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Chapter I Outline
20th Century Fund Book

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CHAPTER I

INTRODUCTION

Is the fulfillment of these ideas a visionary hope? Have they insufficient roots in the motives which govern the evolution of political society? Are the interests which they will thwart stronger and more obvious than those they will serve?

John Maynard Keynes, G.T., p. 383.

A. Introduction

The above is the first paragraph of the last section of the last chapter of Keynes' General Theory, the monumentally influential, though imperfectly understood, work that was published some forty years ago in 1936. The revolution in economics that followed turned out, after the academics did their synthesizing, to be more of a revolution in the attitude towards economic policy than in the substance of economic theory. In terms of where we now are and the path we have travelled since 1936, the major contribution of Keynes has been to transform economics, and the believed to be public's and politician's perception of economics, into a policy science, what happens is subjected to control, rather than an abstract statement of natural forces that determine the destiny of nations and of men.

In the past decade there has been a policy counter-revolution identified with the Chicago School of Economists and given political voice by Treasury Secretary Simons and Chairman of the Council of Economic Advisors Greenspan. The contention of these counter-revolutionaries is that economics is not a policy science. They hold that natural market forces, whatever that may mean, determines what happens, and that the best or worse that economic policy can do is to introduce some transitory noise into the development of the economy.

It is an underlying contention of what follows that there was a real revolution in economic thought embodied in Keynes' last work but that this revolution was aborted. The truly revolutionary insights into the workings of a capitalist economy that were contained in the General Theory were overlooked, ignored, or misconstrued in the construction of today's standard theory. Even though, because of its emphasis upon fiscal handles for policy, a leading branch of today's standard theory is called Keynesian, in truth, aside from some language and the habit of thinking in income theory aggregates today's standard theory owes little to Keynes. Today's theory is much more consistent with the doctrines that ruled prior to Keynes' great work than it is with the revolutionary teachings embodied in the General Theory.

The basic theorem of the General Theory of Keynes is that a capitalist economy, with the sophisticated financial institutions that can be conveniently labeled as "Wall Street" or "The City", is essentially flawed in that its normal path over time is cyclical: i.e., a thrust towards business cycles is inherent in the market processes of a financially sophisticated capitalist economy. Business cycles are often mild and, although mild cycles hurt, especially to particular victims, they are essentially benign in that they are soon over and in the aggregate, the losses are mild. The movements, whether towards depression and unemployment or towards boom and inflation in these mild cycles, are soon corrected and offset. However, from time to time, the boom gets out of hand -- speculation becomes rampant -- and the boom leads to financial fragility, a financial crisis, and a debt-deflation. Historically these developments have led to a deep and serious depression followed by a period of chronic high unemployment, as in the 1930's. Thus although the flaw in capitalism is at times not serious, the occurrence of a deep-depression

is serious. The losses of output, human suffering, and misallocation and misuse of resources that strong booms and deep-depressions bring are unacceptable to a society that is humane. The problem as Keynes saw it is to determine whether a better organization of economic affairs is possible in practice. Such a better economic organization will combine the economic efficiency, that decentralized markets in principle imply but which decentralized markets do not lead to in fact when booms and depressions occur, with conditions conducive to social justice and individual liberty.

Even though the full power of Keynes' analysis of the functioning of a capitalist economy were not absorbed into the economic theory and policy analysis that now rules, enough of the message that our economic destiny is controllable came through, so that in the era after World War II, which closely followed the publication of the General Theory, conscious management of the economy became an avowed aim of government. The Employment Act of 1946, which set up the Council of Economic Advisors, the Joint Congressional Economic Committee, and required an annual Economic Report was a commitment to try and manage the economy so that depressions and inflations do not occur. For some twenty years after the end of World War II -- from 1946 to the middle of the 1960's -- the deviations from a reasonable approximation to full employment and price stability were minor. In the decade that has followed, from the mid-1960's to the mid-1970's, the smooth path of the 1945-65 era was replaced with strong inflations and strong threats of financial collapse and deep-depressions. By 1976, thirty years after the Employment Act and forty years after the publication of Keynes General Theory it seems as if the economy and economics are back to square 1936. Not only does the economy suffer from chronically high unemployment and unacceptable high rates of

inflation but the current standard economic theory neither offers an adequate explanation of why what happens happens nor a useful guide to policy.

