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Political Economy for the Next Century

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Foreword

The United States has come to a watershed in public life and economic policy. Changes in the relation among our various levels of government, and between government and the citizenry, are on a very rigid and active political agenda. This agenda, represented most concretely by the Republican "Contract with America," rests on a particular variant of neoclassical economic theory -- a variant grounded in two propositions which cannot be proven: (1) that the very complex and ever-evolving set of interrelated markets that constitute modern economies is *stable*; and (2) that the result of unconstrained market processes is *optimal* (that is, no agent can be made better off without some other agent being made worse off).

One can only marvel at the heroic jumps in logic that are permitted in our current policy discourse. One can only stand in awe at the consummate economic and historical ignorance displayed by both the architects of the current agenda and their chief political adversaries. It is trite but nevertheless apt to cite Santayana -- "Those who cannot remember the past are condemned to repeat it" -- as we commit our 'lives, fortunes and sacred honor' to engage in a discourse where the prize is the development of the policy agenda that will come to the fore after today's agenda leads to an even greater economic and social malfunctioning than that which has troubled us during the past few decades.

Unfortunately, economists are generally ill-equipped to provide much practical guidance. One peculiarity of the preparation of economists at the end of the Twentieth Century is that the modern graduate curriculum does not require students to study either the history of economics or economic history. In fact the curriculum is extraordinarily anti-intellectual: graduate programs in economics aim to train rather than educate.

Most articles in the academic economics literature are bereft of citations that go back more than a few years. As a result, economists often engage -- unknowingly -- in the repackaging of old wine in new bottles. What is particularly appalling is that even journal editors and referees are seldom aware that today's "contributions" often merely "reinvent the wheel."

Contemporary neoclassical economics purports to derive propositions about real-world activity which are independent of the actual institutional structure. Thus it is not surprising that today's dominant policy agenda ignores both the history and character of our economic institutions. Underlying this agenda is the same combination of arrogance and ignorance that led American academics to prescribe the now clearly failed "shock therapy" for economies in Eastern Europe and the former Soviet Union.

Given the language and temper of the current political and economic discourse, it may seem that neoclassical theory is both a universally accepted way to analyze the American economy and the sole economic-policy guide appropriate for the rapidly approaching third millennium. Although neoclassicalism, in all its variant forms, does indeed dominate American economics today, it is *not* the only economic theory on hand. The essays that Charles Whalen has collected in this volume provide an outline of one very promising alternative.

A capsule history of the economy and economic policy during the Twentieth Century may help us understand why this collection of essays is important. America's economic experience over the past century breaks down into three parts. The first, from 1896 to 1932, was an unstable period in which economic policy leaned strongly towards *laissez faire*. It ended with the great contraction of the economy between 1929 and 1933 -- a contraction that culminated in the collapse of the economic and financial system in the winter of 1933. At the end of the first third of the Twentieth Century, capitalism was -- especially in the United States -- a *failed* economic order.

The second third of the Twentieth Century began with the inauguration of Franklin Delano Roosevelt on March 4, 1933 -- when the clarion call that "all we have to fear is fear itself" was sounded. It lasted until January 1969 when Lyndon Johnson, defeated by the war in Vietnam, left Washington. The period was characterized by successful government efforts to control cyclical instability, support resource creation, and correct flaws in labor, product and financial markets.

Over the 36 years between 1933 and 1969, America experienced not only a great growth in economic output but also a society in which income became more evenly distributed than had ever before been achieved. The phrase associated with John F. Kennedy, "A rising tide lifts all boats," seemed validated by events. Perhaps the first 20 or so years after World War II was not a "Golden Age," but it certainly stands as a historical and practical best. At the end of the second third of the Twentieth Century, American capitalism --though not perfect -- was a *successful* economic system.

The final third of the Twentieth Century began with the 1969 inauguration of Richard Nixon -- and is still ongoing. In terms of performance, it is somewhat like the first third of the Twentieth Century prior to 1929. In this era we observe both that the amplitude of the business cycle is increasing and that incomes are becoming more unequally distributed even as the economy grows. Furthermore, financial "crises," which were well nigh absent during the second third of the century, have returned with a vengeance. In response to the wholesale failure of banks and other financial institutions between 1929 and 1933, federal insurance of bank and thrift deposits was instituted in the New Deal era. This structure was not tested until the past decade -- when a huge infusion of public funds was needed to prevent a cascade of bank failures.

America's economic performance began to exhibit signs of difficulty in the late-1960s because the postwar prosperity lulled economists and political leaders into thinking that our system could be treated as unchanging. But capitalism evolves -- and so too must economic theory and policy. The task before today's economists and public officials is to meet the challenges of the present without forgetting the valuable lessons of the past. Since the neoclassical economists and the developers of our current political agenda have chosen to ignore the realities of the present and to turn their backs on the past, neither group is capable of leading America into a new period of sustained prosperity.

As the economy was running towards the 1929-33 debacle, Rexford Guy Tugwell took the initiative and brought together a batch of essays by institutionally-oriented economists in a volume published as *The Trend of Economics*. The essays in that volume broke the ground and helped set the agenda for the era of reform and reconstruction that began in 1933. If capitalism is to be successful in the Twenty-First Century, economists must now apply the orientation of Tugwell's *Trend* to a new era. The thought-provoking essays in the present volume are directed toward precisely this end. After the failure of today's political agenda becomes apparent, our *next* reconstruction will need to draw heavily upon insights contained in the pages that follow.

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