KEYNESIANISM AS FULFILLMENT

by

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Master of Arts
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DEDICATION

This is dedicated to my love, Olivia Hart.

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ABSTRACT

KEYNESIANISM AS FULFILLMENT

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This essay is composed of three chapters that contextualize the Keynesian Revolution within trends in history of economic thought and trends in institutional transformations in American public administration.

In the first chapter, I look at the transforming nature of economics between Adam Smith and the Keynesian revolution. It is argued that Smith and the classical economists were engaged in a constitutional analysis and that that perspective gradually faded throughout the nineteenth century and disappeared in Keynesianism.

In the second chapter, I explain why the Keynesian Revolution was able to so quickly sweep the economics profession; Keynesianism represented the opportunity for economists to become experts to the state. The demand for economist experts was generated by the Progressive reforms of public administration that took place through the first half of the twentieth century. Keynesianism fulfilled these demands. Throughout the

chapter I show the affinities between the Keynesian supply of expert economics and the demand that derived from the Progressive ideals.

In the final essay I argue that the failures of Keynesian economics can be seen as a facet of the broader problems in the Progressive paradigm. Because public decision makers are not omniscient or benevolent, institutions must be arranged to cope with knowledge and incentive problems. Ostrom presents a theory of polycentric order as a means of coping with these problems. He also argues that a similar theory was the foundation of the American constitution that the Progressives rejected. The Progressives ignored these issues in their reforms of American public administration. The failures of Keynesian policies can thus be seen as a manifestation of the problems of the Progressive bureaucratic regime.

INTRODUCTION

Over 200 years ago, Adam Smith expressed concern for the juggling tricks that states inevitably perform. Spending financed through borrowing accumulates into debts that eventually have to be paid back or financed through additional debt and at some leveling of spending debt finally becomes unaffordable. The recent debt crises in the U.S. and the ongoing crisis in Europe suggest that many nations are currently feeling the pressure of those accumulating debts. According to Smith, nations then have two options. They can either disgracefully declare bankruptcy or inflate their way out of debt. Neither scenario leaves the nation with a positive looking future

Over the past 50 years we have seen ongoing deficits. Only in a few instances did the U.S. balance its national budget. At the same time, the federal reserve has been steadily increasing the money supply and steadily raising prices. In response to the most recent recession, deficits were dramatically increased. When that failed to produce recovery, multiple rounds of quantitative easing were intended to further boost aggregate demand. Most recently, Ben Bernanke announced unlimited quantitative easing until more positive economic growth is seen.

The Keynesians predicted that if governments followed their prescriptions, business cycles would smooth, unemployment would be eliminated, and inflation would be managed. Since then, Keynesian policies have been half followed. Repeatedly, deficits have been used to boost aggregate demand during recessions. Unfortunately, business cycles and unemployment haven't been eliminated and are not clearly better than in the pre-Keynesian world (Romer, 1999). The Keynesians tell us that business cycles would have been much worse had the spending not taken place, but this kind of unfalsifiable reasoning is hardly helpful. Moreover, instead of following Keynesian prescriptions during the boom, politicians have continuously engaged in deficit spending and inflation, the kind of juggling trick that Smith was concerned about. Whether we deem this the fault of politicians or Keynesians is irrelevant, at some point we have to start questioning the applicability of Keynesian policy prescriptions.

The intention of this essay is to shed light on these events. In the first chapter, I look at the transforming nature of economics between Adam Smith and the Keynesian Revolution. It is argued that Smith and the classical economists were engaged in a constitutional analysis. That is, economics was defined by a focus on rules and the incentive they produced. That perspective gradually faded away throughout the nineteenth century and gave way to a focus on the formal properties of optimality.

This perspective towards economic sets the stage for the second chapter which focuses on the Keynesian Revolution. I argue that the Revolution was so massive and rapid because Keynesianism represented the opportunity for economists to become experts to the state. The demand for economist experts was generated by the Progressive reforms of public administration that took place throughout the first half of the twentieth century. Keynesianism fulfilled these demands. Throughout the chapter I show the affinities between the Keynesian supply of expert economics and the demand that derived from the Progressive ideals.

In the final essay I argue that the failures of Keynesian economics can be seen as a facet of the broader problems in the Progressive paradigm. Because public decision makers are not omniscient or benevolent, institutions must be arranged to cope with knowledge and incentive problems. Ostrom presents a theory of polycentric order as a means of coping with these problems. He also argues that a similar theory was the foundation of the American constitution that the Progressives rejected. The Progressives ignored these issues in their reforms of American public administration. The failures of Keynesian policies can thus be seen as a manifestation of the problems of the Progressive bureaucratic regime.

The conclusion is that in order to change the direction of events in the U.S., we have to better understand the proper scope of government. The conclusion for the economics profession is that if we are not to be experts to the state, then we must rediscover the constitutional analysis found in the classical economists and in some modern public choice and Austrian scholars.

CHAPTER ONE: THE DECLINE OF LAISSEZ-FAIRE

My purpose in this chapter is to document a transformation that took place in the economics profession between Adam Smith and John Maynard Keynes. The argument is that the type of economic analysis that Smith was engaged in was different from that of Keynes. Smith was engaged in a constitutional analysis, as is described below. Gradually, the constitutional perspective and the concern for rules faded, and economists became focused on the formally properties of an optimum. Ignoring the role of rules led economists, in the policy prescriptions, to assume a benevolent and omniscient government that would follow their advice.

I first define the constitutional economic approach. It is necessary to spend a bit of time here, because this approach will also be important in later chapters. I then argue that that approach existed in the classical economists, was fading throughout the nineteenth century, and was non-existent in the Keynesians.

Constitutional Economics

Throughout the second half of the twentieth century, the field of public choice has gained more and more traction within the economics discipline. The core of the public choice paradigm is the idea that our assumptions regarding individual behavior in the market can be usefully applied to the political realm. Prior to the rise of the public choice approach, it had become normal for economists to assume that individuals acted rationally and selfishly on the market, but then to assume otherwise regarding motivations in government (Boettke, Coyne, Leeson, & Sautet, 2005, p. 287). Market failure economists, for instance, could label their approach as such precisely because they assumed there was a capable and trustworthy government that could perfect the imperfections of the market. As Demsetz described it, economists were committing the nirvana fallacy by comparing one set of institutions to an ideal (Demsetz, 1969). Public choice arose to fill the vacuum created by this disregard for institutions. The approach taken applied the same assumptions regarding individual rationality and selfishness in the market to political actors. The general conclusion was that we can't assume that government will actually implement the prescriptions of economists.

The analysis of political decision making fell into a broader paradigm that James Buchanan labeled Constitutional Economics (Buchanan, 1990). Orthodox economics had been primarily focused on choices within constraints. Consumers, for example, choose the wealth maximizing bundle of goods within their budget constraints. More generally, decisions are also constrained by laws, nature, history, etc. The focus of constitutional economics was not on choices within constraints but on choices over constraints.

As Buchanan argues, it might at first seem odd to think of choices over constraints that we typically take as exogenous, but upon a little investigation it becomes clear that we choose constraints all the time. Elsewhere he gives the example of an alarm clock as a constraint that we impose upon ourselves to prevent our future selves from sleeping-in (Buchanan, 1975). Even though the alarm clock restricts our future choices we are surely better off for it. Looking beyond ourselves we also find the desire for constraints over our relationships with others. An individual is, presumably, better off if everyone else is constrained from committing murder. Even though it constrains that individual's choices, and thus makes him somewhat worse off, each individual can "exchange" his freedom to murder in return for the same constraint on everyone else.

The assumptions regarding individual rationality and self-interest are thus applied not only to choice within the rules, but also to choice over the rules. Politics and society are conceived as cooperative, rather than conflictual. From this perspective, there is no "correct" rule, in the same way that on the market there is no "correct" price at which a buyer and seller exchange. Just as the terms of an exchange on the market are determined by the subjective preferences of individuals, so are the agreed upon rules regarding how to live together. Instead of defining any specific outcome as good, the constitutional perspective is concerned more with the process of collective decision making. From a rule of unanimity and through a process of negotiation and agreement, the outcome is ensured to be good.

From this perspective, economic analysis is part of broader institutional analysis. When economists are analyzing the market, they are doing so based on the assumption of well-defined private property rights. Private property rights represent the rules of the game and define the incentives facing individual actors (Alchian & Demsetz, 1973). Those actors then form strategies around those incentives in order to maximize wealth. Investment, for example, is an institutionally contingent action. Without private property, where an investor cannot expect to bear the full benefits and costs of his foregone consumption, there will be only small amounts of investment. Economic analysis is then an analysis of action within the institution of private property.

The important point is that constitutional analysis pushes the focus back a step. The question is not whether a specific allocation of resources is the right allocation or whether there is a better allocation, but is instead a question of which rule system provides the best allocation of resources (Buchanan, 1962). Or another way of looking at it is that any argument about how resources could be allocated better must be based on the institutions that would accomplish that outcome. Take a typical market failure argument as an example, say monopoly. It might be argued that a monopoly inefficiently restricts output and raises price. The problem is with labeling this outcome as inefficient. Compared to what? We might consider creating a public committee to dismantle monopolies, but if, say, it's not clear exactly what qualifies as a monopoly, it will be difficult to ensure that the committee is performing its assigned task. Instead, they could accept bribes from an ambiguous monopoly in exchange for protection and the dismantling of one of their competitors who is ambiguously not a monopoly. Even if the committee is unbiased, it will still err and those errors are costly. The question is whether the costs of this institutional arrangement outweigh the costs associated with the alternative.

A traditional concern in constitutional analysis is the differential costs associated with relying too much on the state versus too much on unconstrained individuals. From a modern perspective, the tradeoff can be seen on Djankov's et al. (2003) institutional production possibility frontier. That frontier represents the cost tradeoffs associated with dictatorial institutions versus anarchic institutions. The traditional constitutional concern is that the costs associated with each of these regimes is asymmetric. That is, the costs associated with a dictatorship have the potential to be much higher than the costs associated with individual orderings. While it is true in an anarchic society individual potential represent a threat to each other in terms of threats of violence and force, many private mechanisms have historically arisen to handle such threats ((Boettke, 2011; Leeson, 2007)). That is, while it might be true that a public police force is beneficial on net, if we were to lose the police force we wouldn't necessarily lose all of the benefits associated with it because private policing mechanisms would arise. There might be costs associated with anarchy here, but they would be less then we might first imagine because of these private mechanisms for dealing with threats of violence. On the other hand, there is much less that individuals can do deal with the threat of force that comes from the state. Black markets are one way that individuals avoid these costs. In the Soviet Union, as Boettke remarks, they "provided some answer to consumer frustrations", but as the Soviet Union indicates, these mechanism pale in comparison to the costs associated with the absence of markets and with oppression.

The costs of individuals acting selfishly in the market, where everyone has been granted nearly equal power, are much smaller than the costs of individuals acting selfishly in the public sphere where unequal power has been granted. Thus the costs of presuming benevolence in public actors will be high when those actors happen to be knaves. The classical liberal concern was with constructing institutions in such a way that when men were at their worst, they could do the least harm.

Additionally, besides the incentive problem, classical economists recognized the knowledge problem that any institutional system had to account for. This was the focus of Mises' (1920) and Hayek's (1945) response to the Socialists who ignored the role that private property rights play in enabling economic calculation and taking advantage of dispersed local and tacit knowledge. Without private property, the exchange and price mechanisms simply would not exist. There would thus be no way of calculating profitability beyond the simplest endeavors. Without a price mechanism to indicate resource scarcities, there would be no accounting for the knowledge and plans of others. The socialists provided no alternative institutional arrangements to overcome these problems. Instead they focused on the formal properties of market outcomes, rather than the process by which those outcomes come about, and their dependence on private property rights institutions.

To summarize, constitutional economics emphasizes the importance of rules for providing incentives to individual actors. Constitutional choice is about choices over the rules of the game. Typically for ease of analysis, those rules have been characterized as either state based rules or market based rules. Within either of those rule systems individuals will engage in rational, self-interested behavior producing certain social outcomes. Economics is the positive science of how the rules of private property translate into social outcomes. Political economy is the positive science of comparing the rules of private property to alternative institutional arrangements. Such a comparison must rest on the analysis of action within both the market based rules as well as, say, the state based rules. Public choice represents the application of the economic analysis to the state. Only with this application can economists make relevant comparisons or evaluations of the market.

The point of beginning this section by describing the rise of public choice is that the discipline didn't actually arise anew. In fact, public choice economists had to rediscover what had been previously understood by classical economists and had been forgotten by their predecessors. In the remainder of this section I document the existence of such constitutional considerations in the classical school and the decline of such considerations in various economists up through Keynes.

The Decline of Classical Political Economy

Within the classical school, I will consider two authors. The first is Adam Smith, who is the obviously place to start in documenting the transition away from what Keynes labeled "classical" economics given that Smith was the leader of the classical school. When Keynes used that term he was being highly inaccurate but there was some truth to the idea that Keynesianism was overturning a long held position in economics. That position began with Adam Smith.

After reading *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776) (from here on TWN) there is no question regarding Smith's general views towards the market and towards government. In brief, exchange on the free market is the cause of national opulence. The market, while imperfect, is self-correcting, and compared to the problems that exist within government, things are typically best left as imperfections. Private property rights are seen as the most effective mechanism for dealing with the absence of omniscient and benevolent individuals. Smith ultimately expresses concern that the market mechanism that leads to opulence may eventually be dragged down by ever growing state interventions.

The difference between Keynes' and Smith's approach to understanding the market is stark. Both are representatives of two orthogonal paradigms. Central to Smith's analysis is the goal of explaining the observed order of the world. That is, when Smith looked out his window he saw vast coordination in the absence of any central designer. "In a civilized society [man] stands at all times in need of the co-operation and assistance of great multitudes, while his whole life is scarce sufficient to gain the friendship of a few persons. (1776, p. 20)" Somehow, anonymous agents were capable of coordination. Contrast this with Keynes who, in the General Theory, is concerned solely with explaining the causes of the inevitable collapse of the free market. Smith begins his analysis in individual action and the "propensity to truck, barter, and exchange.(1776, p. 36)" While he calls it a propensity, he also recognizes that each man exchanges with regard to his self-interest in order to "enjoy the necessaries, conveniences, and amusements of human life(1776, p. 36)". Thus, for Smith the market order ultimately derives from purposive individual action. As a consequence of these foundations, Smith's analysis reveals the self-correcting nature of the market. Through individual purposive action prices and quantities adjust and resources are allocated in such a way as to make everybody better off.

Behind this analysis is the assumption that individuals are self-interested. "It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.(1776, p. 20)" Very little of our life depends on the benevolence of others, instead most of it depends on their "self-love". By starting from this assumption, Smith makes his analysis that much more robust. It is easy to explain cooperation amongst anonymous individuals by assuming they are all altruistic. The tougher case is in explaining cooperation when men are knaves. (Boettke, 2004) Smith's analysis of the price system leads him to conclude that man is "led by an invisible hand to promote an end which was no part of his intention."(1776, p. 351) Within the institution of private property, it is the price system and the incentives of profit and loss that lead self-interested individuals to promote social interests.

The point here is that Smith was analyzing a system that, by and large, worked on its own. However, that doesn't mean that Smith thought the market was perfect. He recognized a number of what would later be called market-failures. For instance, Smith discusses a variety of public goods that the market would be unable to provide and that may necessitate government provision. In addition, Smith repeatedly recognizes a problem of "over-trading". "When the profits of trade happen to be greater than ordinary, over-trading becomes a general error both among great and small dealers.(1776, p. 334)" It seems that Smith is getting at something very similar to Keynes' concern for "animal spirits" where men are swept up by the "spontaneous urge to action". But these imperfections were seen in a much different light for Smith than for Keynes..

The bigger concern for Smith was that our attempts to correct those imperfections may actually be ineffectual or do more damage to the system than repair. Smith repeatedly stressed the inability of government interventions to achieve their intended outcome. In the case of public spending, Smith defends a version of the position that would later be called Say's law: "the capital which the first creditors of the public advanced to government, was, from the moment in which they advanced it, a certain portion of the annual produce turned away from serving in the function of a capital, to serve in that of revenue; from maintaining productive labourers to maintaining unproductive ones.(1776, p. 583)" That is, government taxing and borrowing do not expand trade, but instead just reallocate resources from one use to another. In this light, over-trading is a misallocation problem, for Smith, rather than a problem of a general glut in which case the question is whether government can allocate better than the market.

These arguments fit into Smith's broader approach to government that recognizes both the lack of omniscience and benevolence within government. At various points, Smith makes proto-knowledge arguments that would later be elaborated by Mises and Hayek. "What is the species of domestic industry which his capital can employ, and of which the produce is likely to be of the greatest value, every individual, it is evident, can, in his local situation, judge much better than any statesman or lawgiver can do for him.(1776, p. 352)" Smith is clearly recognizing the importance of time and place knowledge in efficiently allocating resources which a central planner would have no access to. Smith takes a similar perspective in his analysis of public goods. He argues that there is an issue of knowing which public goods are worthwhile, and additionally, that the method of administering the public good transmits some knowledge about whether or not it should be provided.

