation that proto-Keynesian policies were most likely to be adopted during the interwar era by political parties seeking to build a coalition between the working class and agrarian sector.

sored the two most prominent Keynesian initiatives in the United States, the Full Employment Bill of 1945 and the tax cut of 1963. In postwar Germany, Keynesian policies became a central component of economic policy only after the Social Democrats entered the government in 1966; and it was an eclectic group of social democrats who took up Keynesian ideas most readily in France.

The Scandinavian cases provide a nice additional test for this hypothesis. All have been governed to some degree by Social Democrats, but, if party orientation matters, the commitment to Keynesianism should have been strongest in nations where Social Democrats had the greatest influence. That is precisely what Pekkarinen finds.[31] The commitment to Keynesian policies was greatest in Sweden and Norway where Social Democrats have been virtually hegemonic, middling in Denmark where they shared power with other parties, and very limited in Finland where social democracy has been weakest.

Of course, social democracy is not synonymous with Keynesianism. Reflationary experiments could be inspired by militaristic territorial ambitions, as the cases of interwar Germany and Japan indicate; and both the 1929–1931 Labour government in Britain and the Weimar Social Democrats failed to embrace Keynesian proposals.[32] Even these exceptions, however, are congruent with the main point that Keynesianism was generally associated with attempts to appeal specifically to the working class. The 1929 Labour government and interwar SPD were both in weak minority positions within the legislature and anxious to distance themselves from charges that they were simply working class parties or the tool of the trade unions. Hence, they were even less inclined than usual to respond to trade union pressure for Keynesian policies. This was hardly social democracy at its most robust.[33]

Finally, it is important to distinguish between the initial introduction of Keynesian policies and their continuation. Social democratic parties have been most responsible for the initiation of Keynesian policies. Once tried, those policies were often maintained by more conservative successors.[34] But reverse cases are rare. The lengthy resistance to Keynesian policies that we find in postwar Germany, Italy, and Japan seems related to the political hegemony that conservative parties enjoyed there in the two decades after the war.

[31] In this case, the term *Keynesian* refers to policies that had a Keynesian complexion, since Keynes' own ideas were very quickly merged in Scandinavia with the indigenous doctrines of the Stockholm and Oslo economists.

[32] See the chapters in this volume by Lee, James, Hadley, and Weir.

[33] Individual personalities may also have played a role here: both Philip Snowden and Rudolf Hilferding, the leading financial experts in their parties, were opposed to reflation for rather different reasons. Multiple factors were at work in these, as in every historical case.

[34] Witness President Richard Nixon's well-known pronouncement: "We are all Keynesians now."

The Structure of the State and State-Society Relations

Despite their entrepreneurial qualities, however, politicians do not make policy in isolation. They operate within the institutional framework of a particular state, which structures the flow of advice they receive, vests some officials with more authority than others over economic decision making, and provides a specific set of institutional capacities for implementing policy. Hence, the structure of the state and state-society relations can also affect the ability of Keynesian ideas to secure influence over policy.

Three features of a state's structure seem to have conditioned its overall receptiveness to Keynesian ideas: (1) the permeability of the civil service; (2) the degree to which power over macroeconomic management was concentrated; and (3) the power of the central bank over policy making.

To make complex economic judgments, politicians rely heavily on the advice of experts.[35] In some states, this advice comes primarily from an echelon of permanent civil servants who have a virtual monopoly on access to official economic information and to the ultimate decision makers. In others, a new administration can bring in its own advisors and consult widely with outside economists. Keynesian ideas made the fastest inroads into policy in states like Sweden and Norway, where the use of public commissions and outside experts is an institutionalized component of policy making, and in the United States, where the president traditionally brings a wide range of outside advisors into his administration.[36] By contrast, Keynesian ideas were accepted only slowly in Britain, where policy is made by a permanent set of civil servants primarily concerned with the control of

[35] See Peter A. Hall, *The Political Dimensions of Economic Management* (Ann Arbor, Mich.: University Microfilms, 1982).

[36] Gunnar Myrdal and Bertil Ohlin both published important theoretical justifications of fiscal reflation as appendices to an official report on the unemployment problem in 1931. Other contributors to that report included economists Dag Hammarsjkold, Gosta Bagge, and Alf Johannson; Myrdal then wrote the sections justifying reflation in the pathbreaking Finance Bill of 1933. See C. G. Uhr, "Economists and Economic Policy-making 1930–1936: Sweden's Experience," *History of Political Economy* 9, 1 (Spring 1977), pp. 89–121; Lars Jonung, "The Depression in Sweden and the United States," in Karl Brunner, ed., *The Great Depression Revisited* (London: Martinus Nijhoff, 1981), pp. 286–315; Donald Winch, "The Keynesian Revolution in Sweden," *Journal of Political Economy* (1966), pp. 168–76; Bent Hansen, "Unemployment, Keynes and the Stockholm School," *History of Political Economy* (1981), pp. 256–77. In the United States, Marriner Eccles, Lauchlin Currie, and others used the resources of the government to gather data with which Keynesian concepts could be applied; and they seem to have been instrumental in persuading Roosevelt to pursue a policy of demand management after the 1937 recession. Currie says that he "bootlegged" some of Keynes' ideas even though he admits that initially U.S. economists felt they "had little to learn for policy purposes from *The General Theory* [and] did not . . . appreciate fully its novelty or importance for theory." See "Comment," *American Economic Review* (May 1972), pp. 139, 141; see also Alan Sweezy, "The Keynesians and Government Policy, 1933–1939," *American Economic Review* (May 1972), pp. 117–81.