B. The Current Disarray

Thus, as we enter the last quarter of the twentieth century our economic world and our economics are in disarray. After what seemed like a secure period of progress -- from the end of World War II until the mid-1960's -- instability, as evidenced by bursts of accelerating inflation, higher chronic as well as ever higher cyclical unemployment peaks, and rashes of corporate bankruptcy and bail outs, together with "crises" or "messes", in energy, transportation, foodstuffs, medical care, welfare, and our cities, have become the order of the day. Quite suddenly the world is not working well. The economic policy and social synthesis, that seemed to work well during the first twenty years after World War II, has broken down. What we now need is to understand how 1966-75 is as different from 1950-65 and why a new policy synthesis, which differs in fundamental respects from that which we have, is needed.

Even though the recognition that a problem exists is the first step towards a solution, mere assertion that something is rotten in the Denmark in which we live is not sufficient to guide us to a new policy synthesis. Recognition that a problem exists must be accompanied by an identification of what is wrong, an understanding of the social and economic processes that govern the behavior of our society, and the development of an agenda for reform that responds to the problem and which does not do violence to fundamental economic and democratic processes. In the absence of an understanding of economic processes and a passionate, nay irrational, commitment to political democracy, the agenda for change, in response to the felt need

for change, can become the property of demagogues who play upon fears and frustration and offer ends without specifying means. An awareness of process is needed, so that a statement of goals for policy must always be accompanied by a specification of how the goals are to be accomplished if the avowal of goals is to be taken seriously. Scientific scepticism needs to be wedded to a vision of a better world; aspirations must be constrained by an understanding of how mechanisms determine what can be achieved. There are limits to the attainable that are set by how things work. Because of the limits imposed by process we cannot promise "Utopia", but we can in truth offer something much better than what exists and what has been. Too often the best has been the enemy of the good. A serious program of reform can only offer better, not perfection.

The center of our current crises lies in the malfunctioning of the economy. It is evident that non-economic concerns of private safety, public honesty, social decorum, and institutional integrity -- which are much deeper and in truth more important than the purely economic concerns -- cannot be effectively attacked unless our economic house is in order. There is an economic determinism which limits what social policy can achieve. Even the most enlightened social policy will come to naught if the economy is not doing well. If mass unemployment and chronic inflation are the dominant facts public crusades against crime, poverty and bigotry are doomed to failure. On the other hand if the economy is doing well so that income through work is available to all and the future is not incoherent because inflation is expected to rule the day, then social policy has a chance to work. Only if elemental economic security and a feeling of personal worth that comes with a job exists for all are the social problems -- crime, family dislocations, deteriorating neighborhoods, and a collapsing school system -- reduced to manageable proportions.

In this volume we restrict our concerns to the domestic United States economy. This is done because a thorough analysis of United States economic policy is in itself a large job but also because of a feeling that even in 1976 the United States Economy looms so large in the world that if the United States Economic House is in reasonable order then the international economic concerns will be reduced to manageable proportions.

C. The Three Crises in Economics

Thus the central problem of our time is the economic crisis. In fact, what we are now in can be considered as three concurrent crises in economics. These crises are in the behavior of the economy, in economic theory, and in economic policy. As a result of these crises economics is now too important to be left to the economists.

The current crises in economics are as deep and as significant as the crises in fact, in theory, and in policy of the 1930's. Our hopes for a better world in the near term depend upon a public understanding of these crises. Our future rests upon achieving a wide understanding of issues and agreement upon a policy response that respects the way things work. Our response if it is to be successful, will need to be based upon a deeper understanding of the world in which we live than now exists. The inherited "cliche's", slogans, and policy posturing which no longer serve us well need to be abandoned. Wide and deep understanding of what is wrong is needed before directions in economic policy can be taken.