> Even those public works which are of such a nature that they cannot afford any revenue for maintaining themselves, but of which the conveniency is nearly confined to some particular place or district, are always better maintained by a local and provincial administration, than by the general

> revenue of the state, of which the executive power must always have the management. Were the streets of London to be lighted and paved at the expense of the treasure, is there any probability that they would be so well lighted and paved as they are at present, or even at so small an expence?(1776, p. 479)

While we can see Smith making early versions of the knowledge argument, we can also see him making early version of public choice arguments. That is, Smith abides by Buchanan's rule of applying symmetrical assumptions across private and public analysis. Because we cannot rely on the benevolence of individuals in the market, neither can we in the public sphere. Following the quotation above regarding individual local knowledge, Smith points out that

> the statesmen, who should attempt to direct private people in what manner they ought to employ their capitals, would not only load himself with a most unnecessary attention, but assume an authority which could safely be trusted , not only to no single person, but to no council or senate whatever, and which would no-where be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it.(1776, p. 352)

So not only can we not presume benevolence in the public realm, but we should also be concerned that the worst tend to get on top. This aligns Smith with the traditional classical liberal position that the costs of knavery in government can potentially be very high. In addition, Smith makes similar arguments to Buchanan and Wagner in *Democracy in Deficit* (1977). Instead of being concerned with rational economic policy, politicians are concerned with catering to voters. Those voters, according to Smith, are differentially responsive to tax financed compared to deficit financed spending. Taxing tends to offend the people and is thus avoided by politicians, while "the facility of borrowing delivers them from the embarrassment which this fear and inability would otherwise occasion."(1776, p. 581) As debts accumulate, according to Smith, states engage in the juggling trick that was discussed in the introduction whereby debts are alleviated through increasingly oppressive taxation and monetization. Smith's concern was that, while the market is able to bear the burden of a fair amount of regulation and intervention, it may not be able to bear *any* burden and that the market mechanisms of exchange and innovation may eventually be overrun by the state.

It should be clear why Smith marveled at the market. Even though the market was imperfect was *relatively* amazing. This perspective derived from both an economic and public choice analysis as described above. His public choice analysis led him to doubt the ability of state based institutions to produce desirable social outcomes. Smith wasn't an anarchist, but he relied on the state as little as possible to explain the observed order of the world. In turn, Smith advocated for market based rules of private property and free trade. They were imperfect, but so were the alternative institutional arrangements and to a much greater degree. In contrast then to describing them as market failures, they were imperfections in an otherwise awe inspiring rule system.

With the intention of clarifying the position taken here, it is worth considering Stigler's (1971) position regarding Smith. Stigler questions how Smith could recognize the self-interest foundations of economic outcomes, and then turn around and recommend policy, supposedly implicitly ignoring the self-interested foundations of political outcomes. Note the similarity here to the argument in this paper regarding the Keynesians, that they ignored the self-interest of political decision makers in making policy prescriptions. The difference between Smith and the Keynesians is that Smith was engaged in a constitutional type analysis. After recognizing the self-interested nature of politicians, as he obviously did, the question is which set of institution results in the best outcomes. Smith concluded that given the constrains of human behavior private property institutions would result in the best outcome. Not only is that position not inconsistent with a recognition of political self-interest, it derives directly from it.

Smith is important for this paper as a founder and leader of the classical school and as someone who is cited throughout the classical literature. Thomas Robert Malthus represents a useful comparison in that he is typically considered to lie on the fringe of the classical school. What is interesting though is that from the perspective that the classical economists were engaged in an institutional analysis, Malthus was doing the exact same thing. Obviously Malthus' economic analysis was often very different than Smith's, in terms of rejecting Say's law for instance, but at the same time, Malthus recognized that his economic analysis was part of a broader institutional analysis and that imperfections within the market didn't immediately imply the need for state intervention.

These sentiments can be found in Malthus' *An Essay on the Principle of Population.* In that essay, Malthus argues that population growth will continually put pressure on income growth such that growth in total income doesn't translate into growth in per capita income. "Population, when unchecked, increases in a geometrical ratio. Subsistence increases only in an arithmetical ratio." (1798, para. I.18) Typically, this argument is contrasted with other classical economists in order to place Malthus on the fringe. If Malthus' argument were made 100 years later, almost assuredly, the economist making it would describe it as a market failure and conclude that government intervention could be used to remedy the situation.[1] However, Malthus was much more reluctant to draw such conclusions. He argued that forces of population growth could be put in check through informal institutions. Rules surrounding marriage, for instance, can act as a preventative check on population growth. That is, Malthus recognized that incentives and the rules of the game matter. He is also implicitly recognized that the costs of private ordering may not be as high as we might first believe. He then spends the majority of his essay discussing the comparative affects of alternative institutions on the population problem.

Malthus framed much of the essay as a response to William Godwin's ideas on the perfectibility of man. What is notable is how Malthus both accepts the imperfections of man that potentially lead to population growth, while at the same time rejecting Godwin's proposals for institutional reform. Malthus, just as Smith, was engaged in a comparative institutional analysis. Recognizing imperfections in one set of institutions does not imply the desirability of alternative institutional arrangements. Such an argument would have to be based on a comparison between the alternatives. Additionally, for Malthus as well as Smith, we have to compare only feasible institutions. Part of the of the feasibility of an institutional arrangement means taking man as he is and devising and comparing institutions around our imperfections. Recognizing both the comparative and constrained nature of institutional analysis, Malthus states that "it is the lot of man, that he will frequently have to chuse between two evils; and it is a sufficient reason for the adoption of any institution, that it is the best mode that suggests itself of preventing

[1] Note that the eugenics movements was part of the broader Progressive movement and was based on similar concerns.

greater evils."(1798, para. XIII.8) Private property was seen as a desirable institutions for precisely these reasons:

> It is to the established administration of property, and to the apparently narrow principle of self-love, that we are indebted for all the noblest exertions of human genius, all the finer and more delicate emotions of the soul, for every thing, indeed, that distinguishes the civilized, from the savage state; and no sufficient change, has as yet taken place in the nature of civilized man, to enable us to say, that he either is, or ever will be, in a state, when he may safely throw down the ladder by which he has risen to this eminence.(1798, para. XV.6)

Malthus explicitly recognizes that incentives, and thus the rules of the game, matter. It is only through a system of private property that men bear the costs and benefits of their decisions that they are motivated to rise out of the savage state. It is very similar considerations that lead Malthus to reject Godwin's institutional reforms:

> The proper office of benevolence is to soften the partial evils arising from self-love, but it can never be substituted in its place. If no man were to allow himself to act, till he had completely determined that the action he was about to perform, was more conducive than any other to the general good, the most enlightened minds would hesitate in perplexity and amazement; and the unenlightened would be continually committing the grossest mistakes. (1798, para. XV.13)

> As Mr. Godwin, therefore, has not laid down any practical principle, according to which the necessary labours of agriculture might be amicably shared among the whole class of labourers; by general invectives against employing the poor, he appears to pursue an unattainable good through much present evil.(1798, para. XV.14)

From these remarks, we can clearly see that Malthus was concerned with institutions and their effects. Compared to a system of private property, Malthus did not believe that Godwin's institutional system would accomplish its goals of helping the poor. Malthus was clearly recognizing how a system of private property aligns the self-interests of the butcher and the baker, such that, acting based on their own interests and knowledge, their individual actions would benefit others. In the quotation above, Malthus makes explicit how Godwin's alternative institutional arrangement would fail to account for the fact that individuals can only act on their own limited, local knowledge. Without the price system, attempting to act towards the benefit of all would be paralyzing.

Again, the point here is in recognizing the Malthus, like Smith, was engaged in a comparative institutional analysis. The point is not to evaluate his economic analysis. Instead, even though Malthus recognized (maybe incorrectly, but that is not the point here) imperfections in the market, he didn't then conclude the need for government intervention. He couldn't draw those conclusions because, at least with Godwin, there was no alternative institutional process that could match the, albeit imperfect, market.

John Stuart Mill's ideas in *On Liberty* are somewhat transitional in the narrative I am telling. More than the previous economists we have discussed, he focuses on the possibility that individual actions have negative effects on others. That is, he is more cognizant of the "market failure" perspective than was found in, say, Smith. "The only purpose," as Mill puts it, "for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others" (1869, para. I.9) However, there are many ways in which individual actions harm others:

> Acts injurious to others require a totally different treatment. Encroachment on their rights; infliction on them of any loss or damage not justified by his own rights; falsehood or duplicity in dealing with them; unfair or ungenerous use of advantages over them; even selfish abstinence from defending them against injury—these are fit objects of moral reprobation, and, in grave cases, of moral retribution and punishment. (Mill, 1869, para. IV.6)

Mill takes a somewhat similar position to the economists before him, like Smith or Malthus, by recognizing imperfections in individual actions, but also recognizing imperfections in the state. He recognized the need to limit government as well as the inadequacy of the popular vote as such a limit:

> The limitation, therefore, of the power of government over individuals loses none of its importance when the holders of power are regularly accountable to the community, that is, to the strongest party therein.

Relying solely on the popular vote as a limit to government, according to Mill, can lead to the tyranny of the majority and to the simple preferences of some being imposed on others, both of which contradict Mills starting point of individual liberty. So while Mill recognizes, like the earlier economists we have discussed, the imperfections in the state, he also served as a transitional figure by shifting the focus towards those instances when individual actions affect others.

Henry Sidgwick too can be seen as transitional in this narrative. Steven G. Medema recently provided a detailed account of Sidgwick's transitional nature (2009, pp. 42–50). On the one hand, Sidgwick built upon Mill's account of market imperfections, including individual moral failures, proto-tragedy of the commons arguments, externalities, monopolies, and unequal distribution (Medema, 2009, pp. 44–45; Sidgwick, 1904, p. 202). While Sidgwick recognized the importance of individual decision making in producing wealth, he was quick to emphasize its problems. On the other hand, Sidgwick was still concerned with the problems found in state-based institutions, from corruption, to special interests, to just plain waste (Medema, 2009, pp. 48–49).

The important difference between Sidgwick and the economists that came before him, as Medema puts it, was that "in spite of the various negatives that Sidgwick associated with state action, he did not share the degree of pessimism exhibited by Mill and the larger classical tradition toward the possibilities of government intervention"(2009, p. 51) In contrast to the classical economists, Sidgwick believed that while government is currently burdened by a variety of problems, those problems are likely to diminish in the future. This is what Medema describes as the "improvability thesis"; the problems that exist in government are seen as not necessarily inherent to public action, but are instead the result of ill-informed statesmen or particularly greedy men. As society progressed, these features of humanity could be expected to fade and government could be expected to improve.

It is important to emphasis this as a transition away from the constitutional analysis that engaged the Classical economists. When Smith supports free trade he is not doing so with the goal of instructing the ill-informed statesmen to better promote the national interest. That would be inconsistent with Smith's recognition that the statesmen is self-interested. His argument is a constitutional argument that instead of a rule system that empowers the statesmen to make such decisions regarding free trade, in the long run everybody would be better off if we had a rule system that empowered the individual to trade with whomever he wants. Such a rule system comes from the constitutional choices of individuals, rather than the post-constitutional choices of public decision makers. In contrast, Sidgwick sees the problems in government not as inherent in the rule system, but as a product of the intelligence and morality of particular statesmen. When Smith compares the problems in the market with the problems in government he is forced to make a choice between those two rule systems and the outcomes they produce. The implication of Sidgwick's perspective is that we don't have to make that same choice. Imperfections in a state-based rule system can be diminished by having a well-instructed statesmen. In turn, this opens the door for the instruction of statesmen. I don't mean to suggest that Sidgwick himself was engaged in this kind of statecraft, but only that he was taking a different perspective toward the institutional analysis than had the economists that came before him.

Culmination

Keynes placed himself at the nadir of this trend in an aptly titled essay, *The End of Laissez-Faire* (1926). Support for laissez-faire, according to Keynes, was based on either error or on ideology. At the time that it was first introduced, the idea of laissez-faire seemed to align the interests of individuals with society, satisfying anyone who was concerned with either. Additionally, according to Keynes, government had, historically speaking, been corrupt and incompetent:"almost everything which the State did in the eighteenth century in excess of its minimum functions was, or seemed, injurious or unsuccessful."(1926) All of this was compounded by the Darwinian revolution which seemed to add significance to the idea of the survival of the fittest capitalist. Keynes rejects all of these foundations for the support of laissez-faire and then offers his own alternatives.

Keynes begins by taking on free market competition as a mechanism for aligning social and individual interests, which as he see it "is a method of bringing the most successful profit-makers to the top by a ruthless struggle for survival, which selects the most efficient by the bankruptcy of the less efficient." (1926) Keynes illustrates these process by analogizing them to giraffes eating from a tree:

> if only we leave the giraffes to themselves, (1) the maximum quantity of leaves will be cropped because the giraffes with the longest necks will, by dint of starving out the others, get nearest to the trees; (2) each giraffe will make for the leaves which he finds most succulent amongst those in reach; and (3) the giraffes whose relish for a given leaf is greatest will crane most to reach it. In this way more and juicier leaves will be swallowed, and each individual leaf will reach the throat which thinks it deserves most effort.(1926)

He then also points out that profits act as an incentive by accruing "to the individual who, whether by skill or good fortune, is found with his productive resources in the right place at the right time."(1926) All of this is seen in the light of Darwin's theory of evolution where "sexual love" is akin to the love for money, both of which act through a process of the survival of the fittest whereby the weak are weeded out.

Such a beautiful and simple theory, argues Keynes, follows not from "actual facts, but from an incomplete hypothesis introduced for the sake of simplicity."(1926) He then goes on to list a variety of alternative assumptions which he suggests lead to alternative conclusions, like overhead costs, adjustment costs, "when ignorance prevails over knowledge", and also monopoly. (1926) But on top of these consideration is the question of whether we want the giraffes to have to engage in competition and whether we want to reward them for their selfishness. All in all, the only reasons that the principle of laissez-faire could have been accepted, according to Keynes, is because the alternative theories were even more wrong or because it was in the individual's material interests to defend it.

Before going on to discuss Keynes' solutions, it is worth discussing these ideas and whether they accurately characterize the market process. Keynes completely ignores the idea of comparative advantage. For such a simple and beautiful theory, it is puzzling why Keynes has to use the analogy of the giraffes, because doing so distorts the theory more than it illuminates. It is as if there is only one thing that man can do, produce (or eat leaves from a tree). If you are not among the best producers then you simply starve. The problem with the analogy is that the classical profit and loss argument was not that it weeded out the weak, but that of the variety of productive projects one could undertake, the profit and loss mechanism directed producers to the task where they had a comparative advantage.

The classical argument simply rested on the idea that rational individuals, pursing their own self-interest would engage in exchange and production as a way of alleviating their dissatisfactions. There was never any conclusion that the market was perfect. Keynes was missing the point when he argued that in a variety of circumstances the market doesn't produce "the greatest aggregate wealth". The question is: greatest compared to what? For classical economists the answer to that question involved a comparison of institutional arrangements and their ability to cope with knowledge and incentive problems. Private property and the institutions associated with it did a better job than alternative institutions. For Keynes, "the greatest" refers to an ideal and of course the real world market fails to live up to perfection, the problem is that no reasonable economist ever thought that it did.

Finally, it is also worth pointing out that the classical argument wasn't about encouraging or rewarding self-interest. Keynes was concerned that "we must not overlook...the evil look of anxiety or struggling greediness which overcasts the mild faces of the herd." He disliked the fact that the market mechanism relied on the self-interested nature of man. However, he misunderstood the reason for doing so. The classical economists were concerned with taking man *as he is*. That is, though men are sometimes angelic, they are often knaves and our institutional system must account for the way men actually behave. The classical argument wasn't that greed is good, but that greed can be harnessed. (Hirschman, 1997)

While Keynes expressed clear disdain for market mechanisms, he also recognized that they do much good, and his conclusion then was that we simply could not sweepingly rely on the market. This is a somewhat puzzling conclusion, given what we have seen in the classical economists. No one was wholesale rejecting government. The classical argument recognized the problems of individual decision making with regard to things like public goods and then considered the merits of alternative institutional arrangements for dealing with these problems.

It seems then the difference between Keynes' argument and the classicals' was not the recognition of a role for government, but instead in his analysis of those public institutions and what we could expect them to accomplish. Keynes relied on a distinction from Bentham between the agenda and non-agenda of government to distinguish those tasks that government ought to take on. However, he insisted on doing this "without Betham's prior presumption that interference is, at the same time, 'generally needless' and 'generally pernicious' (1926). It seems that the concern for "corruption and incompetence" in government that Keynes recognized as a classical consideration in the defense of laissez-faire had faded.

In Keynes' vision, "progress lies in the growth and recognition of semi-autonomous bodies within the state" (1926). Like a corporation, the task of managing the nation could be separated from the shareholders and their political interests. The semi-autonomous body could be solely charged with promoting the public interest. Who was to determine the agenda of government? Keynes gives his answer by stating that "[p]erhaps the chief task of economists at this hour is to distinguish the *Agenda* of government from the *Non-Agenda*" (1926). For Keynes, expert commissions, who were independent of political checks, could be relied upon to promote the public interest. It is worth noting that Keynes didn't completely reject political checks:

> though some place it may still be necessary to leave, until the ambit of men's altruism grows wider, to the separate advantage of particular groups, classes, or faculties - bodies which in the ordinary course of affairs are mainly autonomous within their prescribed limitations, but are subject in the last resort to the sovereignty of the democracy expressed through Parliament (1926).