public expenditure.[37] The Treasury of Gladstone was not well disposed toward Keynes, and Keynesianism took hold only when the war brought an influx of outside economists into government service.

Conversely, once Keynesian ideas had been introduced into policy making, the same structural features could affect the degree to which they became established there. It was many years before the British Treasury finally accepted Keynesian ideas, for instance, but once they were accepted, its hierarchical administrative structure rendered them an entrenched component of the policy process for over thirty years. By contrast, Keynesian ideas quickly found a foothold in the permeable U.S. state, but they never became so firmly entrenched there because their influence over policy fluctuated with the flow of Keynesian economists into and out of various administrations.[38]

Similarly, sustained countercyclical demand management has been most feasible in states where power over spending and taxing is highly concentrated. Where the executive is fragmented or faced with an especially powerful legislature, countercyclical demand management has been more difficult. Fiscal fine tuning has been almost impossible in Italy, for instance, where a legislature heavily oriented to patronage has great authority over spending, and even civil servants are subject to the pressures of *clientela* and *parentela*.[39] Likewise, the history of economic management in the fragmented U.S. state is best described as a series of episodes in which very disparate advisors attempt to persuade the president to reflate or deflate the economy while he tries to estimate what sort of taxing or spending program might make it through Congress.[40]

Finally, where the central bank played a powerful role in the process of economic policy making, it was likely to inhibit the pursuit of Keynesian policies. As noted above, central bankers evince special anxiety about deficit spending because it increases the public debt, which they have to fund, and tends to

[37] As Howson and Winch have shown, the Economic Advisory Council established by MacDonald helped to familiarize treasury administrators with Keynes' views, but it seems to have had a small impact, at best, on the overall formulation of policy. Susan Howson and Donald Winch, *The Economic Advisory Council 1930–1939: A Study in Economic Advice during Depression and Recovery* (Cambridge: Cambridge University Press, 1977); see also the essay by Winch in this volume.

[38] See the essay by Margaret Weir in this volume.

[39] See Joseph LaPalombara, *Interest Groups in Italian Politics* (Princeton: Princeton University Press, 1964).

[40] Compare Stephen Bailey's observation that "a majority sentiment expressed in popular elections for a particular economic policy can be, and frequently is, almost hopelessly splintered by the power struggles of competing political, administrative, and private interest [in the legislature], and is finally pieced together, if at all, only by the most laborious, complicated and frequently covert coalition strategies." *Congress Makes a Law* (New York: Columbia University Press, 1950), p. 237; see also Stein, *Fiscal Revolution in America*, chaps. 10–18; and George L. Bach, *Making Monetary and Fiscal Policy* (Washington, Brookings Institution, 1971).

threaten the value of the currency, which they have to defend. Three of the countries that were slowest to make active use of fiscal policy for countercyclical purposes—Finland, Germany, and Italy—all have had powerful central banks; and, even in France and Britain, the postwar move toward Keynesianism was accompanied by nationalization of the central bank.[41]

The structure of the state itself has been the subject of considerable research in recent years and its impact on policy making well explored.[42] However, much less attention has been paid to the structure of state-society relations and their impact on policy. Every state is tied to society by a network of institutionalized relations that structure the flow of information, resources, and pressure between public and private sectors. They include: established networks for interest intermediation, institutional arrangements for the provision of public finance, and organizational ties to private centers of knowledge. These relations can have an equally significant impact on the state's capacity to implement certain policies, and they deserve further scrutiny.[43]

In the Keynesian case, one aspect of these relations seems to have been particularly important. This was the institutional relationship developed between each state and the capital markets for the purpose of providing public finance. That turned on the kind of financial instruments that each state developed to fund its debt, the regulatory regime it imposed on the banking sector, and the general character of the capital markets at its disposal. Although it has been virtually ignored by those who write about Keynesianism, this relationship was crucial to the capacity of a state to sustain high budgetary deficits and one of the principal reasons that Keynesian experiments were not undertaken more quickly or more widely in the 1930s.