Intellectually the most interesting of the three crises is in economic theory; a crises that exists independently of the problems posed by the behavior of the economy and the breakdown of the post World War II policy synthesis. The crisis has its origin in abstract, logical telling points

scored on orthodox theory by economic theorists led by Piero Sraffa, Joan Robinson, and Robert Clower among others in the 1950's and 1960's. Basically the lesson to be learned from these telling points is that the economic theory that is taught in the graduate schools, which is embodied in college textbooks, which is part of the intellectual fix of all who studied or practiced economics in the past thirty years, and which is the intellectual basis of policy in capitalist democracies is logically flawed. The logical flaw in our current standard economic theory means that the conclusions derived in the analysis of theoretical economic models which abstract from uncertainty, time, and money cannot be carried over to the operations of our type of economy. In particular orthodox economic theory, especially the highly mathematical economic theory developed in the post-war era, makes a nice case that an abstractly defined market mechanism will lead to a coherent, if not an optimum, result if the market mechanism does not have to deal with time, money, uncertainty, capital-asset ownership, and investment; i.e., if all the concerns of the corporate board rooms and the "Wall Streets" of the world can be ignored. As a result of the debate in theory it is now clear that if time, money, uncertainty, capital-asset ownership, and investment are important in an economy -- if the financial organizations of the "Wall Streets" and the "Main Streets" are significant determinants of what happens -- then economic theory does not yield an underpinning for a view that the result of a decentralized market mechanism is coherent. The proposition that the market mechanism if left alone will lead to full employment at stable prices is at best an article of faith -- it has no "scientific" validity for any existing capitalist or free market economy. In fact the "Wall Streets" of the world generate essentially destabilizing forces, so that from time to time the

processes that center in "Wall Street" engender serious threats of financial instability; i.e. of incoherent economic behavior: Our economy is essentially unstable.

Another facet of the crisis in economic theory revolves around the question of whether the Keynesian economics that is exhibited in the text books and taught in the Universities is really the economic theory of Keynes' General Theory. Much of the richness of analysis and the entirety of the concern with decision making under uncertainty so evident in the General Theory is absent from the standard school version of Keynes. Thus in economic theory a discussion as to the nature of the real Keynes has arisen. It seems clear that a perspective that views the market mechanism as being flawed, once capital-assets and financial relations are taken into account, is closer to Keynes' theory than the theory that is today's standard economics. Thus a number of economists have put forth their versions of the true Keynes, and these versions all lead to an economic theory that in significant details differs markedly from the standard theory.

Of course the current interpretation of Keynes is an issue in the history of ideas and not in positive science. It matters little for policy whether the standard interpretation of Keynes or the interpretation that is emerging as an alternative correctly interprets Keynes. What is important is which if any theory gives us a better understanding of what happens and by helping us understand events seems a better guide to policy. One contention underlying this work is that an alternative interpretation of Keynes, which emphasizes the essential cyclical characteristic of the capitalist process, is a better basis for understanding our economy, and thus is a better guide to policy, than today's standard theory.

The economy, beginning in the mid-1960's, began to behave in a manner that cast serious doubts upon the validity of standard theory; doubts that are independent of the logical flaws uncovered by Cambridge, England or the aptness of the standard interpretation of Keynes. After twenty years of relative tranquility following World War II, when politicians, pundits, and the public began to take for granted that the capitalist world would never again go through the agonies of a great depression, a near financial crisis, the so called credit crunch of 1966, took place. This event was initially treated as a transitory aberation. However it was not a transitory event for it was the first of a set of financial disturbances that have plagued the economy in the past decade. As a result of these financial disturbances capitalism in the 1970's is more like the capitalism of the era prior to the 1930's than like the capitalism of the 1950's.

The past decade, covering the years 1966-75, saw three near financial crises. Each financial crises was worse than the one before. Furthermore the "inter-crisis" periods 1966-69 and 1970-74 were years of high and accelerating rates of inflation. Starting in the middle 1960's the economy began to behave in an apparently incoherent way, shifting rapidly back and forth from a threat of run-away inflation to a threat of a plunge towards truly mass unemployment.