While Keynes does consider alternative institutional arrangements to the market, it's not with the same critical eye. The knowledge and incentive problems that Keynes recognizes in the markets are, for some reason, not problems in government. Note again the difference between Keynes and the classical constitutional perspective that takes man as he is. For Keynes, as it was for Sidgwick, man is currently self-interested but over time we could expect that he would become more and more altruistic. We thus didn't have to design institutions that harnessed man's greed, but instead we could rely on that greed to fade. Keynes did recognize that, given man's greed, some checks in government might be desirable, but he concludes that a vote imputed through parliament is a sufficient check. It seems that the only wholesale rejection going on here is Keynes' disregard for hoards of historical scholarship regarding the insufficiency of the vote as a check on public decision makers.

Keynes also recognizes that there is problem of knowledge and uncertainty that must be accounted for, but he doubts whether the market is capable of handling such problems. Instead, "the cure lies outside the operations of individuals" (1926). The cure, for Keynes, lay in centralized control over money and national production of business statistics. In addition, Keynes argued that

> some coordinated act of intelligent judgment is required as to the scale on which it is desirable that the community as a whole should save, the scale on which these savings should go abroad in the form of foreign investments, and whether the present organization of the investment market distributes savings along the most nationally productive channels (1926).

Keynes is correct to recognize that there is a problem of uncertainty and knowledge that any institutional system has to handle. The desirable allocation of resources through time is a matter of individual time preference. Even if that future demand were known there is still the problem of structuring capital such that it satisfies that demand. The point of the profit and loss mechanism is to direct resources to those avenues that best satisfy consumer demand, even though that mechanism is not perfect, as had long been recognized. Keynes is correct that to some degree entrepreneurs get lucky in their predictions, as well as that some resources are misallocated along the way. The problem is that Keynes rejects this mechanism without providing an analysis as to how his alternative institutional structure would solve these problems. In what way would aggregate statistics alleviate the problem of uncertainty or imperfect information? By what mechanism would consumer demand be expressed such that investment and capital could be structured to meet it? How would errors in such a mechanism be corrected? Would the vote act as a sufficient check on experts to ensure that, even if they did have the knowledge to solve these problems, they would act in the public interest?

Addressing these questions will be delayed until later in this essay. The point for now is that Keynes was writing within an intellectual trend that was increasingly analyzing the market in comparison to an ideal and disregarding the comparative institutional analysis. In a more general sense, economists were increasingly disregarding the institutional foundations of their discipline. The market was increasingly being analyzed in terms of the formal optimal properties, rather than the processes and institutions that produced those outcomes. The optimum situation, for instance, was one in which individual costs aligned with social costs, but what was ignored is the way in which property rights and exchange serve to internalize costs (Coase, 1960). Investment and the capital structure have to adjust to account for changes in individual time preferences and consumption and saving decisions, but what was ignored was the way in which private property and a system of profit and loss directed resources to align them with underlying preferences (Hayek, 1931)

Along with this shift away from institutional economics went the comparative institutional analysis that was political economy. By comparing and evaluating the market compared to an ideal, it was implicitly assumed that a government existed that was capable and trustworthy enough to implement the prescriptions of economists. Where Smith was forced to reject "man of systems" type prescriptions because they conflicted with his and the classical school's institutional analysis of the state, economists in the early to middle twentieth century now had nothing to hold them back.

Keynes' General theory both was introduced into this world and made significant advances in these trends. On the one hand, Keynes completely disregarded the institutional foundations of market outcomes. The word "property" appears zero times in The General Theory. In contrast to the traditional focus on rules and incentives, Keynes focused on the interaction of aggregate variables. To the extent that these derived from individuals, it was through behavioral equations. Individuals had a "propensity" to consume a portion of their income[2]. There was no intention behind the actions. At a fundamental level, Keynes' approach assumes away the self-correcting nature of the market. At the heart of the classical perspective towards market correction is purposive individuals who are seeking to make themselves better off. By definition, if the market had not yet corrected to a change in an underlying variable, there was an implied profit opportunity from, say, consuming less, saving more, and investing more to match consumers' longer term time preferences. The only reason that takes place is because consumption is not a fixed function of income and because individuals could respond rationally to profit opportunities. That incentive only exists under a system of private

[2] While it's true that Smith referred to a "propensity to truck, barter, and exchange" (1776, p. 19) it is clear that Smith recognizes that individuals engage in exchange with the purpose of attaining the "necessaries, conveniences, and amusements of human life" (1776, p. 36). For Keynes, instead of intention behind the propensity to consume, there is only psychology an d habit.

property where the actor expects to bear the full costs and benefits of his decision. In ignoring private property and incentives, Keynes was assuring a non-correcting market.

Where economists had traditionally been concerned with the way in which private property provides the mechanisms that utilize individuals' local, tacit knowledge, Keynes' aggregate approach to the economy bypassed these concerns - though this is illusory, as will be discussed below. For Keynes, the economic problem was not an allocation problem (at least not until full employment existed), but was instead simply a problem of the *volume* of economic activity. Instead of ignoring the knowledge problems, Keynes simply rejected them.

Combined with his position in *The End of Laissez-Faire*, there was no comparative institution problem for Keynes to consider. The knowledge problem was overcome by a focus on aggregates and volumes of economic activity. Knowledge of such problems could come straight from the national accounting data which were becoming readily available by the time the General Theory was published. Moreover, Keynes expressed his disregard for the incentive problems in *The End of Laissez-Fair*. Unbiased, independent, expert commissions could be relied upon to promote the public interest, and until the ambit of men's morality had widened, they could be held accountable by a popular vote. Given these premises, it is a small logical step to socialism and that's where Keynes went. In the end of the General Theory, he argued for a "comprehensive socialisation of investment (1936, p. 374). In doing so Keynes wasn't completely rejecting the mechanisms of the market. He wasn't completely rejecting the need for individual exchange to allocate resources. Instead, that allocation problem had become secondary to the employment problem, so it could safely be ignored until the latter was solved.

Interestingly, Keynes did recognize the importance of political interests in determining economic policy. In concluding his book, Keynes questioned whether his visions of socialization were merely visions: "are the interests which they will thwart stronger and more obvious than those which they will serve (1936, p. 379)?" He is recognizing that political decision makers are self-interested and thus may not implement his ideas, even if they are correct, as long as they are not in the politicians' interests. As we have seen, the question then is one of the rules of the game that define political incentives. Socialization of investment is just such a reform of the game. How could Keynes not have questioned whether, if upon instituting socialized investment, his fiscal and monetary prescriptions would be followed?

As Keynes ideas spread through the economics profession, the budget became the emphasized policy tool rather than socialized investment. Abba Lerner elaborated the theory of functional finance, in *The Economics of Control* (1944), which Buchanan and Wagner describe as the "widely shared" ideas of the times (1977, p. 33). Taxing and spending could be used as tools to control the business cycle. Increases in spending and/or decreases in taxes would boost aggregate demand. There was no need to worry about the deficit that emerged, because we simply owed it to ourselves. If the deficit was undesirable, because a lower interest was preferred, the difference between taxes and spending could simply be paid for through money printing rather than borrowing. During periods of full employment, cuts in spending and increases in taxes could be used to prevent inflation. Thus, budget balance was relegated to secondary, or even negligible, importance (Lerner, 1944, Chapter 24). Budget balance, if it was a concern at all, could occur over the cycle or at some hypothetical level of full employment income (1977).

Milton Friedman recognized the themes in the current paper in his review of Lerner's book (1947). He argued that "most of the book is devoted to the formal analysis of the conditions for an optimum. The institutional problems are largely neglected and, where introduced, treated by assertion rather than analysis" (1947, p. 405). The Keynesian prescriptions, according to Friedman, give the illusion of the ability to control. Preventing business cycles requires the management of effective demand, but the problem is that effective demand is not something that is immediately known by government. As Freidman points out, at any given moment in history it is easy to find competing expert opinions over whether we are entering into inflation or deflation, or whether the cycle is about to turn around or drop downward. Additionally, alternative institutional arrangements must be judged according to "the extent to which they lend themselves to abuse, i.e. the ease with which they can be used for objective other than the general welfare" (1947, p. 415). These two arguments reflect the same political economy perspective held by the Classical economists. The Keynesians, exemplified here by Lerner, represented the culmination in the diminishing recognition of the importance of comparative institutional analysis in political economy. Lerner explicitly places himself within this trend: "[i]n this study we shall not go into the merits of this political issue. We shall assume a government that wishes to run society in the general social interest" (Lerner, 1944, p. 6)

Thus, with the Keynesian revolution, the comparative institutional analysis that had long defined economic analysis was rejected. Economists could now formulate economic prescriptions as if they would be implemented by a benevolent and omniscient government. Where the concern had traditional focused on the way in which private property institutions did or did not generate the conditions of optimality, the focus shifted to defining those conditions and prescribing the actions that such an omnipotent government should take to promote them.

Smith was constrained by the recognition of these knowledge and incentive problems in the kind of institutions that he could recommend. Even recognizing the imperfections in the market, the classical economists were confined by these constraints to hands-off institutions, because the potential costs associated with hands-on institutions were relatively high. But for the Keynesians, these constraints had been lifted, not in reality, but in terms of analysis. Such unconstrained analysis enabled the Keynesians to provide policy advice to the state in a way in which Classical economists never could.

CHAPTER 2: BECOMING DOCTORS TO THE WORLD

"The Keynesian Revolution is one of the most remarkable episodes in the entire history of economic thought; never before had the economics profession been won over so rapidly and so massively to a new economic theory, and nor has it since" (Blaug, 1997, p. 642) Recognizing the same fact, Paul Samuelson described the Revolution as having the "unexpected virulence of a disease first attaching and decimating an isolated tribe of South Sea Islanders" (1946, p. 187). The intention of this chapter is to explain the uniquely "rapid and massive" quality of the Keynesian Revolution.

Keynes published his book in 1936. A year prior, he had written to George Bernard Shaw and prophesied the revolutionary nature of his book: "I believe myself to be writing a book on economic theory which will largely revolutionise - not, I suppose, at once but in the course of the next ten years - the way the world thinks about economic problems" (cited in (L. H. White, 2012, p. 126)). If he was wrong, it was only in underestimating how quickly his book would overturn the economics profession.

As Blaug argues, one way to date the end of the revolution is to look at introductory textbooks. Popular textbooks offer a window into the ideas that economists largely take for granted in their everyday research. Lorie Tarshis is credited with publishing the first textbook that expounded Keynesianism in 1946. Shortly after, Paul Samuelson published his textbook, *Economics,* in 1948. Samuelson's textbook would go on to become the most widely used introductory textbooks of all time (Blaug, 1997, p. 643). It is notable how Samuelson arranged his textbook; the first half of the book is devoted to aggregate demand analysis while standard supply and demand analysis is only introduced after over 400 pages (Samuelson, 1964). Not only did the Revolution complete within about the span of a decade, but it completely transformed what it means to do economics.

In order to determine what happened in the Keynesian revolution, it is necessary to first understand what was novel in Keynesianism. Blaug describes three such features: the use of aggregates; the focus on the short run; and the more paradigmatic perspective that markets failed to achieve full employment output without government intervention. In light of the previous chapter, we can see these features as part of a broader trend of disregarding institutions in economic analysis.

Explaining the fact that these features led to a "rapid and massive" revolution requires looking beyond the economics profession in isolation. That is, Keynesianism did not just represent a new way of thinking about the economy, but instead represented a platform from which economists could propose policy advice. The Revolution was taking place within broader institutional transformations and it is the contention of this paper that the Progressive administrative reforms throughout the first half of the twentieth century created a demand for expert economists which Keynesians were uniquely fit to supply. Keynesian ideas, and importantly the novel ideas pointed out by Blaug, aligned both with the broader progressive ideals as well as with the narrower paradigms in public administration enabling Keynesians to fill the demand for experts that derived from these movements.

This thesis is not wholly new. The idea that Keynesianism and economist's role as experts go hand in hand has been advanced elsewhere. N. Gregory Mankiw, in his 2006 JEP piece, *The Macroeconomist as Scientist and Engineer*, argued that the rise of Keynesianism and of macroeconomics was the result of engineers seeking to "solve practical problems" rather than "propose and test elegant theories" (2006, p. 29). As he points out, this difference is reflected in which economists are found working in Washington:

> Among the leaders of the new classical school, none (as far as I know) has ever left academia to take a significant job in public policy. By contrast, the new Keynesian movement, like the earlier generation of Keynesians, was filled with people who traded a few years in the ivory tower for a stay in the nation's capital. Examples include Stanley Fischer, Larry Summers, Joseph Stiglitz, Janet Yellen, John Taylor, Richard Clarida, Ben Bernanke, and myself. The first four of these economists came to Washington during the Clinton years; the last four during the Bush years. The division of economists between new classicals and new Keynesians is not, fundamentally, between the political right and the political left. To a greater extent, it is a split between pure scientists and economic engineers. (2006, p. 37)

Robert Lucas described the Keynesian Revolution in very similar terms in a lectured titled *My Keynesian Education* given in 2003 and it is worth quoting him at length because he not only points out the relationship between the rise of Keynes and the role of economists in society, but he also touches on themes that will be important later when drawing connections between Keynes and the Progressives:

> What [Keynes] hits on is that the government should take some new responsibilities, but the responsibilities are for stabilizing overall spending flows. You don't have to plan the economy in detail in order to meet this

> objective... I think this was a great political achievement. *It gave us a lasting image of what we need economists for.* I've been talking about the internal mainstream of economics, that's what we researchers live on, but as a group we have to earn our living by helping people diagnose situations that arise and helping them understand what is going on and what we can do about it. That was Keynes's whole life. He was a political activist from beginning to end. What he was concerned about when he wrote the General Theory was convincing people that there was a way to deal with the Depression that was forceful and effective but didn't involve scrapping the capitalist system. (Italics added) (2004, p. 24)

This chapter's novel thesis is in drawing the connections between the Progressive reforms, the administrative theories upon which they were based, and the role that they created for economists in society. The Keynesian Revolution can then been seen in the light of economists taking on the role of experts in society that was created by the Progressive reforms.

That the Keynesian Revolution represented the possibility for economists to become experts was recognized by economists of the time as well. As Lorie Tarshis has since recollected, he wanted to be a doctor but entered economics somewhat arbitrarily - he was good at mathematics. However, the rise of Keynes was seen by him and his fellow graduate students as a kind of adventure, where they could be "doctors to the world" (Colander & Landreth, 1996, pp. 20, 51). John Kenneth Galbraith expressed similar sentiments when he said that "[w]e younger economists were, as I've said, all *looking for an escape* from the commanding horror of the times. We were comfortable, and we believed others should be too" (Italics added) (1996, p. 185). What these remarks reflect is the sentiment that Keynesian economics could be used as a tool to solve the depression problem in the same way that doctors could solve the malaria problem. It is not that surprising that the Keynesian paradigm could be so enticing; where the alternative meant being an ivory tower theorist within the dismal science, Keynesianism offered the prospect of being a "doctor to the world".

The Perceived Failures of Capitalism

At the heart of the Progressive movement was a growing disdain for pure capitalism. Progressivism entailed a duplicitous view towards the market. While, it was generally recognized that capitalism led to high levels of productivity, growth, and innovation, it was also believed that capitalism had formidable dark side. In his *A Very Short Introduction*, Nugent describes Progressivism as "a growing ... consensus among Americans that major changes in the late nineteenth century had produced unwelcome, un-American imbalances in their society. Evidences of this were a new class of ostentatious millionaires, monopolistic and out-of-control corporations, conflict (often violent) between workers and capitalists, and supine responses from governments" (2010, p. 2)

The Progressives believed that industrialization had marked the entrance of the U.S. into a new stage of history. The country had been founded in a setting of individual pioneers. The problems faced in 1900 were fundamentally different from the problems faced a hundred years prior (Pestritto & Atto, 2008). As Henry Demarest Lloyd put it: "now we are touching elbows again, and the dream of these picnic centuries that the social can be made secondary to the individual is being chased out of our minds by the hard light of the crisis into which we are waking (1894, p. 495)"

An important problem of the modern age was the inequality engendered by the individualist system. Herbert Croly, in *The Promise of American Life* (1909), described the problem as one of an inadequate conception of democracy imbued to us by the founders. Where the individualist ideals had been based on a kind of equality between all men, industrialism and the modern age had changed all of that and demanded new ideals. Capitalism, according to the Progressives, inevitably led to monopoly, where resources were controlled by only a few wealthy men, where employers had control over employees, and where poverty was the result of restrictions on production. The problems that the Progressive saw in government were also, to them, the result of unequal wealth and the pressures it put on politicians. Lloyd nicely summed up the Progressive approach to capitalism: "liberty creates wealth, wealth destroys liberty" (1894, p. 2).

Keynes and the Keynesians held similar dispositions towards the market. As Blaug pointed out above this was one of the crucial changes in the Revolution, that economists came to believe that markets alone could not self-correct but were instead prone to long term stagnation. Keynes believed that economists before him had been too faithful towards the market's ability to align individual and social interests. Where the 'classical' economists believed that "all is for the best in the best of all possible worlds provided we will let well alone" (1936, p. 33) Keynes saw the affects of an array of market imperfections from price stickiness to uncertainty.