Today, the financing of public sector deficits is not generally assumed to be a problem; but relations between the state and the capital markets were more prob-

[41] On this point, see the essay by Pekkarinen in this volume; Michael Kreile, "West Germany: The Dynamics of Expansion," in Peter Katzenstein, ed., *Between Power and Plenty* (Madison, Wisc.: University of Wisconsin Press, 1978), pp. 191–224; and Donald Hodgman, ed., *The Political Economy of Monetary Policy* (Boston: Federal Reserve Bank, 1983).

[42] See Evans, et al., *Bringing the State Back In*; and Hall, *Governing the Economy*, chap. 8.

[43] For work that does take such relations into account, see Theda Skocpol and Kenneth Feingold, "State Capacity and Economic Intervention in the Early New Deal," *Political Science Quarterly* 97, pp. 256–78; and Theda Skocpol and Edwin Amenta, "States and Social Policies," *American Review of Sociology*, 12 (1986), pp. 131–57. Similarly, I have argued elsewhere that the success of an economic strategy depends as much on the organization of society as on the organization of the state; see Hall, *Governing the Economy*, chap. 8. See also Peter Lange and Geoffrey Garrett, "The Politics of Growth: Strategic Interaction and Economic Performance in the Advanced Industrial Democracies, 1974–1980," *Journal of Politics*, 43, 3 (August 1985), pp. 792–827, who argue that the feasibility of an economic policy depends simultaneously on the complexion of the governing party and the organization of labor.

lematic during the interwar era. The aversion that many public officials felt toward government deficits in the 1930s did not derive solely from traditional forms of thought. Few states had yet perfected the contemporary institutions that facilitate deficit finance; and the willingness of interwar governments to embark on reflationary experiments corresponds rather closely to the institutional problems that each faced in financing its deficits.

The Swedish Riksbank, for instance, could fund the 1932 public works program primarily because that program made little use of deficit financing. The public debt of Sweden rose only slightly between 1932 and 1937, as improvements in the terms of trade for Swedish exports increased both the level of economic growth and government revenues shortly after the program was passed.[44] By contrast, the seemingly incomprehensible decision of President Hoover to raise taxes in order to balance the budget at the depth of the 1931 Depression was primarily motivated by fears that the U.S. government could no longer finance a deficit in the face of falling bond prices, rising interest rates, and large outflows of gold that year. President Roosevelt's later decision to tolerate rising deficits was greatly facilitated by prior measures to limit the convertibility of gold, shore up the banking sector, authorize unsecured currency, and improve the financial balance of the Federal Reserve system. Even then, Roosevelt's hesitation to endorse a fiscal stimulus stemmed largely from continuing concerns about the government's ability to sell its bonds.[45]

The situation in many other nations was much worse. The Weimar Republic's attempt to raise 500 million reichsmarks in 1927 to finance agricultural and industrial subsidies had failed; and in 1929, the Republic raised only 177 million reischsmarks of the 500 million it sought at particularly generous terms.[46] A reflationary policy would have been virtually impossible to finance, except by means likely to rekindle the hyperinflation of 1922–1923, at least until Hitler found that even bankers respond to the barrel of a gun. In France, the government's ability to fund public sector deficits without resorting to monetary creation depended on a market for long-term bonds that was dominated by foreign capital; yet 11 billion francs left France in the three months preceding the 1936 Blum government and another 7 billion francs went in the six months after devalua-

[44] The Swedish debt rose from 2202 million Kroner in 1932 to only 2342 million kroner in 1937. See Kindleberger, *The World in Depression 1929–1939* (Berkeley: University of California Press, 1973), p. 182; H. W. Arndt, *The Economic Lessons of the 1930s* (London: Oxford University Press, 1940), p. 209, n. 3; and Margaret Cole and Charles Smith, *Democratic Sweden* (London: Routledge, 1938).

[45] See Stein, *Fiscal Revolution in America*, pp. 35, 98; and Kindleberger, *World in Depression*, pp. 185ff.

[46] See Harold James, *The German Slump* (Oxford: Clarendon Press, 1986), chap. 3.

tion.[47] The Blum government had to seek advances from the Bank of France amounting to half its budgetary receipts in 1936 because it could not find purchasers for its bonds, and its brief experiment at reflation was terminated in 1937 largely because the government could not finance the deficit. It is not surprising that "the obsession of the directors of the Treasury from 1932 to 1944 and of the Ministers in the rue de Rivoli as well was to reduce the gap between declining revenues and growing expenses."[48]

Even in Britain, the economic policies of the 1930s were dominated by the report of the May Committee, appointed to devise means of refunding the public deficit, rather than the report of the Macmillan Committee looking into industrial renovation. Despite Keynes' assertion that funding the deficit was "mainly a technical matter . . . for inside experts," Treasury officials warned the prime minister in 1930 that the government simply could not raise enough money to finance a major public works program.[49]