> The world is not so governed from above that private and social interest always coincide. It is not so managed here below that in practice they coincide. It is not a correct deduction from the principles of economics that enlightened self-interest always operates in the public interest. Nor is it true that self-interest generally is enlightened; more often individuals acting separately to promote their own ends are too ignorant or too weak to attain even these. Experience does not show that individuals, when they make up a social unit, are always less clear-sighted than when they act separately. (J. M. Keynes, 1926)

Like the thinkers he aligned himself with: Mathus, Marx, Gesell, and Major Douglas (p. 32), Keynes rejected the self-correcting mechanisms of the market. The interest rate no longer cleared the market for savings and investment; individual increases in savings reduced aggregate demand because they did not translate into increased investment. Instead, changes in income equilibrated the system. Further, wages could not be expected to adjust to clear the market for labor. In Keynesian theory there is thus no tendency for the market to reach the full-employment level of output. As Blaug describes it, the rise of Keynesianism reflected a new perspective on the functioning of the market:

> Equilibrium for the economy as a whole now involved 'unemployment equilibrium' and the introduction of this oxymoron involved a profound change in the 'vision', Weltanschauung, paradigm - call it what you will - of orthodox economics, which undoubtedly included the faith that competitive forces are capable of driving the economy towards a steady state of full employment without the assistance of governments. (Italics in original) (1997, p. 675)

The important point here is the alignment between the two paradigms. Both Keynes and the Progressives rejected Socialism in favor of individual freedom, but at the same time they believed that that individualism came with a high cost if left to its own devices. They both believed that the individualism of the market failed to align with modern social interests. This can be seen in the remarks from Keynes and the Progressives themselves.

But Keynes' fulfillment of the Progressive ideals goes deeper than the simply agreeing that the market will fail. For the Laissez-faire economists that the Progressives had always fought against, growth in the market depended on savings and who tended to save the most in absolute values but the rich. The Progressive's disdain for the inequality of the market could thus be tempered by the argument that the rich were necessary for the system to grow. For Keynes, it was nearly the opposite. Over-saving was precisely what was preventing the system from reaching full employment:

> For we have seen that, up to the point where full employment prevails, the growth of capital depends not at all on a low propensity to consume but is, on the contrary, held back by it; and only in conditions of full employment is a low propensity to consume conducive to the growth of capital... Thus our argument leads towards the conclusion that in contemporary conditions the growth of wealth, so far from being dependent on the abstinence of the rich, as is commonly supposed, is more likely to be impeded by it. (1936, p. 369)

That is, not only did Keynes align with the Progressives in providing an explanation for why the free market will stagnate, he went even further by providing the Progressives with a justification for the dispositions that they had long held. Combined with the Keynesian argument, the Jeffersonian conception of democracy had lost any redeeming factor in the mind of the Progressives.

Historically, these thinkers saw their ideas confirmed during the Great Depression. The effect of the Depression was to solidify the beliefs of those who thought the market failed to adjust, while persuading many of those who had been resistant. This is especially true of the extended duration of the depression. In the early years both Hoover and Roosevelt repeatedly predicted that the recovery was just around the corner (Barber, 1985). These predictions, in turn, affected the kinds of policies that each of them was willing to engage in. It's not until the end of the 1930s that Roosevelt began to consider the use of spending programs as a recovery, as opposed to relief or reform, mechanism. (See (1969) chapter: *The Struggle for the Soul of FDR)* This is getting ahead of the story, but it leads nicely into a discussion about the way in which both the Progressives and the Keynesians responded to market imperfections

The Government Solution

As a complement to the Progressive's dissatisfaction with the apparent outcomes of unregulated capitalism, the movement also represented a general shift towards the use of the state as a means to perfect the imperfections of society. Murray Rothbard describes the progressive movement as "basically a movement on behalf of big government in all walks of the economy and society, in a fusion or coalition between various groups of big businessmen…and rising groups of technocratic and statist intellectuals" (1989, p. 81) Herbert Croly described it as a shift from a policy of "inexorable national destiny" to a "conscious national purpose" (1909). Since the problems the nation faced were no longer individual but social problems, individuals alone could not be expected to attain our "national purpose". Instead, the Progressives believed that we had to rely on conscious management of the economic system in order to attain that purpose. The Progressive's goal of conscious national direction depended on strong, active leadership based on scientific principles. For Croly, attainment of the national purpose

> implied an active interference with the natural course of American economic and political business and its regulation and guidance in the national direction. It implied a conscious and indefatigable attempt on the part of the national leaders to promote the national welfare. It implied the predominance in American political life of the men who had the energy and insight to discriminate between those ideas and tendencies which promoted that national welfare, and those ideas and tendencies whereby it was imperiled.(1909, p. 40)

We can see here in Croly the idea that not everyone is capable of government. Instead, government is restricted to energetic and insightful men. We had to rely on the strength of extraordinary men who were neither too "ignorant or weak" to harness the enlightened self-interest of themselves and the nation. That is, though it was in the interest of the people to attain the nation's purpose, according to the Progressives, on their own they would not achieve it. A quote from Wilson is illustrative of the need for power and force to get people to do what is actually in their interest,

> The competent leader of men cares little for the interior niceties of other people's characters: he cares much - everything for the external uses to which they may be put. His will seeks the lines of least resistance; but the whole question with him is a question as to the application of force. There are men to be moved: how shall he move them? He supplies the power; others supply only the materials upon which that power operates. The power will fail if it be misapplied; it will be misapplied if it be not suitable both in its character and in its method to the nature of the materials upon which it is spent; but that nature is, after all, only its means. It is the power which dictates, dominates; the materials yield. Men are as clay in that hands of the consummate leader. (Pestritto & Atto, 2008 "Leaders of Men", Woodrow Wilson)

There is an obvious tension here within the Progressive paradigm; Pestritto and Atto call this the "central irony in progressive thought" (2008). Like their duplicitous view towards the market which brings both growth and squalor, they also have a half hearted perspective on democracy. On the one hand, the Progressives repeatedly refer to democracy as self-government, but on the other hand, good government is not something those same people could achieve on their own. It instead has to be produced by wiser and stronger men and then forced upon the ignorant and weak. Note to that the Progressives are not just referring to representation. For Wilson, the leaders of men are not just agents of the community, but instead take on a much more paternalistic role. The question is how to prevent the paternalism from becoming tyranny.

The Keynesians came to the same conclusions as the Progressives. Given that the market system was bound to collapse, as both groups believed, it was necessary that government step in to do something about it. Keynes called for investment socialization, while the less extreme Keynesians assigned to government the task of stabilizing spending flows and managing aggregate demand. Such a scheme was seen as mostly consistent with individualist principles while also necessary to save capitalism from itself.

The same duplicitous perspective is seen in Keynes when he advocates for socialization of investment. Normal men were subject to psychological propensities in allocating their income and animal spirits in considering the future. Somehow though we could rely on more reasonable men in government to act solely on cool rationality. He recognized though that men are not completely benevolent, at least not yet, but it seems it should have been clear to the Progressives and to the Keynesians that these asymmetric assumptions across the public and private spheres were untenable. If men are selfish and irrational in their own lives, it is unlikely that they will suddenly become prudent and altruistic in the command of others.

Nonetheless, the implication of both the Progressive and Keynesian paradigms was the need for a stronger central government. Only a strong central government could counter the centralization in industry that concerned the progressives, as well as provide strong leadership to guide the nation towards its national purpose. Local governments would be too concerned with their own interests rather than the nation's, whether this was in terms of combating large-scale business or implementing budgetary programs to promote recovery, and would be less capable of engaging in wise, scientific government. While we see growth in the size of the federal government beginning in the early 1900s with the Progressive Reforms, the major shift takes place during the Great Depression and WWII when, as was described earlier, belief in the market's corrective capabilities were largely replaced with belief in the corrective capabilities of government. We can see these effects in Figure 1 and Figure 2 which shows federal spending as a percentage of total government spending and as a percentage of GDP increase around the 1930s. At this point, these charts are simply meant to be illustrations of the fact that the Progressive movement and Keynesian Revolution were tied up in large scale societal shifts toward the increasing role of the state in everyday life. The Progressive purposes behind these reforms and the role they created for Keynesian economists will be elaborated throughout the remainder of the paper.

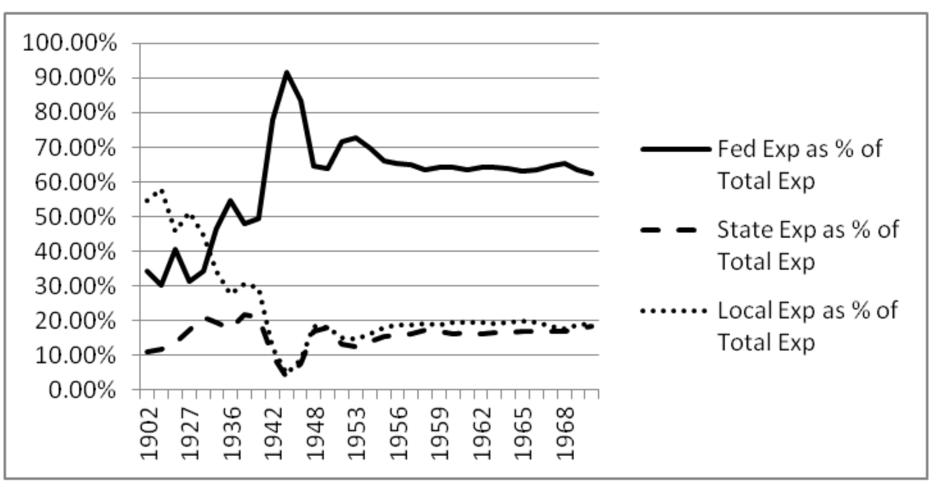

Figure 1: Federal, State, and Local Share of Total Expenditures

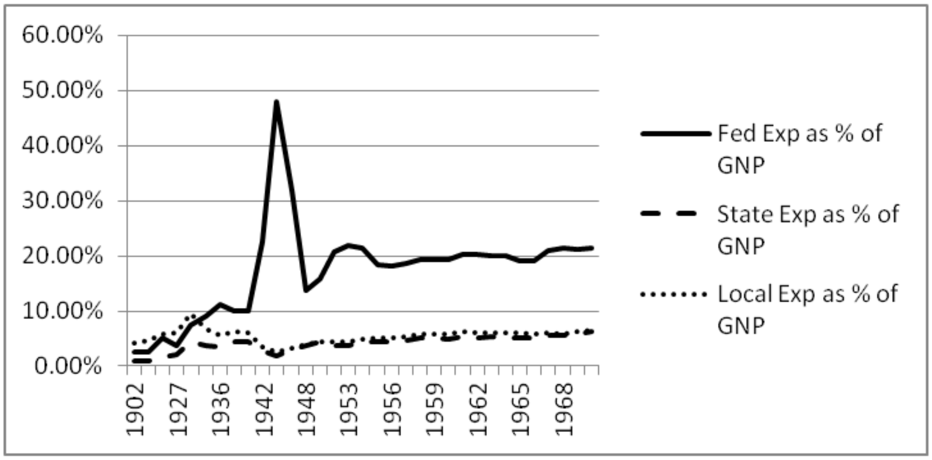

Figure 2: Expenditures as a percent of GNP

Efficient Management

Thus far I have focused on the broader Progressive movement., but I now want to turn to reforms of public administration which can be seen as a narrower movement with the broader one. That is, many of the Progressive reforms had an aspect to them that was concerned with reforming the structure of administration. Woodrow Wilson was both an intellectual and political leader of this movement. The reforms themselves, which continued after Wilson's presidency and progressed greatly during the Great Depression, derived from Wilson's 1887 paper, *The Study of Administration.* That paper is often credited with founding the discipline and, according to Vincent Ostrom, the classical paradigm of public administration (1973).

The approach to administration taken by Wilson is part of, another movement within the Progressive Era which advocated scientific management. It was argued that management could be subject to the same kind of scientific analysis that had been so successful during the industrial revolution. Efficiency, as in getting greater (the same) output for the same amount of (fewer) inputs, was a mainstay of that approach to management. This was the essence of Wilson's approach to public administration as well. The goal was to execute the will of nation at least expense possible. Again this was a part of the broader Progressive ideals and, as such, viewed the problems of administration from a scientific stand point. That is, the problems that faced society were within the ambit of scientific administrators as long as nothing was in the way to hold them back.

For Wilson, this approach had obvious organizational implications. Efficient administration required hierarchy and professionalization. The goal of hierarchical organization was to define responsibility. He was concerned that “as a matter of fact and experience, the more power is divided the more irresponsible it becomes” (Wilson, 1885) The corollary of this problem was the lack of leadership. It was only when responsibility was clear that individuals sought leadership and that their efforts could be harnessed in attaining the national will. The problem of the day, for Wilson, was that responsibility had been spread and thinned through the committee system and had prevented leadership from fomenting. In addition to hierarchical reorganization, Wilson believed that the civil service needed to be professionalized. Ordinary people could not be counted on to be able to solve the complex problems facing the nation. Administration based on the principles of scientific analysis required a well-trained civil service.

In line with these movements, the Pendleton Civil Service Reform Act was passed in 1883. This act was the product of increasing dissatisfaction with the government based on perceptions of corruption and inefficiency (Van Riper, 1958, pp. 74–75). An integral component of the inefficient and corrupt public sector was the spoils system in the civil service. In general, the spoils system refers to the hiring and firing of civil servants based on their political views. A recently elected President could relatively easily fire and replace high level civil servants who served in the previous administration with new employees of his choice, who would then do the same thing to the next level of employees. It was seen as a kind of exchange where the party in power offered employment in the civil service and the employee would offer their vote and support for the party (1958, p. 46). The result was that every time a party fell out of power, a large portion of the civil service was replaced. This system was perceived as being unfair and unequal, because only those who were in the appropriate political circle could participate in the administration of government, but also inefficient, as patronage made no guarantee of the scientific qualifications of administrators. The goal of the Pendleton Act was to replace the spoils system with one where administrative employment was determined based on merit.

The effects of the act were seen slowly, through numerous administrations and subsequent acts. The act itself was based on a number of procedural ideals, that would lead to a merit based civil service. The act established a Civil Service Commission manned by three members who were appointed by the President with the approval of Congress. Along with the commission, the act set up competitive examinations that potential employees had to pass prior to civil service employment. By regulating hiring of the potential employees who scored the highest on the exams, the Commission hoped to ensure that the civil service would gradually come to reflect merit rather than patronage.

The merit system offered a suitable niche in the federal government for the expert. In terms of political pull, experts do not necessarily have anything to offer beyond the average person. Under the merit system, however, hiring is biased towards those with higher levels of training and education. Within this institutional system, experts have a comparative advantage in the market for federal jobs. It's extension would mean that experts, those with above average intellectual capital, in contrast to those with above average political capital, could increasingly find employment under the State.

The obvious question then is: why didn't we see professionalization of the civil service in 1887? The problem with the initial act in terms of the goal of replacing the spoils system was that the act pertained to only a small piece of the total federal government. These positions were labeled "classified" and those outside the requirements of the act were labeled "unclassified". The initial act only classified about 10% of the total civil service. However, the act enabled the President to extend the "classified" label to other departments. A large portion of the civil service was still hired based on patronage. Therefore, the effects of replacing the spoils system would only be seen gradually over the next 60 years (for our purposes) through multiple additional acts and executive orders that redefined the classified civil service.

Recognizing these details of the act not only explains the timing of professionalization, but it also explains part of the secular growth in government we have seen over the past century that is shown in figures 1 and 2. This set of rules incentivized politicians to expand the civil service outside of the merit classification early on in the term in order to reap the political benefits of patronage hires and to extend the classified label to their constituents right before they left office, and that is what they did. At the end of Chester A. Arthur's term in 1886, he had classified some 15,000 positions, leaving 125,000 as unclassified and by the end of Grover Cleveland's second term around the turn of the century "close to 50 per cent of some 190,000 federal civil employees were under the merit system" (1958, p. 130) By the end of Theodore Roosevelt's presidency classification covered 60% of the civil service. Finally, by 1930 Hoover had increased the classified civil service to nearly 80% of all federal positions.

All of this implied a greater demand for experts in the civil service. Early on, classification was not only limited to a small set of positions, but those positions also tended to be lower level. Gradually the Commission developed examinations for higher level positions. In the late 1890s the commission introduced "non-assembled examination", primarily in scientific positions, where experience and training substituted for written examinations. The demand for experts would only increase as government generally became more active and as scientific classifications were refined and advanced examinations were developed in the twentieth century.

Given Wilson's importance for the Progressive movement, it is worth briefly looking at his influence on the civil service. Wilson's presidency illustrates the incentives created by the merit system, and highlights the connections between Wilson and Franklin Roosevelt. Wilson supported the merit system in his campaign and shortly after his election he announced his plan to hire based on qualification alone. However, the extension of the merit system was really only beneficial to a president at the end of his term, otherwise it might be preferable to hire based on patronage. Extending the classification was a way to entrench the existing civil service. Also, aside from the entrenchment incentive, the cost of extending the merit system, in terms of reduced ease of political activism, is largely gone at the end of the term (Rothbard, 1995). Wilson gave in to these political pressures even though, he stated, "the matter of patronage is a thorny path which daily makes me wish I had never been born" (Van Riper, 1958, p. 234). Wilson's own actions should have given him and the Progressives reason enough to question the importance of 'getting the right people into government'. If Wilson himself succumbs to political incentives, who wouldn't? At the end of his presidency, where the incentive is to extend the merit system, opposing pressures prevented such reform. The emergency of the war and disarmament meant that civil service reform was to be put on hold (1958, pp. 250–283)

In Franklin Roosevelt's Administration we see a similar pattern within the civil service classification system, though massively expanded. By the end of 1934 nearly 60 new agencies had been exempted from classification. "By 1936 only about 60 percent of a total federal public service of more than 800,000 was on the classified list" (1958, p. 320). Along with this massive use of the patronage system, Roosevelt separated "in a way that had not been so thoroughly done before in American history intellectual policy-making from political-policy selling" (1958, p. 324). Instead of looking to industrial and political leaders to formulate policy, as previous politicians had, Roosevelt was looking to "idea-men". As Van Riper describes, "[t]his phenomenon of the division of labor between the intellectuals and the politicians arose in part out of the tremendous pressures of the times, pressures which demand extraordinary political and social inventiveness...As these ideas became incorporated into the expanding New Deal, their authors too became integrated into the public service through the encouragement of Roosevelt and those who could understand their importance and function" (1958, p. 325).