Mechanisms for the provision of public finance were much more rudimentary in the 1930s than they are today. Even if the image of the British Cabinet waiting in the garden of No. 10 Downing Street for the verdict of J. P. Morgan and Co. on their 1931 deflationary package is slightly melodramatic, capital markets were less developed than they are today, and a few private bankers played a much greater role in the provision of public finance. Few governments wanted to increase their dependence on these individuals. It is revealing that the state secretary responsible for German economic policy resisted calls for reflation in September 1930 with the comment that "I am afraid of the dependence of the Government on the Behrenstrasse [the street traditionally associated with the German banking community]. . . ."[50] This aspect of state-society relations is one of the important reasons why Keynesian proposals for deficit spending were greeted so coolly in the interwar years.[51]

[47] See R. Frankenstein, *Le Prix du Réarmement Français 1935–39* (Paris: Sorbonne, 1982); and Christian Saint-Etienne, *L'Etat Français Face aux Crises Economique du XXème Siècle* (Paris: Economica, 1983).

[48] Michel Margairaz, "Direction et Directeurs du Trésor de l'Orthodoxie à la Reforme (1930–1950)," in Patrick Fridenson and Andre Straus, *Le Capitalisme Français* (Paris: Fayard, 1987), pp. 49, 52; see also André Straus, "Le Financement des Depenses Publiques dans L'Entre-Deux-Guerres," ibid., pp. 97–114; L. Germain-Martin, *Le Problème financier, 1930–36* (Paris: Domat-Montchrestien, 1936); and R. Frankenstein, *Le Prix du Réarmement Français 1935–39* (Paris: Publications de la Sorbonne, 1982).

[49] Keynes is quoted in Robert Skidelsky, *Politicians and the Slump* (London: Macmillan, 1967), p. 179; see also Sir Richard Hopkins' testimony to the Macmillan Committee, Q5549, Committee on Finance and Industry, *Report* (London: HMSO, 1931).

[50] Quoted in James, *German Slump*, p. 61; see also pp. 50–52; and Harold James, *The Reichsbank and Public Finance in Germany 1924–33* (Frankfurt: Fritz Knapp, 1985).

[51] See Williamson, "Banker's Ramp"; Marquand, *Ramsay MacDonald* (London: Jonathan Cape, 1977), chap. 25; Ross McKibbin, "The Economic Policy of the Second Labour Government

The Structure of Political Discourse

We are used to thinking about the structure of the state and even the structure of state-society relations as factors that affect the policies a nation pursues. These are variables of recognized importance to contemporary political analysis. But to stop the analysis here would be to miss a crucial component of the environment in which policy is made. Policy making takes place within an institutional framework, whose configuration varies from nation to nation, but it also occurs within the context of a prevailing set of political ideas. These include shared conceptions about the nature of society and the economy, various ideas about the appropriate role of government, a number of common political ideals, and collective memories of past policy experiences. Together, such ideas constitute the political discourse of a nation. They provide a language in which policy can be described within the political arena and the terms in which policies are judged there.

Once a new set of economic ideas, like Keynesianism, becomes the object of official scrutiny and debate, it enters this universe of political discourse and is accorded a particular niche within the web of meaningful concepts and associations that make it up. The nature of prevailing political discourse can work to the advantage or disadvantage of new policy proposals. In terms of prevailing discourse, some new proposals will be immediately plausible, and others will be barely comprehensible. Therefore, like the structure of the state or the orientation of the governing party, the nature of national political discourse can have a major impact on the likelihood that a new set of policy ideas will be accepted.[52]

There is also a certain structure to the political discourse of every nation, based on the network of associations that relate common political ideals, familiar concepts, key issues, and collective historical experiences to each other. This network of associations is what gives most political terms their collective meaning. The term *planning*, for instance, summons up one set of associations in France and another in the United States. Such associations are generated by the shared historical experiences of a nation as interpreted by a succession of political leaders. Over time, each nation builds up a set of politically evocative concepts and

1929–31," *Past and Present* 68 (August 1975); R. Bassett, *Nineteen Thirty One: Political Crisis* (London, 1958); and more generally, Stephen Schuker, *The End of French Predominance in Europe* (Durham: University of North Carolina Press, 1979).

[52] A number of works draw our attention to the role of discourse in the determination of policy. See Jane Jenson, "Struggling for Identity: The Women's Movement and the State in Western Europe," *West European Politics* 8, 4 (October 1985), pp. 5–18, who uses the term *universe of political discourse* with slightly different emphases; Rosemary C. R. Taylor, "The Politics of Prevention," *Social Policy* 13, 1 (Summer 1982), pp. 32–41; William Connolly, *The Terms of Political Discourse* (Princeton: Princeton University Press, 1983); and Murray Edelman, *The Symbolic Uses of Politics* (Urbana, Ill.: University of Illinois Press, 1985).

collective reference points that define the terms of political debate and provide participants in the political arena with a discursive repertoire to be used there.

Therefore, when Keynesian ideas were introduced into each nation, the particular political meaning accorded to them was affected by the nature of prevailing political discourse. Indeed, the same set of ideas acquired a rather different meaning in different countries. During the 1950s, for instance, the British saw Keynesianism as a relatively noninterventionist doctrine that promised hands-off economic management in contrast to the nationalization program, wage controls, and industrial planning of the 1945–1951 Labour government. At the same time, however, many Americans took Keynesianism to be a relatively interventionist doctrine, as a result of its association with wartime controls and proposals for national economic planning. In both cases, the political meaning attached to Keynesian ideas was affected by the kind of advocates it attracted and the way they presented the doctrine, but this presentation was itself influenced by the terms of national political discourse. Moreover, the initial connotations attached to Keynesian ideas in each nation were slow to change.

The structure of political discourse is most useful, however, for explaining the cool reception that Keynesian ideas received during the interwar years. This is difficult to appreciate today, because we are used to relatively large governments that engage in substantial amounts of social spending, regularly incur deficits, and commonly practice Keynesian forms of demand management. We know that none of these practices has led inexorably to totalitarianism, destroyed the private economy, or unleashed unbearable political pressures for ever-higher levels of spending. Indeed, Keynesianism has been widely associated with the thirty years of prosperity that followed 1945.

In the 1920s and 1930s, however, the structure of political discourse was quite different and Keynesianism was an unknown quantity. An entirely different set of issues was salient at the time.[53] There was widespread uncertainty about whether the capitalist economy would survive the Depression. The rise of oligopolies, militant trade unions, and the managerial revolution had called long-standing models of free market capitalism into question, but no one knew for sure what might replace them. Many believed that a return to laissez-faire was the only alternative to Bolshevism; others hesitated to interfere even farther with a system that was badly out of equilibrium. In the face of such uncertainty and deteriorating economic conditions, many politicians were understandably reluctant to fiddle with the role of the state in the economy.

Some saw real dangers in this. The massive growth of the state during World

[53] For a nice elaboration of these issues, which has influenced this account, see the chapter by Bradford Lee in this volume.

War I and the recent Bolshevik revolution shook public consciousness about what an unbridled state could or might do.[54] Millions of people had been given the vote after World War I, and governments that had rested comfortably on elite accommodation for decades suddenly had to cope with an era of mass politics.[55] By this time, moreover, the principle of balanced budgets had become a defining element of limited government. It provided a rationale with which public officials could resist the potentially limitless demands of the masses for ever more public resources. Few were as bold as Keynes, who said that the task was "to invent new wisdom for a new age."[56] Instead, most saw the principle of balanced budgets as a guarantor for the integrity of the state. Like the gold standard, it put a limit on the ability of unscrupulous politicians to bid for public support with ruinous handouts of public money, and it served as a bulwark against debasement of the currency.[57] Many believed that if this dike were breached, the economy could be ruined and the democratic state itself swept away by a rising tide of popular demands for spending.[58]

In the context of such discourse, it is easier to understand why interwar politicians were reluctant to incur the massive budgetary deficits that Keynesians were urging on them. To do so was not simply to choose one economic policy among others; it meant abrogating the most fundamental principles of fiscal responsibility and democratic governance of the time. Moreover, precisely those businessmen whom Keynes expected to invest in response to a fiscal deficit were saying that a deficit would have just the opposite effect. A Keynesian stimulus works through a kind of self-fulfilling prophecy about investment and demand,

[54] As one group of British politicians observed in 1927: "The war period shattered preconceived economic notions, proved possible theoretic impossibilities, removed irremovable barriers, and created new and undreamt of solutions." R. Boothby, J. de V Loder, H. Macmillan, and O. Stanley, *Industry and the State* (London, 1927), p. 35, quoted by Arthur Marwick, "Middle Opinion in the Thirties: Planning, Progress and Political 'Agreement,'" *English Historical Review* 79 (April, 1964), p. 286.

[55] See Seymour Martin Lipset and Stein Rokkan, *Party Systems and Voter Alignments* (New York: Free Press, 1967), pp. 1–64; Hans Daalder, "Parties, Elites and Political Divisions in Western Europe," in Joseph LaPalombara and Myron Weiner, eds., *Political Parties and Political Development* (Princeton: Princeton University Press, 1966), pp. 43–78; and Peter Flora and Arnold Heidenheimer, eds., *The Development of Welfare States in Europe and America* (London: Transaction, 1981).

[56] John Maynard Keynes, *The Economics of the Peace*, p. 327.