Knowing that these New Deal hires would only be temporary and encouraged by the recommendations from The President's Committee on Administrative Management, Roosevelt extended the merit system to cover these newly created agencies and more. The Ramspeck Act of 1940 authorized the extension of the classification system of nearly 200,000 positions, at the President's discretion. Through a number of executive orders in the early 1940s, Roosevelt did exactly that. "By 1943 approximately 95 percent of the nearly 2,000,000 federal employees occupied positions under the "jurisdiction" of the Civil Service Commission" (1958, p. 344). With this act, and a few others, the Commission had taken on a nearly completely centralized authority over the civil service (1958, p. 386)

The Commission would again play an important role in terms of recruitment during the Second World War. Important for this paper was the National Roster of Scientific and Specialized Personnel created by the National Resources Planning Board. Under the jurisdiction of the Commission, the Roster enlisted a number of scientific societies to list potential personnel. "Altogether, it was estimated that at least 180,000 referrals and 50, 000 placements were made from the Roster" (1958, pp. 375–376)

Thus, with the Great Depression and the Second World War, the merit system almost entirely replaced the patronage system in the Federal administration. Under the spoils system expert training had very little to do with being hired in the federal government. Of course, experts were occasionally hired outside the civil service, often simply because having an expert on staff lent credence to policy proposals. However, the replacement of the spoils system with the merit system meant that administrative hiring was no longer based on party patronage but on training, where experts had the competitive advantage. Thus, with the increased demand for experts in the federal administration, the quantity hired went up.

Leonard White, in a 1937 article discussing *New Opportunities for Economists in Federal Employment*, states that in 1896, not a single 'economist' position existed and only 87 statisticians were employed (1937, p. 210). He also cites a 1931 study "that revealed 774 positions in economics and statistics, as the term is used in the official classification of the federal service" (1937, p. 210) His own estimate was that between 1935 and 1936 new economics positions totaled 583, with 129 in statistics(1937, p. 211). Because the 1931 estimate is a stock, we can compare these numbers by averaging the growth between 1896 and 1931 per year; over 35 years that is an average of less than 20 economics jobs added per year compared to 583 added in 1936. Of course, most of the early growth probably occurred much closer to the 1930s than the 1900s, but even if it occurred over a decade, that is still a substantial difference in growth. Harold Bowen's 1953 AEA study of graduate education in economics cites two separate studies as estimating the number of economists in government in 1938 and 1951 as 5,050 and 3,261 respectively (1953, p. 13). The decline reflects the flight of economists from Washington back to academia after the War, but also suggests that even with disarmament, a permanent foothold had been made by large number of economists. This is confirmed by Barber's citation of the Civil Service Commission estimates of 1958 and 1978 as 3,012 and 5,763 respectively (1981, p. 185). Along these same lines, when Bowen asked supervisors of economists whether formal graduate training was essential for persons who expected to serve in the lower grades of the public service a majority answered yes (Bowen, 1953, p. 16) This data on the professionalization of the civil service and rise of economists in government gives us a consistent picture of the rising demand for and supply of economists in the federal government around the turn of the twentieth century.

There is an important informational aspect of bureaucracy that relates to these reforms, because such a bureaucracy handles information through a different mechanism than a more fragmented system (See V. Ostrom, 1973; or Tullock, 1987). Information must travel up the chain of command from those who are the ground to those who are at the top. The problem is that the transfer of information from each subordinate to their superior is not unbiased. As opposed to a world where each communication of information objectively represents the world, each subordinate has the incentive to distort the information in order to please their superior. This is true of any bureaucracy, but is exponentially more problematic the larger the scale of the bureaucracy. The result of this is that decision makers at the top may have no real understanding of the problems on the ground. This raises a broader issue over the capabilities of large scale bureaucracy to solve the kinds of problems that were being assigned it which will be discussed later. For now, the information processes within the bureaucracy highlight the importance of manipulability of different kinds of information. Knowing that the information coming to him is likely biased, the executive at the top of chain can take measures to mitigate against this problem. One of the ways of doing so is the use of statistics, which are presumably less susceptible to manipulation compared to more qualitative accounts.

As Rothbard put it, "deprive government of its statistics and it would be a blind and helpless giant, with no idea whatever of what to do or where to do it" (1989, p. 106) It therefore may not be surprising that WWI "prompted what appears to be the first instance in the history of the U.S. [National Accounts] estimates of preparation and analytical use by a high government official" (Carson, 1975, p. 154) given that war has historically been associated with massive administrative centralization. The wartime administration initiated a long-term relationship between economists and the federal government. Rothbard cites Edwin Gay as a prime example of the war expert. First staffed on the Commercial Economy Board, Gay quickly rose in rank. “Gay had risen from a special expert to the unquestioned czar of a giant network of federal statistical agencies, with over a thousand researchers and statisticians working under his direct control” (1989, p. 111) Centralization of administration created a demand for economists, but early on, such centralization would be limited to wartime measures.

While the political rhetoric of the twenties called for a 'return to normalcy', economists saw the postwar world in a different light. For them, the war had opened their eyes to the potential role that economists could play in managing the economy. In 1918 Fisher gave a talk to the AEA were he stated: "Of the many effects which the war has exerted on the minds of men, one of the most notable is the keener desire which we all now feel to be of genuine public service" (1919, p. 5). Fortunately for economists who agreed with Fisher, not all of the wartime agencies were dismantled. As described earlier, the use of statistics in the federal government was on the rise, particularly with the help of Hoover.

Two agencies were integral in the growth of national statistics after the war, the National Bureau of Economic Research and the Institute for Government Research (Barber, 1985). The IGR was established during the war with the explicit purpose of providing expert economic advice to the administration. In 1927 it would merge with the Institute of Economics to become the Brookings Institute. In 1920 the National Bureau of Economic research was established after the war by Gay and Wesley Mitchell. In the same year, the secretary of commerce Herbert Hoover appointed an Advisory Committee on Statistics. The committee included Wesley Mitchell, Allyn Young, Walter Willcox, Carroll Doten, Gay, and Seligman: “a formidable assemblage of talents which embraced some of the most respected names in American academic economics (Barber, 1985, p. 8). In the year following, Gay and Mitchel were placed by Hoover on a committee to assist in the creation of the Survey of Current Business. Organizations and committees like these served to link the economics profession with the federal government. The growth of the use of statistics only strengthened the credibility and respect economists were gaining as experts.

Throughout the Great Depression the use and production of the National Income Accounts grew alongside government's interventions into the economy. A variety of different estimates of the national accounts preceded concurrently. Importantly for this paper, Lauchlin Currie was producing one of those estimates. In 1934 he was estimating a series labeled "the pump priming deficit" of the federal government and " in 1935 this adjusted deficit was estimated, projected, and then related to national income in order to evaluate the effectiveness of government efforts to end the Depression (Carson, 1975, p. 165). In 1939 Currie, along with Alvin Hansen presented their analysis at the Temporary National Economic Committee hearings and "their testimony was instrumental in introducing the Keynesian thinking to popular Washington economics" (1975, p. 166)

It is necessary to summarize a bit here. The classical paradigm in public administration, founded by Woodrow Wilson, predicated the Progressive administrative reforms that took place throughout the first half of the twentieth century. That paradigm called for hierarchy and professionalization in the public service in order to enable administration to actively and efficiently execute the national will. Based on these ideas, American government was centralized and the merit system was implemented in the civil service. The result was to create a demand for expert economists within the federal government.

As we saw in the first chapter, these ideas were not foreign to economists around the turn of the twentieth century, instead the economics profession was slowly aligning itself with a political economy that presumed experts in government. Beginning with Sidgwick and culminating in the Keynesians, economists were increasingly relying on the assumption that government would be capable of implementing their prescriptions. It was because of this assumption about the capabilities of the state that economists were able to formulate their prescriptions. It was in Keynesianism where these trends were fully embraced, where Keynes could completely disregard the role of property rights in the economic process. In this way, the Keynesians were much more suited to providing economic advice than some of the competing schools. A solution to an economic problem that revolves around constitutional choice, as Smith's did, is not helpful for political agents who take the rules as given. By disregarding the institutional questions, Keynesians could provide a clear-cut, actionable policy tool to the state. Lerner, as we saw, was explicit about his purpose of providing a logical analysis of the policy tools available to the state to manage business cycles.

Recall that the one of the novel characteristics of the Keynesian paradigm was the framing in terms of the National Income and Product Accounts. Keynes framed the General Theory in this way, but the formalization of that theory took place through the Keynesians. John Hicks published his *Mr. Keynes and the Classics* in 1937 where he originated the now familiar IS-LM model. It is important to note here that Hicks recognized that this aspect of Keynes was not wholly new. So even though the IS-LM model pervaded the Keynesian Revolution, it couldn't have been its novelty that drove it. In light of the previous discussion it seems that the Revolutionary aspect of the model was as a policy tool that potentially enabled escape from the depression. The Progressive ideals and reforms had created institutions that had no way of attaining accurate information about the problems on the ground except by trying to measure them through the national accounts, but even then those statistics alone are worthless without a theory to guide their use. A prevalent theme in the growth of the National Income Accounts was the need to do something about the Great Depression. Keynesianism was a theory that provided a solution to that problem. The IS-LM model, as a particular instantiation of the broader Keynesian paradigm, was a simple framework for understanding the storm and guiding the ship's escape, all while putting economists at the helm.

The Active State and the Economic Expert

By continuing to go deeper into Wilson's analysis of public administration. we are able to further understand the connections between Keynes and the Progressives, as well as the reforms of American administration that gave us the largely bureaucratic state that we have today. In the previous section we saw that Wilson and the Progressives had a particular organizational framework, based on hierarchy and professionalization, that predicated the Progressive administrative reforms and opened up the administration to expert economists. We also saw that the Keynesian paradigm was particularly suited to working within these reforms as it not only aligned with the broader ideals of the movement but it gave them a practical tool to accomplish their goals. In doing so, the Keynesians were making implicit assumptions regarding the constitutional setting in which those policy tools would be used. This was recognized and elaborated by Buchanan and Wagner, and indirectly by Milton Friedman. Wilson was doing a very similar thing. His organizational framework derived from implicit assumptions regarding the constitutional setting within which those administrative structures would exist.

The classical approach to public administration separated politics from administration. Politics was a question of *what* while administration was a question of *how* (Wilson, 1887, p. 210). Politics referred to the source and content of the will that determined what government should do. Democracy, for instance, referred to the "will of the nation", whereas dictatorship referred to a single person's will. Administration, in contrast, was completely apolitical. As Pestritto and Atto put it, “administration, in contrast to politics, was about ‘truth’” (2008, p. 20). This dichotomy between politics and administration led to the classic public administrators’ belief that administration could be analyzed apart from politics. Good or efficient administration took the same structure under all forms of politics, democratic and autocratic alike, whether they were talking about America or Prussia (1887, pp. 218–219). And for Wilson, it was getting more important to understand administration. As he says: “the weightier debates of constitutional principle are even yet by no means concluded; but they are no longer of more immediate practical moment than questions of administration. It is getting to be harder to *run* a constitution than to frame one” (1887, p. 200).

For Wilson, within any system of governance there existed only a single, ultimate center of power. "The leading inquiry in the examination of any system of government must, of course, concern primarily the real depositaries and the essential machinery of power. There is always a centre of power: where in this system is that centre? in whose hands is self-sufficient authority lodged, and through what agencies does that authority speak and act" (Wilson, 1885) This was in contrast to the belief that the "literary theories" of the constitution had actually managed to separate powers. "The noble charter of fundamental law given us by the Convention of 1787 is still our constitution; but it is now our form of government rather in name than in reality, the form of the Constitution being one of nicely adjusted, ideal balances, whilst the actual form of our present government is simply a scheme of congressional supremacy" (1885). Understanding the operation of government required one to "escape from theories and attach himself to facts" (1885).

The "facts" of history showed, according to Wilson, that the separation of powers had failed to take hold. At the time of writing *Congressional Government* it was congress that was the supreme authority and the history of American government was basically the story of Congress grasping that authority. Later on his career, however, Wilson came to believe that it was the Executive that held ultimate authority.

But it wasn't just that the separation of powers was merely a "literary theory", Wilson argues, "checks and balances have proved mischievous just to the extent to which they have succeeded in establishing themselves as realities" (1885). Separating power served to obscure responsibility. The people are unable to punish transgressions and inefficiency in the complicated system that is engendered by the doctrine of checks and balances.

> This, plainly put, is the practical result of the piecing of authority, the cutting of it up into small bits, which is contrived in our constitutional system. Each branch of the government is fitted out with a small section of responsibility, whose limited opportunities afford to the conscience of each many easy escapes. Every suspected culprit may shift the responsibility upon his fellows. Is Congress rated for corrupt or imperfect or foolish legislation? It may urge that it has to follow hastily its Committees or do nothing at all but talk; how can it help it if a stupid Committee leads it unawares into unjust or fatuous enterprises? Does administration blunder and run itself into all sorts of straits? The Secretaries hasten to plead the unreasonable or unwise commands of Congress, and Congress falls to blaming the Secretaries. The Secretaries aver that the whole mischief might have been avoided if they had only been allowed to suggest the proper measures; and the men who framed the existing measures in their turn avow their despair of good government so long as they must intrust all their plans to the bungling incompetence of men who are appointed by and responsible to somebody else. How is the

> schoolmaster, the nation, to know which boy needs the whipping? (Wilson, 1885)

So we can see here the heart of Wilson's concern with the separation of powers, they prevent accountability. In addition, the dispersed responsibility prevents government action in times of emergency. Of course, for Wilson, it tends to paralyze all the time, but in instances of emergency where timing is key, the division of authority and lack of action might prove fatal. An example of Wilson's concern that is familiar today is with gridlock. The problem with separating powers is that it creates an extremely complicated system that paralyzes actors within it. It enables self-interested individuals to put their own interests in the way of the national will. Instead of action we get bickering over how a program will benefit them in particular.

The solution for Wilson is to make the administration directly accountable to the legislature or whichever agency holds supreme authority, that is to remove the separation of powers. "The natural means would seem to be the right on the part of the representative body to have all the executive servants of its will under its close and constant supervision, and to hold them to a strict accountability: in other words, to have the privilege of dismissing them whenever their service became unsatisfactory. This is the matter-of-course privilege of every other master" (1885).

The administrative approach outlined above fits into this broader Progressive governmental structure. Ultimate authority rests in some elected body, say, the president, who has the power to hire and fire the administration that sits directly below him and is legally required to obey his command. Ordering such an administration hierarchically serves to assign responsibility and provide accountability. Civil servants who are inefficient can be fired and replaced. With a professional civil service, the President is capable of tackling the complex problems of society and can ensure that administrators will tend to act in the public rather than their partisan interests. The voting public can incentivize the president to act in the public interest through the threat of the vote.

Keynesianism fit itself into this bureaucratic paradigm by ignoring or simply asserting the institutional setting within which the Keynesian policy prescriptions would be executed. By ignoring such institutional consideration, the Keynesian made the implicit assumption that an active, responsible state existed to implement rational economic policy. That is, behind the Keynesian economic paradigm that prescribed functional finance type economic management, was a bureaucratic administration, efficiently structured, staff by economists, and unrestrained by divisions of authority that would otherwise paralyze the state. Though this assumption was implicit in someone like Lerner, who simply just asserted that government would and could implement rational economic policy, it was explicit in Keynes when he argued along nearly identical lines that the public interest could be promoted by semi-autonomous bodies checked, if at all, by the majority vote. Note how Smith could not have provided such a theory. His assumptions about the capabilities of the state prevented him from performing the kind of economic analysis that could be used by administrators as a policy tool. Nothing in Smith's theory corresponded to "those variables which can be deliberately controlled or managed by the central authority."(Keynes, 1936, p. 241) Smith was not engaged in the kind of statecraft, as Richard Wagner might put it, that the Keynesian's were. They were instead concerned with explaining the success of the system in the absence of central direction. This, as we know, fundamentally changed with the Keynesian Revolution. Economists no longer took the paradigmatic position that the market worked in the absence of government intervention, instead the Keynesian paradigm started from the belief that the market failed and the question then was what government and economists could do to fix it.

Based on Wilson's ideas, the Progressive reforms throughout the first half of the twentieth century sought centralization from local to state to federal authority in order to remove the checks and balances that existed across levels of government as well as concentration of authority within the executive branch in order to bypass the separation of powers across branches that had historically paralyzed the federal government.