[57] See the chapter by Bradford Lee in this volume. Even Herbert Hoover saw that higher public expenditure might reduce unemployment by increasing purchasing power, but he was prevented from acting on this economic view by a political philosophy that objected to such measures on the grounds that they would likely lead to increased state intervention. See William J. Barber, *From New Era to New Deal* (Cambridge: Cambridge University Press, 1985), p. 190.

[58] Another economic crisis in the 1970s, this time based on rising inflation, inspired a similar set of concerns, best expressed in Michel Crozier et al., *The Crisis of Democracy* (New York: Trilateral Commission, 1974).

but it is hard to see how that dynamic could take place when those who were supposed to invest themselves saw deficit spending as disastrous rather than reassuring. The effectiveness of Keynesianism itself may have depended on some prior changes in the structure of political discourse.

In short, during the interwar period, Keynesianism raised a set of issues that we barely think about today. These were often reinforced by the peculiarities of national political discourse. The U.S. case provides a particularly interesting example. There is a paradox at the heart of the New Deal: why did President Roosevelt, who was willing to countenance heavy economic intervention through the regulatory programs of the first New Deal, nonetheless resist calls for deficit spending until well into his second term in office? This outcome can be traced to the impact of the Progressive movement on political discourse in the United States.

At the turn of the century, the Progressives mounted an influential attack on the rising power of business oligopolies and on the corruption associated with patronage politics. They saw these as the two evils afflicting U.S. politics. To limit the power of oligopolies, they campaigned for regulatory policies; and to inhibit patronage, they sought strict limits on federal spending so that social programs could not be used for partisan political purposes.[59] As a result, regulatory policies became an accepted tool of governance in the United States, and large spending programs became associated in the public mind with corruption. In this context, President Roosevelt's position is much more comprehensible. Like the Progressives, he saw regulation as an acceptable weapon of reform, but he hesitated to incur large budget deficits or to embark on massive spending programs because these practices were still associated with irresponsible and corrupt government.

The structure of national political discourse had an important impact on the way in which Keynesian ideas were received in each nation. National discourse could change over time, however, under the impact of new historical experiences; and it is to one such experience, especially significant for Keynesian ideas, that we now turn.

The Impact of World War II

Conventional wisdom regards the Great Depression of the 1930s as the historical experience that was most crucial for persuading policy makers to accept Keynesian ideas. It certainly *did* much to demolish classical views of the econ-

[59] Cf. Ann S. Orloff and Theda Skocpol, "Why Not Equal Protection? Explaining the Politics of Public Social Spending in Britain, 1900–1911, and the United States, 1880s–1920," *American Sociological Review* 49, 6 (December 1984), p. 743.

omy as a stable system in no need of state intervention. However, Keynes' own ideas had little influence in the 1930s.[60] Much more central to the eventual acceptance of Keynesian ideas were the events associated with World War II. There are several respects in which the war and its immediate aftermath propelled Keynesian ideas forward.

First, the war provided a crucial testing-ground for Keynesian concepts in Britain and the United States; and the success of those experiments was instrumental in persuading policy makers to try Keynesian policies in peacetime as well. The war brought an influx of economists into both governments, and many were Keynesians who saw that the concepts of aggregate demand management could be applied to the problem of depressing consumer spending so as to make room for war production. The need for techniques of monitoring war production also lent impetus to the efforts of James Meade, Richard Stone, and their U.S. counterparts to develop statistical series along Keynesian lines.[61] In short, the war provided orthodox policy makers with an opportunity to try out Keynesian ideas in a situation where they were to be used for deflationary, rather than reflationary, purposes. This was less threatening to officials with traditional Treasury concerns about budget deficits and public spending than earlier proposals for a fiscal stimulus had been. The war provided crucial experience with Keynesian techniques, and as those techniques proved useful, policy makers began to apply them to the anticipated problems of the postwar economy as well.

Second, the outcome of the war placed the United States in a hegemonic position from which it could exercise great influence over the postwar economic strategies of its former opponents and allies. Along with the financial aid that it

[60] Despite his famous letters, Keynes seems to have made very little impression on Roosevelt and his advisors. The Swedes were primarily influenced by the theories of the indigenous Stockholm school. Hitler's economic policies seem to have been motivated by a variety of factors quite independent of Keynes. And, although Blum's reflationary proposals may have been indirectly influenced by Keynes' writings through George Boris's advice to Pierre Mendes France, the first was short-lived and the second was never implemented. See Sweezy, "Keynesians and Government Policy"; Donald Winch, "The Keynesian Revolution in Sweden," *Journal of Political Economy* (1966), pp. 168–76; Bent Hansen, "Unemployment, Keynes and the Stockholm School," *History of Political Economy* 13, 2 (1981), pp. 256–77; Carl G. Uhr, "The Emergence of the 'New Economics' in Sweden," *History of Political Economy* (1973), pp. 243–60; John D. Heyl, "Hitler's Economic Thought: A Reappraisal," *Central European History* (March 1973), pp. 83–96; François Fourquet, ed., *Les Comptes de la Puissance* (Paris: Recherchés, 1980), pp. 21ff.; Michel Marguiraz, "Les Socialistes face à l'Economie et à la Société en Juin 1936," *Le Mouvement Social* 99 (Oct.–Dec. 1975), pp. 87–108.

[61] See Richard Stone, "The Use and Development of National Income and Expenditure Estimates," in D. N. Chester, ed., *Lessons of the War Economy* (Cambridge: Cambridge University Press, 1951), pp. 83–101.; Don Patinkin, "Keynes and Econometrics: On the Interaction Between the Macroeconomic Revolutions of the Interwar Period," *Econometrica* 44, 6 (December 1976), pp. 1091–1123; Carol S. Carson, "The History of the United States National Income and Product Accounts," *Review of Income and Wealth* (1975), pp. 153–81.

provided for postwar reconstruction, the United States also sent economic advisors to Europe and Japan, many of whom were proselytizers for Keynesian views. Keynes himself contributed to the development of new international economic arrangements designed to allow some room for national programs of demand management.[62] The international exchange of economists that followed the war further accelerated the diffusion of Keynesian ideas.[63]

However, the influence of U.S. advisors was not monolithically Keynesian. As Albert Hirschman points out, the aggregate thrust of U.S. pressure seems to have been more orthodox in the nations it defeated because they were dominated by occupation authorities in which businessmen and State Department officials with orthodox economic views tended to play a prominent role, while U.S. influence over its former allies may have been more Keynesian because they dealt primarily with international advisory agencies and bilateral delegations in which many Keynesian economists played a greater role.[64] Domestic factors were at work here as well, but the bifurcated nature of U.S. influence may have contributed to the reluctance with which postwar Germany and Japan accepted Keynesian ideas.

Finally, the deep social and political upheavals associated with World War II shifted the tectonic plates of the political order in ways that made room for economic experimentation. The war had a deep impact on the structure of political discourse. It discredited the political forces associated with the lead-up to war and the preceding depression in nations as diverse as Britain, France, Germany, and Italy. Depending on the nature of the 1930s regime, that worked for or against Keynesianism. In Britain and France, a reaction against the "wasted years" or "economic malthusianism" of the 1930s brought social democrats with strong interests in full employment and Keynesian ideas to power.[65] In Germany, Italy, and Japan, the reaction against fascism and military defeat initially

[62] See the essay on Keynes and international economics by John Williamson, "Keynes and the International Economic Order," in David N. Worswick and James Trevithick, eds., *Keynes and the Modern World* (Cambridge: Cambridge University Press, 1984); John Gerald Ruggie, "International Regimes, Transactions and Change: Embedded Liberalism in the Postwar Economic Order," *International Organization* 36 (1982); and Stephen Krasner, "United States Commercial and Monetary Policy," in Peter Katzenstein, ed., *Between Power and Plenty* (Madison, Wisc.: University of Wisconsin Press, 1978).

[63] See G. John Ikenberry, "The Spread of Norms in the International System," paper presented to the Annual Meeting of the American Political Science Association, Chicago, September 5, 1987.

[64] See the essay by Albert O. Hirschman in this volume. In many cases, there were conflicts among Keynesians and anti-Keynesians on the U.S. side at this time that paralleled those among European officials; and as ad hoc coalitions between the two sides rose and fell, policy as well tended to shift in this period. For several good examples, see John Lamberton Harper, *America and the Reconstruction of Italy, 1945–1948* (Cambridge: Cambridge University Press, 1986).

[65] See Stanley Hoffmann, et al., *In Search of France* (New York: Harper & Row, 1963); and the essay by Pierre Rosanvallon in this volume.

brought conservative democrats, determined to revive a free market system and restore their nation's international economic stature, into office. Here Keynesian emphases on aggregate demand and employment also took second place to the supply-side problems of reconstruction. In more general terms, however, the break with traditional patterns of policy making that the war precipitated created openings for Keynesian ideas in all the nations studied here.

In some respects, these events have a status in this analysis that is somewhat different from that accorded the other three factors outlined above. We can expect the progress of any new set of ideas to be affected, as Keynesianism was, by the orientation of the governing party, the structure of state-society relations, and the nature of political discourse. Similarly, wars have traditionally been a variable of great importance to political outcomes, and the events associated with World War II pushed Keynesian ideas forward. But the precise constellation of events that followed World War II is unlikely to be repeated. As Albert Hirschman points out, the economic ideas of the future are likely to be propelled across nations by a somewhat different combination of events. However, we can learn something from the events of World War II about the kind of factors that tend to facilitate the international diffusion of economic ideas: a national crisis that mobilizes professional talent may bring new ideas into the policy system; a new hegemony that gains force in the international arena, like the United States after World War II, may be a powerful transmitter of new economic ideas; and wars or significant regime changes can inspire a break with the economic orthodoxies of the past.