Wholly in line with Wilson's approach to government, Theodore Roosevelt once remarked that "there inheres in the presidency more power than in any other office in any great republic or constitutional monarchy of modern times," and that "I believe in a strong executive; I believe in power." (Cited in Denson, 2001, p. 344) Roosevelt's presidency represents the beginning of the Progressive reforms. The theme of rising authority within the federal government and the executive in particular can be seen in Roosevelt's passing of the Pure Food and Drug Act and the Hepburn Act, which respectively gave the federal government authority to regulate interstate food and drug, and the authority to regulate railroad rates. Roosevelt was also a leader in federal intervention into labor disputes. Where wages had traditionally been based on a negotiate relationship that sometimes involved disputes, Roosevelt conceived of the issue as a problem to be *solved*.

The federal Progressive reforms that took place prior to the 1920s generally revolved around the control of business based on the ideas discussed earlier that business was getting out of control and creating an unequal relationship between employers and employees, or owners and customers, or capitalists and regulators. Federal anti-trust laws and railroad regulations began in the late 19^{th} century and were strengthened under Theodore Roosevelt's administration. The period between 1910 and 1917 saw a continuation of this trend in new federal power. The 16^{th} amendment was ratified in 1913, giving congress the power to tax income. The Federal Reserve Act was made law also in 1913. This period also saw the Federal Trade Commission Act and the Clayton Anti-Trust Act. This is of course not anywhere near an exhaustive list of legislation that passed during this time but is meant to illustrate the federal government's newly acquired aptitude to regulate business in order to solve social problems.

These centralization reforms gave economists the first hint of an attainable expert status, though it was limited (Bernstein, 2001). The Progressive policies mentioned earlier (i.e.the Federal Reserve Act, the Federal Trade Commission Act, and the Clayton Antitrust Act) created federal arenas in which economists wanted to proffer their expert advice. Bernstein cites as an example Wilson's tariff policy commission. On the one hand, he appointed Irving Fisher, Ida Tarbell, and Frank Taussig to the commission. On the other hand, he also appointed, "among others, practical shipping men, one admiralty lawyer, one electrical engineer, and a lumber producer"(2001, p. 50). What we see pre-WWI was the beginnings of the rise of the administrative state which included an increasing role for experts, but economists had a difficult time fitting themselves into that role.

The Progressive reform trend reached an apex in World War I where the centralized war-time administration took on a wide scope of authority. The federal government regulated wages and hours worked and implemented large scale price controls on food and fuel. The Overman Act, passed in 1918, gave the President the ability to rearrange executive departments without the approval of Congress. Through this act Wilson was able to massively increase the powers of the War Industry Board, which then combined the powers of other agencies to control the production of private industries. Overall, the war time policies massively shifted the control of resources from the private sector to the federal government (Higgs, 1987, pp. 123–159). Higgs' "ratchet effect" was clear, as post-war government never returned to its pre-war level. The war impacted the traditional view of the market/government relationship. With mobilization came a large increase in production. It appeared to reflect a gap between potential and actual output in the economy that administrative controls could eliminate (Barber, 1985, pp. 1–2).

WWI had both direct and indirect effects on the economics profession. Directly, as was discussed earlier, the need for statistical representation of the economy in order to apply wartime controls created a role for economists in providing those statistics. Indirectly, the American Economic Association was working with the federal government as a representative of the economics community. The association set up committees to study practical problems that were directly relevant to the war effort rather than the standard abstract theoretical discussions. In doing so it was consciously reorienting the questions that economists were asking in order to make the profession more relevant. Further, part of the Civil Service Commission's strategy was to take advantage of professional associations as representatives of a community to find out who was eligible for the civil service. They did exactly that with the AEA who, "with an explicit government request to do so...canvassed its members in the early summer of 1917 with a view toward providing the Civil Service Commission with a full census of the capabilities of its constituency" (Bernstein, 1990, p. 409). As Bernstein cites, the committee sought to classify those members who qualified for "economic expert" status. The point of this evidence is that young economists, who were about to begin developing their intellectual capital, could increasingly expect that their role as an economist could involve acting as an expert advisor to the state.

In contrast to the rhetoric of the twenties of a "return to normalcy" following the war, the size and role of the federal government was far from pre-war levels. As Holcombe puts it: "[t]he advance of Progressivism may have been slower than before the war or during the New Deal, but a slower advance is not a retreat" (Holcombe, 1996, p. 180). Particularly important for this paper is that during the 1920s we saw the rise of stabilization policy through Herbert Hoover. This increasing concern over stabilization was the impetus for creation of the national income accounts, discussed earlier. Hoover was a leading figure in the fight against business cycles and unemployment during this time. With the onset of the recession of 1921, the President convened the Conference on Unemployment, organized by Hoover. He believed that there were at least two methods by which the federal government could and should smooth business cycles. The first was through information. Statistical knowledge, provided through the *Survey of Current Business,* would enable the business community to avoid speculative booms and busts in order to “iron out” the business cycle. Note here the connection to Keynes who also believed that the problems of imperfect information could be alleviated by production of national statistics. The second, largely hammered out during the Conference on Unemployment, was the use of public works. In a manner similar to arguments that would be made post-Keynes, the publication supported the use of accelerated public works spending during times of recessions that had been postponed during the boom. While they used proto-multiplier arguments to make their case, they also argued that spending could only take place on projects that were publically valuable, that is, projects that would have taken place anyway but at a different time. Throughout the 1920s these discussions continued but the importance of using delayed public works faded and borrowing was favored. However, Hoover insisted on the importance of balancing the budget. A compromise was made by planning to divert resources from sinking funds – the budgeted expenditures toward paying off war debts – to countercyclical spending programs. As an accounting trick this enabled emergency funds to be labeled as off budget, while the standard budget remained balanced. However, with all the tools ready, the boom of the 1920s delayed implementation of these policies.(Barber, pp. 7-65) Even though these ideas were not yet put into practice, it is clear that there are strong similarities between the administration's interventionist plans and the Keynesian paradigm.

With Hoover as President, the onset of the Depression meant that he could at last implement his plans to eliminate business cycles. Quickly after the start of the Depression, Hoover initiated his spending program. He asked the various departments within the federal government to increase spending on projects they would have already pursued. He asked state and local governments to do the same. He also asked leaders of private industry to increase their capital investments (Barber, 1985, pp. 78–92). The same goal of stabilization was imbued into Hoover's other interventions as well. Hoover believed that generally higher wages could lead to recovery by raising consumer income and spending. Toward the end of 1929 Hoover called industry leaders to Washington to ask them not to lower wages. By striking a deal with industry and Union leaders, this high wage policy worked for a few years and arguable contributed to the persistence of high wages in the face of vast unemployment during the earlier years of the depression. As well, one of Hoover's campaign promises was to increase tariffs to protect farmers from foreign competition. He supported and signed the passage of the Smoot-Hawley tariffs in 1930, which raised tariffs to historic levels. The justification was that higher farm wages would lead to higher consumer spending and would bolster aggregate demand. The Smoot-Hawley act went further though and set up a Tariff commission that could adjust rates with the approval of the President. Hoover supported this provision and its ability to provide “prompt and scientific adjustment” that was “free from pressures inherent in legislative action” (Hoover, 1930). Hoover's remarks reflect the Progressive ideology that treats social problems as scientific problems to be solved through efficient, expert administration. In general, Hoover's presidency reflects a growing role for the federal government in stabilization policy even if the exact method wasn't yet worked out.

In retrospect, Hoover's presidency appears somewhat transitional, rather than revolutionary, when compared to Franklin Roosevelt's presidency. Roosevelt's first 100 days in office “hold an unbroken record for governmental activism in peacetime.”(Barber, 2006, p. 23). The perception of the depression as an emergency enabled Roosevelt to dramatically increase the federal government's role in society. The creation of the National Recovery Administration, the Agricultural Adjustment Act, and Social Security, all reflect the new found role of the administration in providing for public welfare. The creation of the NRA implemented a massive public works program which meant wide discretionary power for the president in allocating those funds. It also authorized the president to regulate industry based on ‘fair competition’, this meant regulating monopoly power, minimum wages, maximum work hours and so on. The AAA charged the administration with raising farm prices. The mechanism for doing so was vague, but gave the administration wide discretionary control of farm supplies and prices. Contrasted with Hoover and even more so with the Presidents that came before him, it is clear that Roosevelt’s administration represented a dramatic shift in the role of government in American lives.

The recession of 1937 was a painful surprise. It followed Roosevelt's attempts to the balance the budget and therefore was seen as support for the Keynesian perspective (Currie, 1980). In 1938, Roosevelt embarked on a massive spending program. Hoover’s and Roosevelt’s administrations had already implemented numerous policies with the explicit intention of trying to promote recovery, however there were a couple of unique traits to this spending program. The first is that there was no attempt to balance the budget. The reasoning that was given to Roosevelt by his economic advisors was explicitly Keynesian and persuaded Roosevelt that the deficit could actually be used as a tool of fiscal management rather than being a burden on the economy. They estimated full employment output to be around $88 billion, where actual output was about $60 billion. Six billion in federal spending was predicted to be enough to close the gap. Further, it wasn't just spending in the face of a deficit but also had the explicit goal of raising national income (Barber, 1996, pp. 112–115). Thus what we see with Hoover and Roosevelt is the beginning of the shift within the federal government to use fiscal policy to stabilize aggregate demand. It is arguable whether the 1938 policy was Keynesian, but it seems it was a policy intended to promote recovery in the face of deficits, based on the advice of economic advisors who found themselves aligned with Keynes. More generally, there was little question that the federal government had a role to play in the depression and that that role must be based on scientific analysis, the open question was exactly *how* government could do this.

As has been argued, Keynesian economists were aptly trained to answer this question. Throughout the depression, economists increasingly found themselves in more visible, reputable, and influential positions in the federal government. Rexford Tugwell, who received his degree from Columbia University, worked on Roosevelt's 'Brain Trust'. Tugwell formulated the outlines of the NRA prior to entering public service. He would go on to participate in the creation of the AAA and the NIRA (L. H. White, 2012, p. 102).

Lauchlin Currie, a graduate of the Harvard PhD program, is another example of an economist who found influence inside the politics of the New Deal. Currie officially worked at the Federal Reserve but partnered with the Department of Commerce, where the National Income Accounts were being developed. From this vantage point, Currie set out to persuade the administration of the desirability of counter-cyclical spending. Currie was an early advocate of Keynesian type policies, even prior to The General Theory. By the end of the 1930s Currie's work had been persuasive enough to get him appointed to Roosevelt's White House staff as economic adviser to the President, the first appointment of its kind. At this point, Currie describes, the beachheads had been established; "the fiscal policy later know as Keynesian became a central piece of New Deal economic policy and the work of recruitment and placement of younger economists in the various agencies, in which I took an active part, continued." He goes so far as to say that "[e]ven if the other War had not intervened, I still feel that by 1940 the war over the responsibility of the State for employment and the use of fiscal and monetary policy to this end was well on the way to being won." (1978, p. 547) Currie's appointment in the White House was important in establishing the beachheads, because, like Tugwell in the Brain Trust or Mitchell at NBER, it represented the rising status of economists in government.

Like The First World War, The Second also involved centralizing administration and authority in the federal government. The important aspect of mobilization for the war, for this paper, was the huge increase in federal expenditures and fall in unemployment. This was interpreted in the same way as it was after WWI, that there was gap between actual and potential employment and that the federal government could remedy it. However, the country now had the experience of the Great Depression to amplify the importance of this interpretation. Further, they also had Keynesian economic theory which predicted these outcomes and was increasingly being accepted by the economics profession. The same interpretation of the war was also used to justify Keynesian spending after the war in order to avoid unemployment (Samuelson, 1944). Also, as in WWI, Higgs' ratchet worked here too. With the end of the war, the United States was left with a federal government that represented a larger portion of our society then it ever had before, and the belief in an economy that was prone to depression if government didn't intervene.

World War II, like the First World War, had a major impact on the economics profession. Economists were highly active in the federal government. Keynesian economics coupled with National Income Accounting statistics were used by economists across multiple departments to control prices, maximizes wartime productivity, minimize inflation, all while supposedly increasing private consumption (See Higgs, 1992 for the case against wartime prosperity). Again the Civil Service Commission asked the American Economic Association to classify its membership, asking also for credentials and specialties of all AEA members (Bernstein, 1990, p. 410). The major effect of the war and the participation of the profession was to solidify the status of economists, essentially granting them a monopoly on expert economic advice. Samuelson quite appropriately summed up this result:

> It has been said that the last war was the chemist's war and that this one is the physicist's. It might equally be said that this is an economist's war.

> Especially in the business-as-usual period, but equally since, the Washington economist, whether recruited from the permanent civil service or from academic life, has done an excellent job, either in comparison with reasonable expectations or in comparison with business executive who have been called to the government service. At a time when the term bureaucracy is anathema, it is well to emphasize that no administration in history has commanded the services of men of equal zeal, honesty, or competence (Samuelson, 1944, p. 298)

In that 1944 *New Republic* article, Samuelson was addressing the public and attempting to persuade them of the coming post-war storm. In the same year Alvin Hansen served as the coordinator of the drafting committee which was assigned to create an American white paper on post-war full employment. The committee also included Arthur Smithies and Walter Salant, among others. Their proposal was for an administrative board composed of economists who would have discretionary control over fiscal policy in a fashion similar to the Federal Reserve’s authority over monetary policy. Note the similarity between these ideas and Wilson's bureaucratic paradigm. The very fact that economists were assigned to draft such a bill is telling. But Congress was not quite willing to grant such authority to an independent executive commission so the proposal was watered down and turned into the Employment Act of 1946.

The Employment act formalized the federal government's responsibility to maintain employment, and simultaneously created the Council of Economic Advisors. Where Currie's appointment in the White House was, no doubt, a significant event for expert economists, the creation of the CEA institutionalized a prestigious role for economists in the federal government. It is notable, as Barber points out, that no other discipline, even in the hard sciences, found such recognition and influence(1981, p. 181).

Therefore, by the end of the war economists had gained enough status to grant them a permanent role in the federal government.

The CEA is still active today and as Mankiw argues, it has been a venue for macroeconomists looking to engineer the economy ever since. From 1946 onward, there was little in the way of a young economist who wanted to put his skills to work in the public service. And such an economist would have pretty good reason for wanting to do so, economists now had the opportunity to step out of the ivory tower away from the dismally abstract theories and into the public service where they could be engineers, or "doctors to the world".

Before continuing, it is necessary to summarize the argument thus far. Based on the ideas of Woodrow Wilson and the classical public administrators, the Progressives reformed American government to be more bureaucratic, professionalized, and centralized with the intention of removing the paralyzing effects of the separation of powers and enabling active, efficient, and rational government. These reforms created a role for experts in the federal government advising the administration. The Keynesians provided a policy tool that enabled the Progressives to accomplish their goals of stabilizing the economy and that aligned with their broader ideals. As the Progressive reforms surged during the Great Depression, so did the role for Keynesian economists. Between 1936 and 1948, it became clear that Keynesianism didn't just represent an explanatory tool, it represented a policy tool that enabled economists to take on the role of expert. That is, by placing the Keynesian Revolution in the broader institutional transformations of the time, we are able to explain its "rapid and massive" nature. In addition, by comparing Wilson's bureaucratic paradigm to Vincent Ostrom's democratic paradigm, we are able to better understand the failings of the Keynesian paradigm.

CHAPTER 3: THE FAILURES OF KEYNESIAN ECONOMICS

The Failures of Keynesianism

Following the Keynesian ascendency, it was not long before problems started to arise. As documented by Buchanan and Wagner (1977), the Keynesian program failed to work as expected. At the economic level, the Phillips curve analysis showed to be inadequate and harmful (Friedman, 1968). Without microfoundations, the Keynesians failed to understand the wage and employment relationship. There was no permanent tradeoff between unemployment and inflation, because employees would demand higher nominal wages as prices rose. From a classical perspective, this should have been obvious, but without foundations in individual purposeful action, the Keynesians could easily imagine a world where planners could rearranged society like pieces on a chess board.

Moreover, at the political level the Keynesian prescriptions had resulted in a propensity for deficits, inflation, and growth in government. By looking at data provided by the St. Louis Federal Reserve, we can compare the deficits in the first and second half of the century. Of the first 50 years of the twentieth century, 22 (44%) of them showed a surplus in the federal government's budget. Note that these years included both World Wars and the Great Depression. Of the 62 years between 1950 and 2012, only 9 (13%) of them showed a surplus. Clearly something had shifted in the budgeting process to result in a program of continuous deficit spending. Concurrent with this pattern, and the growth of government that we saw earlier, the second half of the twentieth century has also seen a large growth in inflation. The monetary base and the consumer price index have paralleled each other in their substantial growth since the end of World War II. As was discussed in the introduction, the growth of the monetary base has reached astronomical levels since 2008. Why we would expect price inflation to follow a different pattern than it has for the past 50 years of rising with M0 is a mystery. That is, along with the significant rise in deficits over the past few years, it's not unreasonable to fear the possibility of serious price inflation around the corner.