CONCLUSION

The essays in this volume take the role of ideas in political life seriously. Over the ages, politics has traditionally been seen as a struggle for power, a contest for control over scarce resources that pits one social group against another in recurring conflict for domination. Without denying the truth of this, however, we can see that politics is more than that. In democratic societies especially, it is also a process whereby the basic ideals and identity of a nation are defined, as attempts are made to master the collective problems facing society. Hence, ideas are central to politics in two ways. From the competing moral visions put forward by contenders for political power, a sense of collective purpose is forged; and out of the policy proposals generated by intellectuals and officials alike, solutions to common problems are devised.[66] We can think of these as two complementary

[66] This approach to the role of ideas in politics is well represented by the work of Samuel H. Beer and Hugh Heclo; see Beer, *Modern British Politics* (New York: Norton, 1982); and Heclo, *Modern Social Politics in Britain and Sweden*.

processes that call upon the best in human beings, even though politics is all too often thought to thrive on the worst aspects of human nature.

This study of Keynesianism shows how closely intertwined these two processes are. On the one hand, the essence of Keynesian doctrine lay in a technical argument about the operation of the economy and the role of fiscal policy in its modulation. This was an argument of interest primarily to economists and officials charged with responsibility for the performance of the economy. On the other hand, the adoption of Keynesian policy generally depended on the triumph of a broader political vision that saw unemployment as an intolerable collective problem and was willing to condone a transformation in the role of the state in order to resolve it. The developments that led to the Keynesian era took place as a result of ideological change in the administrative and political spheres simultaneously.

If the Keynesian case demonstrates that ideas have real power in the political world, however, it also confirms that they do not acquire political force independently of the constellation of institutions and interests already present there. This volume begins with John Maynard Keynes' well-known tribute to the political power of economic ideas, but it is more appropriate to conclude with the observation of his predecessor, John Stuart Mill, that "ideas, unless outward circumstances conspire with them, have in general no very rapid or immediate efficacy in human affairs."[67] We have found that the influence of Keynesian ideas within a nation depended heavily on the range of material circumstances, institutional structures, and ideas that were already there.

To sort through those circumstances for those factors that most affected the progress of Keynesian ideas is a difficult enterprise. I have summarized many of this volume's findings by suggesting that Keynesian ideas were judged, not only in terms of their economic viability, but in terms of their administrative and political viability as well. In addition, I have suggested that the readiness of a nation to implement Keynesian proposals for countercyclical demand management depended primarily on four factors: the orientation of its governing party, the structure of the state and of state-society relations, the nature of existing political discourse, and the impact of events associated with World War II.

For the most part, it is not unreasonable to think that factors of this sort would condition the reception accorded any new set of economic ideas. We must remember, however, that Keynesianism itself changed the economic and political worlds in important respects. Notwithstanding thirty years of prosperity, founded to some degree on the confidence that Keynesianism inspired, the international economy encountered great difficulties in the 1970s. Deficit spending, in part

[67] John Stuart Mill, "The Claims of Labour," *Edinburgh Review* 81, 164 (1845), p. 503.

associated with Keynesianism, contributed to an expansion in the world's money supply and serious increases in global rates of inflation. Similarly, the relatively high levels of employment that Keynesian policies helped to secure strengthened the position of trade unions in the industrialized nations; and attempts to impose wage restraint on these unions led many nations toward incomes policies that strained the authority of their regimes.[68] Electorates accustomed to steady growth became disillusioned with the stagflation of the 1970s and shifted their allegiance from one governing party to another. As an economic theory devised for the 1930s seemed increasingly unable to cope with the economic problems of the 1980s, many politicians began to cast about for alternative solutions.

Over the last two decades, then, Keynesian doctrines have fallen into disrepute. Rival ideas associated with monetarism have made considerable headway in the economic world; and a variety of governments have found new reasons to celebrate the private market economy. However, it is mute testimony to the resilience of Keynesian ideas that many of the most radical economic experiments of the 1980s still have a faint Keynesian tone about them. No government has yet been able to shed the responsibility for economic management that the Keynesian era bequeathed to it, and none has fully renounced the macroeconomic tools that Keynes devised.

Moreover, as we contemplate the way forward, we know from the history of Keynesianism, that any new solutions to economic problems will also have to provide solutions to prevailing political problems, if they are to be viable. We can think of economics as a science that allows mankind to gain greater mastery over the environment. However, this case, like many others, suggests that science has no purchase over politics unless it also speaks to the interests of those who operate in that realm. The ultimate influence of Keynesian ideas stemmed from their ability to address the concerns of both realms, and the impact of Keynes' successors will undoubtedly rest on the same foundations.

[68] See Hall, *Governing the Economy*, chaps. 4–7.