These results were to be expected, Buchanan and Wagner argue, following the Keynesian removal of the balanced budget norm. The Keynesians ignored the constitutional role that a balanced budget rule played in constraining self-interested politicians. This disregard is clear when Lerner presumes that his Keynesian prescriptions would be followed as he intended. Instead of following the guidance of the Keynesians, politicians responded to the incentives defined by the collective decision making rule of majority rule. That is, instead of pursuing the public interest per se, politicians pursued votes. Buchanan and Wagner argue that for any given level of public spending, it is easier for a politician to attract votes by deficit financing rather than tax financing. Doing so shifts costs into the future and obscures liability. A dollar spent through tax financing represents an immediate and clear cost to the taxpayer. A dollar spent through deficit financing is a much more nebulous cost. It requires the taxpayer to first *imagine* himself bearing the cost in the future as opposed to *actually* bearing the cost now. Besides, future costs are clouded with uncertainty. Changes in income, in taxing rules, and the possibility of simply not being around to pay the tax, all tend to obscure the costs of the spending. The perceived relative cost of borrowing is thus lower than taxation. The converse of this statement is that additions to the level of public spending will also be perceived as cheaper when they are deficit rather than tax financed. Therefore, Buchanan and Wagner are able explain both growth in deficits and debt as well as the growth in government. Politicians who are competing for votes will gain a competitive advantage by borrowing instead of balancing. Voters who now see public spending as relatively cheaper, will prefer to shift more funds into the public sector (Buchanan & Wagner, 1977).

As Wagner (2011) points out, this is all exacerbated by the fact that political decisions are often of a short-term nature. In the market, if the owner of a firm finances spending through borrowing, he has only rearranged assets on a balance sheet. Even though he has more money now, the net present value of the company will reflect the future liabilities. There is no similar mechanism in government. Politicians who deficit spend now receive the immediate benefit in terms of votes, but then leave office. There is no liability attached to those decisions. As Wagner argues, it is true that the liability does get marked down on the books, but that does not reflect a liability in the true sense of the word. No individual is held liable for those funds, instead they just become part of the common liability of some group of people in the future. Wagner's point is that spending in this arena represents a fiscal commons and is liable to the tragedy of the commons (2011, p. 29).

All of these points are amplified when deficits can be financed through printing money. In this way, not only are costs shifted onto future generations but they are incurred through inflation. Recognizing money printing as a tax requires not only imagining some future cost, but also a fairly sophisticated understanding of economic analysis. The reason we have to teach inflation to undergrads is because they come in to class with the predisposition that inflation is the product of greedy businessmen. From that perspective there may be literally no connection between the financing of spending and the costs of inflation. The point being that when money financing is involved politicians will gain a competitive advantage by using it and taxpayers will prefer more public spending, both to an even greater degree than under deficit financing (Buchanan & Wagner, 1977).

The problem is that different financing schemes do not actually change the cost of public expenditure, it only shifts costs onto future generations (Buchanan, 1958, Chapter 4). Thus we can see the value of a balanced budget norm. Even if the Keynesian prescriptions are logically valid, they are not logically sound given the self-interested nature of politicians. The value of a balanced budget norm is found in securing our long term interests by constraining public decision makers who would otherwise be inclined to increase deficits, inflation, and the overall growth in government.

As we saw, the Keynesian Revolution that upended balanced budget norms took place within broader institutional transformations and fulfilled the Progressive ideals of an active, expertly guide state. The argument in this chapter is that we can see the Keynesian failures, as presented by Buchanan and Wagner, in light of the broader problems associated with the Progressives, as argued by Vincent Ostrom. It is argued that the ideas of Woodrow Wilson, upon which the Progressive reforms were constructed, were inimical to the democratic process. That process depended on certain constitutional rules that were intended to cope with knowledge and incentive problems that face communities. Wilson and the Progressives rejected the idea of constitutional choice and in doing so, somewhat ironically, made constitutional choices that disregarded many knowledge and incentive problems. The general similarities between Ostrom and Buchanan and Wagner should be clear already. Both were engaged with the constitutional level of analysis and criticized those who disregarded it. By using Ostrom's argument to see the problems with Wilson's bureaucratic paradigm, we can see the inconsistencies between the Keynesian policy prescriptions and democracy properly conceived.

I will first discuss the knowledge properties of Ostrom's polycentric order and then go on to discuss the ways in which it copes with the self-interested nature of politicians. The purpose here is to elucidate the way in which the alternative which Wilson and the Progressives reject, polycentrism, dealt with the problems that the Progressives ignored. Following the Progressive reforms, we can see the Keynesian failures as manifestations of these broader constitutional problems.

The Public Problem

Vincent Ostrom and The Bloomington School argue that in order to better understand governance we have to move away from concepts like "the state". Far from simply being characterized by a single entity, government in the United States is highly complex. In 1969, Mancur Olson remarked by one measure there were about 80,000 governments in the United States. "The typical citizen," he elaborates, "is not only under the jurisdiction of national, state, county, and city governments, but sometimes also subject to a metropolitan transport commission, a port authority, a sewage or sanitary district, a Soil Conservation District, a pollution control district, a school district, an airport commission, or a metropolitan planning commission or council of governments" (Olson, 1969, p. 479). Thus, in order to understand government in the U.S. we obviously cannot refer to the "the state" as if it were a single acting entity.

It is easiest to begin by looking at the issue from a relatively simplistic perspective. The first step to understanding the complexity found in the U.S. government is in setting up a number of assumptions regarding the public or private nature of goods. The relevant characteristic of goods for this paper is to what degree they are excludable or to what degree their consumption affects others. Decisions about what book to read, what to eat for lunch, or what kind of television to buy, only affect the chooser. Other decisions have the potential to affect others, like driving a car that pollutes, building a light house, or providing for national defense. The public quality of goods is not binary, but is rather a question of degree. The term "public goods" captures a set of heterogeneous goods that differ in many qualities including their degree of publicness. From these starting assumptions regarding the structure of goods, we can define a community of people that is affected by any specific good as the consumption community.

Based on Mancur Olson's (1969) approach, we can also define a state of fiscal equivalency whenever the governing community of some public good is strictly confined to the consumption community. That goods are highly varied in the degree of their publicness implies that fiscal equivalency will be characterized by various sized and overlapping governing bodies. Any given individual will be a part of multiple overlapping jurisdictions, as highlighted in the Olson quote above. In contrast to monocentrism, where governing authority is lodged in a single overarching body, "the state", fiscal equivalency would be characterized by polycentricism. Authority, under polycentrism, is fragmented across a variety of decision making bodies.

Aside from fiscal equivalency, we could imagine two other scenarios, where a governing body was either smaller or larger than the consumption community. Where its smaller than the consumption community we would get externalities. Ostrom argues that individual decision making rules face weaknesses when confronted with public or common goods and tend to lead to free rider and tragedy of the commons problems (1973). It is worth noting however that individuals and organized communities can, to a degree, rely on Coasian bargains to internalize costs. Where transactions costs are high though, it may be efficient to expand the community. On the other hand, where the governing body extends beyond the consumption community we get the opposite problem, what Olson calls "internalities", where costs and benefits accrue separately to subsets of the group (1969, p. 482). This too could result in the tragedy of the commons where subsets of the group benefit from provision, but the whole group pays.

We can see a connection here to Wagner's (2011) idea of the fiscal commons. Wilson and the Progressives saw the complexity of government in the United States and, without a theory to explain the complexity, called for centralization and consolidation. Such centralization leads to this problem of internalities, where the costs of public spending are not necessarily paid for by the beneficiaries. The standard public choice interest group theory is an example, where benefits accrue to focused groups who can easily organize, but the costs are spread across a population. By centralizing, the costs and benefits of choices are separated from decision makers. Conversely, decision makers are not liable for their choices. It is not surprising then if irresponsible budgeting is the result.

We can also see here some of the efficiency qualities of polycentrism. Just as in the market, public agencies that produce inefficiently can be subject to a degree of competition if public goods consumers are capable of voting with their feet (Tiebout, 1956). Their ability to do so will depend on the costs of exit, which depends on the degree of decentralization. Polycentrism isn't decentralization, because the scale of the governing community depends on the public good in question. However, the centralization efforts of the Progressives would clearly reduce the ability of individuals to vote with their feet. The are some very clear problems with competition in public agencies, the most obvious of which is that it doesn't have the same incentivizing affect that it does in the market, because there is not equal liability and no single individual is accountable to a loss or gain from movers. Even if it's not ideal though, competition between jurisdictions still puts some check on public agencies and allows consumers some preference expression.

In general, with this approach we can explain and justify the complexity of polycentric democratic government. Individuals are seen as purposeful agents who confront a problem when facing certain types of good. Collective action is a mechanism to cope with that problem. Where the ideal involves equating the collective decision making group to with the beneficiaries, the result is a complex system of overlapping jurisdictions. The goal for the Ostrom's and for much of modern political economy is to understand the way in which polycentrism reflects and produces order. The idea of fiscal equivalence helps reveal in a simplistic way an underlying pattern that explains the complexity of the public order. However, there is more to polycentrism once we move beyond this simplistic representation and recognize that the governance refers to rule systems and is thus a matter of analyzing institutional arrangements and their ability to cope with knowledge and incentive problems.

The Role of Rules

Production and provision of public goods can only take place within a system of rules that constrain individual choices. Economists have only recently begun to rediscover the importance of rules and institutions both in society and in economic analysis. Rules are defined simply as constraints on behavior, or conversely, as decision making arrangements. Private property, for example, is a rule that defines decision making rights in terms of mine and thine, which can also be seen as restraints on our choices. Rules enable us to rise out of the Hobbesian jungle, where every man is "free" to do what he wishes but where life is also "nasty, brutish, and short".

In general we can define at least two broad reasons to use rules. They enable individuals to coordinate their actions and to prevent opportunism. These functions are readily seen in simple coordination and prisoner's dilemma's games. The rules of the road are a common example of the coordinating aspects of rules. As long as we both drive on the left side, as long as we coordinate, we are safe. In a commons situation, each individual has the incentive to graze as much as possible now and rules can be used to prevent such opportunism.

Property rights, as rules, also coordinate actions. We can conceptualize the emergence or existence of property rights as a social contract, as portrayed in James Buchanan's *The Limits of Liberty* (1975). In this setting, we want property rights for reasons similar to the reasons for wanting rules of the road. When each individual respects the rule of 'mine and thine', resources can be allocated away from defense and offense; both are made better off than if each were to defect from the rule. The strength of property rights determines the degree to which we can make plans into the future regarding our use of resources.

However, as noted earlier, property rights have weakness when confronted with public and common goods. In order to cope with these problems individuals have to construct rule systems that define and allocate decision making arrangement amongst community members. What was referred to as a governing body in the previous section is really just an arrangement of rules. From this perspective, the tragedy of the commons is not *necessarily* associated with common and public goods. Instead, it seen as an outcome of specific rule system when confronted with public or commons goods. In other words, through alternative institutional arrangements communities are capable of solving the public and common goods problems. An important point here is that private property is only a single institutional arrangement that might have these weaknesses when confronted with public and common goods. Alternative institutional arrangements will also face such problems. The issue than is about picking the right institutional arrangement.

In surveying the successful cases of communities facing a common pool resource problem, Elinor Ostrom discovered that the particular solutions to the abstract problem that economists call the tragedy of the commons was very different in every single case. No two were alike. However, she concludes that this is not a weakness or a problem. Instead, the strength of these institutions is found precisely in their diversity. It is only through diverse institutions that communities are able to solve the unique problems that each of them face. Even though in the abstract they all face the tragedy of the commons, this problem presents itself in concrete form in an infinite variety. In addition, a successful solution in one community would be highly inappropriate, ineffectual, and likely harmful if applied to any other community because of these underlying differences. That is, the diversity of institutions was a product of the fact that each of them was catering specifically to the problem situation of that community (E. Ostrom, 1990).

Boettke, Coyne, and Leeson provide a deeper understanding of those underlying differences in what they call the Métis of the community.

> Métis is characterized by local knowledge resulting from practical experience. It includes skills, culture, norms, and conventions, which are shaped by the experiences of the individual. This concept applies to both interactions between people (e.g., interpreting the gestures and actions of others) and the physical environment (e.g., learning to ride a bike). The components of Métis cannot be written down neatly as a systematic set of instructions. Instead, knowledge regarding Métis is gained only through experience and practice (Boettke, Coyne, & Leeson, 2008, p. 338).

It is the Métis of the community that is underlying the institutional diversity in Elinor Ostrom's argument. The authors also give us a taxonomy of institutions that is useful. Institutions are either endogenous or exogenous and indigenous or foreign. Endogenous institutions are those that emerge informally out of interactions between people. These institutions will of course be indigenous. The endogenous institutions that emerge out of individual interactions are thus necessarily based in the Métis of those individuals. Exogenous institutions are those that are designed and codified, and could be either indigenous or foreign. In fact, while their purposes were in development economics, for our purposes it is best to think of the difference between indigenous and foreign as a matter of degree as to how distant (socially and economically) are the designers of the institution. Their argument is that institutions must align with the underlying Métis of the community in order to stick and to produce the intended consequences.

There are three important implications that derive from this argument about Métis, the first is that any single set of rules will be unable to solve the vast variety of problems that people are trying to collectively solve (V. Ostrom, 1973, p. 60). Black and white rules that divide the world into the market and the state will surely also be problematic. While purely individualistic approaches may face problems like the tragedy of the commons, the singularly bureaucratic approach taken by Wilson and the Progressives will be unable to cope with or even account for the diverse problem situations facing communities.

Second, once we recognize that no single set of rules is going to solve the diverse problems facing communities, there is a second problem of matching or getting the right institutional arrangement for each community. The benefit of a polycentric order, compared to Wilson's monocentrism, is that it is much more able to take advantage of local knowledge. What the Boettke, Coyne, Leeson taxonomy implies is that locally constructed institutional arrangements will be much more capable of accounting for the Métis of the community. The further away the administration of public goods is from the consumption community, the more there will be a disconnect between solutions and problems on the ground.

Third, it is important to recognize that these are not purely scientific problems that a community is solving. Science grants generalized knowledge about cause and effect, which of course will be an important component of the institutional process, but will be inadequate to solve public problems on its own. Note the similarity here to the Hayekian argument against Keynes. Scientific knowledge and aggregate statistics do not provide the time and place knowledge that is necessary to make efficient investments in the capital structure. In a broader sense, large scale bureaucracy, even if it's staffed by the very best experts, will not have access to the knowledge that is necessary to solve problems that face individuals or communities. In other words, the fact that Keynesian policies have failed to solve the problem of business cycles isn't specific to the Keynesians but would be a characteristic of any policy prescription that attempted to solve the business cycle problem through an expert staffed bureaucracy.

The Progressive bureaucracy will face problems on two fronts. The first is related to scale. A singular centralized bureaucracy will face information problems and will be unable to account for diverse interests. In Mancur Olson's terms, it will face internality problems. Additionally, bureaucracy is only a single institutional arrangement and will thus be unlikely to align with the underlying Métis of the community. Problems of public/common-pool goods provision, monitoring, and enforcement will be unlikely to be solved.

Ostrom predicts that a bureaucratic state that is unable to accomplish its assigned tasks, like fighting poverty, crime, drugs, or terrorism, would lead to a public rhetoric that was inconsistent with public reality (1973, pp. 56, 109). Unless bureaucrats are presumed to be omniscient, such reliance will "generate a rhetoric based on concepts that are inappropriate to the resolution of policy problems." If solving public problems requires accounting for the Métis of communities, it is not surprising that federal programs intended to solve the poverty problem become the "war on poverty" or the "war on drugs" or the "war on terror". It is also not surprising then that the same mechanisms that would be used to manage the stability of the economy, the national income accounts, derived from wartime measures to control the economy. The federal bureaucracy is limited in the means by which it can approach social problems. Whether or not terrorism is best approached through the mechanisms of war, surely the same mechanisms cannot solve the problems of poverty or domestic crime, at least not at a cost that is worth paying. There is more to these problems which conceptions like these, and the bureaucratic solutions that are associated with them, simply ignore.

For the same reasons that the bureaucracy is unable to solve the problems facing communities, Keynesian policies are unable to solve the unemployment or business cycle problem. Such problems, assuming they are not structural, exist as part of a adjustment process to get resources to their highest valued use. Of course, it is argued by the

Keynesians that idle resources exist such that any spending program will be better than nothing. The crucial point though is that even if resources are idle, they are not scarce. Because they are not scarce, there is still a cost involved in their allocation and the question then is about minimizing that cost. As Smith, Mises, and Hayek all argued, that will only take place within a system of private property. That is, the solution to those problems lies in the choice over rules that able to cope with knowledge problems. Large scale bureaucracy is an inappropriate institutional arrangement for dealing with market problems. Aside from these knowledge problems, the Progressive bureaucratic regime also faces incentives problems that the Progressives tended to ignore.

General Rules

Institutions and their enforcement are themselves both public goods. Though it may be in each of our interests to have a system of rules which constrains the actions of others, we each have an incentive to break those rules while everyone else abides by them. Sanctions must be implemented to incentivize actors to follow the rules. But who is to impose those sanctions? Enforcement is not the only problem either. Rules need to be made and modified. As with enforcement, the question is: who is to create and modify the rules?

Agreement or unanimity is method of ensuring that governance is beneficial to everyone. In a hypothetical world, we could arrange an assembly of every citizen. Each decision to be made in the collective sphere would be proposed to all and through civil discourse, persuasion, and deliberation citizens would come to a consensus on each issue which could be confirmed through a unanimous vote. It should be obvious that this hypothetical world is highly unrealistic. The costs of coming to agreement would be significant in all but extremely small groups. However, ignoring those costs, it would only take minimal assumptions to describe the outcome of this process as just and desirable. Voluntary agreement is a guarantee that the rules agreed to are in each individuals' interests. The desirability of collective action, the costs of coordination, and the costs of decision making in the collective sphere lead us to grant unequal decision making authority in the collective realm. Once we have granted this authority though, there is the problem of ensuring that decisions made are still in each individuals' interests.

The foundation of this argument is found in James Buchanan and Gordon Tullock's groundbreaking book, *The Calculus of Consent* (1965). In their framework, costs can be categorized into external costs and decision making costs. External costs refer to those costs imposed on individuals outside of the winning coalition in a collective decision. For example, in a direct majority rule vote, the set of successful decisions will include some that are on net harmful to 49% of the voting population. Those decisions would impose external costs on the losers. In a world of unanimous consent there are zero external costs. The set of successful decisions will include only those are on net beneficial to everyone. Decision making costs refer to the costs of coming to agreement. Any given proposal is likely to initially benefit some and harm others. The agreement process is one of negotiating and restructuring the proposal such that those who would otherwise be harmed can be compensated to be benefited on net. Obviously the decision making costs of unanimous consent would be extremely large in all but very small groups. As the inclusiveness of the voting rule falls, external costs rise and decision making costs fall. At some point in the middle the sum of the two cost curves is minimized. The implication being that the optimal decision making rule is something less than unanimity. So we can see why a broader political structure would involve some degree of unequal authority.

However, the ideal is still unanimity. Behind Buchanan's and Tullock's analysis is the assumption that individuals can ever agree to the optimal rule in the first place. The ideal of unanimity rests on paradigmatic view towards the world where individuals are capable of mutually beneficial interaction rather than opposition and zero-sum games. A rule-ordered system of government derives from the purposes, plans, choices, and ideas of individuals. This is in contrast to a view towards the world where power and force determine relationships in society. As we know, Wilson rejected the 'literary theories' behind the constitution. The question currently being addressed is whether the administrative system that Wilson proposed was consistent with ideals of democracy that unanimity is intended to achieve.

In practice, we accept some political inequality. We grant power to others to enforce rules over us. The question however is whether we can expect those to whom we have granted power to enforce the rules to themselves abide by the law. This is what we mean by the rule of law. An important aspect of the Progressive movement, compared to the ideas that came prior, was in accepting a different solution to the problem of political inequality. In rejecting the separation of powers, Wilson was rejecting the solution to the problem of political inequality that had framed the designing of the American constitution. Wilson was more closely aligned with Thomas Hobbes in his analysis of government (V. Ostrom, 1973, p. 66). Hobbes too recognized the problems with rule enforcement. For him, a contract made between two people is but mere writing on paper unless it calls on the enforcement of an external third party who has the power to enforce the contract. In doing so, the third party is himself operating by a new contract that he will enforce the stipulations of the original agreement. But of course, we have only pushed the problem back a step. This second contract is but mere writing on paper. Moreover, the power to enforce implies the power to force. In granting to the third party the power to enforce the agreement, he must have been granted the power to force those individuals to abide. But does that not also grant him the power to force those individuals to abide by whatever commands he makes? They could of course resort to a fourth even more powerful party to enforce the second contract, but this only compounds the problem. For Hobbes, the only solution to this infinite regress was that a sovereign individual be granted the power to enforce the law, but himself be above the law. Wilson took a similar position in *Congressional Government* (1885). Government action derived only from some ultimate authority, as we have discussed. The only check on that authority, for Wilson, was through voting. Further attempts to distribute power only obscured the ability of voters to check the ultimate authority.

In contrast to Wilson's approach, Ostrom argues that the separation of powers was based on explicit intentions and ideas about the structure of government (1973, p. 72). The constitutional democracy that Ostrom has in mind, like Wilson, accepts that political inequality is inevitable, but differs in the solution offered to that problem. Instead of having to accept the rule of man where laws are handed down from above, constitutional democracy rests on the premise that communities of individuals are capable of constructing their own rule systems without reliance on external enforcers. They are capable self-governance (1973, p. 77).

It is not difficult to find examples of rule enforcement in the absence of external authority, and with the goal in mind of discussing how such a system self-enforces, it is worthwhile to consider some rule systems that do not accept the necessity of unequal political power. Consider the traditions of ostracism in Gypsy and Amish law, each of these systems avoids the problem of unequal authority. A rule that says to 'avoid contact with any rule breaker, including breakers of this rule,' is automatically enforced. If person A steals from someone in the group, persons B through Z are forbidden from interacting with A. If any of them do, they too will be ostracized. Reputation based relationships can also be seen as enforcing rules without requiring unequal power. If A breaks a contract with B, and C through Z find out about it, A will be punished for his transgression by having to compensate future exchange partners for assuming larger perceived risks. Again, no person is granted extraordinary power to enforce the rule. Importantly, these rule systems self-enforce. Along with not granting unequal political authority, they are not relying on external parties to govern. They suggest that we should at least hesitate before rejecting the idea of self-governance.

The interesting question is how these rule systems are able to overcome the public goods problem in rule enforcement. To do so, institutions must be arranged in such a way that align personal interests with the public good of enforcement. At a more concrete level, Elinor Ostrom's project provides us with a number of ways in which communities accomplish this. In the case of monitoring irrigation systems, the rules were arranged such that as soon as an individual's allocated time period was up, the next user was there to begin his time. The result was that just as soon as an individual had the incentive to cheat and go beyond his allocated time, the next user would be there to monitor usage and would be personally interested in prevented transgressions as it would take away from his allotted time. Though the water represented a common pool resource and the threat of the tragedy of the commons, by arranging the rules of the game in a certain way the community was able to enforce their rules without reliance on an external entity (E. Ostrom, 1990, p. 95). This is the same way Ostracism and reputation based rule systems work. They make it in each individuals incentive to enforce the rule. That is, the infinite regress to the Hobbesian sovereign was not as inevitable as it first appeared. Individuals and communities are capable of self-governance.

One of the reasons to separate powers lay precisely in this recognition. "Ambition must be made to counteract ambition. The interest of the man must be connected with the constitutional rights of the place" (*The Federalist*, 1787, Chapter No. 51) By separating and fragmenting powers, the authority of public decision makers could be relied upon to check the authority of others. At the heart of this framework is, again, the concept of unanimity or agreement. In those cases, each individual is given equal political authority and their agreement or disagreement acts as a check to ensure that any collective decision is in the interest of each individual. Even though democracy necessitates unequal political power, it does not necessitate rejecting the ideal of agreement. Individual interests can be secured by granting unequal, though not infinite authority, and requiring that those who have unequal power work together to secure agreement amongst themselves. Thus any public decision maker has to be concerned about representing the interests of all those with competing authority. As Ostrom discusses in *Operational Federalism*, any agency or self-governing municipal corporation acting “in a system of government based upon substantial dispersion of authority…must independently formulate its program within the parameters established by all authorities capable of exercising potential veto positions" (1969, p. 12). "Under these circumstances," he continues," the structure of decision making in an American System of public enterprises tends to approach a relatively high level of agreement or consensus" (1969, p. 13), a level that "substantially exceeds the minimal requirements of a simple, majority-vote coalition" (1969, p. 12) If a pubic actor were to try to pass legislation that benefited only his constituents at the expense of the nation, the proposal will simply not find the support to be successfully enacted or will shortly be removed. Additionally, public entrepreneurs have to be concerned with the fact that the individuals who represent competing positions of authority will be changing with election cycles, and therefore also concerned with accounting for the interests of whomever will take their place. In this way, the competing polycentric authority can account for interests that extend beyond a single term.

In *The Meaning of Democracy* Ostrom describes the difference between the standard engineering problem and "the engineering of men", by which he means "the place of political processes in constituting patterns of relationships to both alleviate dangers...and realize opportunities." The engineering problem relates inputs to outputs; getting the most crime reduction for a given amount of spending on police forces; or getting the best student evaluations for a given amount of spending on education. The engineering of men, however, refers to the problem of accounting for and rearranging the interests of the community. It means discovering what people want, constructing institutions that align with the Métis of their community, and accounting for the tradeoff of interests involved in any public endeavor. The engineering problem is only a piece of the much broader "engineering of men" considerations.

A polycentric order, composed of competing centers of authority, is a process of agreement that is concerned with solving this engineering of men problem. Such an order is designed to facilitate action where only local interests are involved or where substantial agreement already exists. Political entrepreneurs will find little difficulty establishing an institutional arrangement to govern the production of lights in a neighborhood, assuming the neighborhood wants lights. In contrast, national issues that involve a variety of interests will involve disagreement and will require debate and negotiation. This process will be slow, but necessarily so in order to account for the diverse interests involved and avoid the threat of the tyranny of the majority.

The Abuse of Expertise

Unless we are willing to accept that public decision makers are both omniscient and benevolent, it seems that the Progressive bureaucracy will be unable to attain the ideals of democracy. Instead of governance in the interest of the people, the Progressive bureaucratic regime both fails to account for the knowledge that is necessary for institutional arrangements to solve public problems, as well as failing to account for the threat of tyranny whether from the majority or from the bureaucracy itself. On the one hand, experts do not have the knowledge that is necessary to know which public goods are demanded, or to know which institutional arrangements align with the Métis of the community. On the other hand, the bureaucracy that is necessary to implement expert prescriptions ignores the engineering of men problem and the need for discourse, persuasion, negotiation, and agreement.

Ignoring these problems, the Progressives chose to reform American government toward a monocentric ideal. Of course, they didn't get everything they wanted, but they did dramatically change the way we approach government. The strength of the federal government and the executive branch have never been stronger. As documented in the second chapter, this transition made great strides during the Great Depression and World War II. Since then, we have lived in a nation of continuing deficits, rising debts, rising inflation, and growing government. The Keynesian Revolution was part of this shift in our conception of government. Where the Progressives presumed benevolence on the part of public figures and centralized authority, the Keynesians presumed the same benevolence and effectively removed the balanced budget constraint. Because politicians are neither omniscient or benevolent, the two reforms combined to produce the irresponsible governance that we have seen over the past 50 years.

CONCLUSIONS

I began this essay with a discussion of the current crisis facing our nation. One of the purposes of this essay has been to address those issues from a constitutional economic perspective. I have intended to indirectly argue that our current problems are not the result of greedy politicians or greedy capitalists, as the self-interested nature of human beings is nothing new, but is instead the results of constitutional rules that have systemic tendencies to produce the kinds of irresponsible governance of which we are now facing the consequences.

Underlying this argument is the idea that human beings are capable of self-governance, that we are capable of choosing the institutional systems that will both constrain us and set us free. The Progressive paradigm, at least in rhetoric, rejected this position. For Wilson, the constitutions represented merely "literary theories". Wilson was concerned instead with simply looking at the facts. The facts of government, he believed, would enable him to determine who is the ultimate center of power. Instead of government being the result of constitutional choice and design, Wilson believed that ultimately it was power and interests that determined our fate.

Ostrom presents an interesting discussion in *The Meaning of Democracy* regarding Wilson's position. He argues that we cannot understand the social world simply through brute facts. To argue this point, he takes an thought experiment from John Searle.

Imagine if we tried to understand a football game through only facts. We might first see the people on the field arranged in two tight circles, which then break up and stand in a line face to face. A player with the ball yells hike, the other players run towards each other, creating a lot of gridlock, until the ball is thrown and is caught by a player down the field who is then tackled. Repeat. From this we are missing any kind of understanding of what the players are doing, making it an extremely dull endeavor. They are not just crashing into each other, they are blocking, but calling the action blocking implies an understanding of the intentions and strategies of the players that form based on the rules of the game. If we only look at the brute facts, we have no access to those concepts. Without access to those concepts we would never come anywhere close to understanding what's going on in the game or that a game was even being played.

In a similar way, Wilson is misguided in thinking that we can understand government without reference to rules, meaning, ideas and plans. Thus, we can't understand the separation of powers or whether it is accomplishing its goal without reference the intentions behind separating powers or the intentions behind alternative institutional arrangements. Recall Wilson's and the Progressive's concern over gridlock. It should now be clear why it is necessary to take account of the institutions, intentions, and meaning behind government. Focus on brute facts fails to provide an understanding of what gridlock is. For Wilson, gridlock is just friction, it's football players colliding, preventing forward progress. For Ostrom, in stark contrast, gridlock is blocking, it is a process of securing agreement amongst a variety of interests. Wilson recognizes that the gridlock requires working with a variety of interests, but for him this is just waste:

> It is impossible to deny that this division of authority and concealment of responsibility are calculated to subject the government to a very distressing paralysis in moments of emergency. There are few, if any, important steps that can be taken by any one branch of the government without the consent or cooperation of some other branch. Congress must act through the President and his Cabinet; the President and his Cabinet must wait upon the will of Congress. There is no one supreme, ultimate head—whether magistrate or representative body—which can decide at once and with conclusive authority what shall be done at those times when some decision there must be, and that immediately. Of course this lack is of a sort to be felt at all times, in seasons of tranquil rounds of business as well as at moments of sharp crisis; but in times of sudden exigency it might prove fatal,—fatal either in breaking down the system or in failing to meet the emergency. Policy cannot be either prompt or straightforward when it must serve many masters. It must either equivocate, or hesitate, or fail altogether. It may set out with clear purpose from Congress, but get waylaid or maimed by the Executive (Wilson, 1885).

In light of Ostrom's discussion of the two kinds of engineering problems, we can understand why Ostrom and Wilson come to two different conclusions based on the same "facts". For Ostrom, democracy is based in agreement in order to account for the diverse interests of "the people". Agreement is a means of solving the problems of "engineering men". The separation and fragmentation of powers serve to secure agreement and account for the variety of interests that exist in a society where we are required to accept unequal political authority. Gridlock is the process of discourse, persuasion, negotiation, and compromise that is necessary to solve the problem of engineering men. Wilson, in ignoring this problem, saw no benefits to such a process. Instead, gridlock only served to get in the way of solving the engineering problem.

Here we can see the fundamental inconsistencies between Wilson's and Ostrom's approaches to government. For Ostrom, government in the interest of the people implied limited government. Voting, under this conception, is only a single and highly imperfect mechanism to impute interests into the public sphere and to act as a check on politicians. By separating and fragmenting powers, competing interests could also act as a check, but such a process requires slow, redundant, and complex relationships. The federal government could simply not be relied upon to solve all of the problems of the nation, because public decision makers were presumed to be neither omniscient nor benevolent. Even if the president were omniscient, we could not expect that he would act in the public interest. A majority vote over two candidates, lumping together a variety of issues, over a four year time period, would do a poor job of checking political transgressions . Even if the President were benevolent, we could not expect that he would have the time and place knowledge that is necessary to solve the unique public problems facing individuals and communities. Wilson, by ignoring the problem of engineering men was assuming both omniscience and benevolence on the part of political decision makers.

The Progressive reforms of public administration served to unleash politicians and place upon them responsibilities which they were unable to solve. One such responsibility was the employment of the nation and the general expectation to stabilize the economy. Prior to the reforms, activist Keynesian policies were inconsistent with the constitutional structure of government that resulted in deliberation and agreement. Upon reforming that structure of government to enable an active state, Keynesianism offered the perfect solution to the Progressive bureaucratic problem. It represented the possibility of scientific governance based on mutual belief in the imperfection of the market. The Keynesian policy prescriptions were framed in terms of data that was newly, but readily available to federal administrators and ignored the public problems that the bureaucrats had no way of fixing. The focal point shifted, as Buchanan and Wagner describe, away from the provision of goods and services that existed under the balanced-budget norm, and towards the stabilization of prices and employment. More generally, this new focal point meant conceiving of government as a social problem solver as if social problems were engineering problems. As has been argued, these new focal point were responsible for the continuous deficits, inflation, and growth in government over the past half century.

We are still facing these problems, because we have not yet changed our conception of government. We still too often look to the federal government and to the President to solve problems for which he does not have the capability. The current problems that we are seeing with the war on drugs, the war on poverty, the war on crime, and the war on terrorism, all stem from the same sources as our debt and inflation problems.

In Democracy in Deficit, Buchanan and Wagner conclude that a potential solution to our deficit problems is a constitutional rule that requires budget balance. More recently though, Wagner argues that formal rules might just be "toothless requirements" (2011, p. 3). Based on Elinor Ostrom's analysis of institutional arrangements that solve common pool problems in local communities, it seems that in order for rules to have teeth they must be arranged to incentivize their enforcement. Vincent Ostrom's concern for polycentrism and competing centers of authority might just be such an arrangement. Without the agreement process that forces decision makers to bear the full costs and benefits of their choices, a commons emerges where decision makers can extract benefits while letting the group bear the costs. Simply writing on paper that a budgets must be balanced doesn't change the "political logic" that leads to irresponsible budgeting. Changing that logic means rearranging institutions to in order to limit government.

The implication of constitutional choice is that such a solution could not come from on high but must come from the bottom up. That is, it must come from individuals who are cognizant of the limits of the state. This creates a role for political economists in understanding the implications of rules and teaching that understanding. Stigler, in his criticism of Smith, would have been more accurate if it had addressed it to the Keynesians who were naive in thinking that politicians would following their prescriptions under a constitutional rule that permitted unbalanced budgets. Economists' efforts would be more productively directed at the constitutional level of analysis where ideas matter. This is exactly what Smith and the classical political economists were doing. Thus we can see why Frank Knight, in his 1951 address to the American Economic Association would describe Keynes as having "succeeded in carrying economic thinking well back to the dark age" (1951, p. 2). Moreover, his prescription might be useful for economists today, that "the time has come to take the bull by the tail and look the situation square in the face" (1951, p. 5)

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