Perhaps President Ford's economic summit in the Fall of 1974 best illustrates the futility of recent policy and the erratic behavior of the economy in the past decade. No sooner had President Ford arranged for WIN buttons to be produced and gotten a campaign to beat inflation, based upon the serious commitment and deep understanding involved in wearing buttons, off the ground than the economy was plunging towards mass unemployment at deep-depression

levels. No sooner had Congress passed a tax rebate in the Spring of 1975, after a two quarter plunge in income and employment, than the fall in National Income and the rise in unemployment rates ceased. The four quarters beginning with the fourth quarter of 1974 make up a statistical year of extreme instability.

Suddenly in the 1970's the economy is not behaving the way it was supposed to: i.e., standard theory cannot explain what is happening. The cry went up from a spate of officials and pundits that this behavior meant that our macroeconomic theory had to be abandoned and that we should return to the presumed tried and true verities of microeconomic theory. In truth the economy was behaving as a capitalist economy with fragile finance and a big government is supposed to behave. The error was in the economic theory of the officials and the pundits not in the behavior of the economy.

When, in the days of the Copernican revolution and the voyages of geographic discovery, evidence accumulated that the old theory, which made the earth the center of the universe and led to the belief that the earth was flat, was not valid, no one suggested that the planetary system be changed so that the sun did revolve around the earth and that the earth be flattened to conform to theory. Economic systems are not natural systems like the planets and the earth. An economy is a social organization created by man either in the conscious process of legislation or in the evolutionary process of invention and innovation. What exists today in the way of economic institutions, be they trade unions, corporations, and particular government bodies, neither always existed nor are they necessary. An economy can exist without General Motors, the Teamsters Union, and the Federal Reserve.

Both the details and the overall character of our economy can be changed. Nevertheless, even though we can, in the Republic of our minds, imagine institutions and usages that are far different from that which exist, in an attempt to do better we have to start with what is. Therefore if we aim to do better we need to know how what is functions. We have to understand how our economy works so as to be able to make some judgements as to whether proposed changes will in fact make things better, however better may be defined. We cannot mandate results but can only mandate processes. Policy objectives can be achieved only as the results that are aimed at are consistent with the processes of our economy, as conditioned by the in fact institutional arrangements recognized that the in fact institutional arrangements are negotiable.

Enough has gone and is going wrong in our economy so that the need for economic change and reform is recognized. Any program of economic reform that is going to succeed in making things better has to be rooted in an understanding of economic processes within the ruling capitalist set of institutions. The understanding of economic processes is the realm of economic theory. But even as institutions and usages are not ordained by nature, so economic theory is not handed down from on high. Economic theory results from acts of creative imagination -- the concepts and constructs by which our theory orders the universe are the result of human thought. There is no such thing as gross national product, aside from a theory which tells us how to combine elements in the economy into this special index number; demand curves do not confront sellers, customers do; the way in which money and finance affect system behavior can only be perceived within a theory which allows money and finance to affect what happens.

Thus we have a three pronged crisis. One is a crisis in the economy, which for the past decade has seemingly oscillated between accelerated inflation and threats of widespread financial crisis. There are many possible points at which one can maintain that a capitalist economy of the kind that we have is flawed: income distribution and poverty, dominance by giant monopolies, urban crises, adulteration of products, and the inability to meet social needs are all candidates for systemic flaws. None of these flaws are inconsistent with the continued operation of an economy. Distasteful as inequality and inefficiency may be there is no scientific law which says that an economic order must meet some external standard of equity and efficiency to survive. However a capitalist economy cannot long exist with rapid oscillations between extremes of threatened imminent collapse of asset values and a resulting deep-depression and threats of an explosion of asset values and a resulting runaway inflation. This is so because decisions which must be made today about the fairly distant future lose their coherence in a regime characterized by such cyclical and price level uncertainty. Social arrangements must exist to constrain uncertainty and to make behavior predictable so that the realized future conforms to a reasonable man's extrapolation of the past. The market mechanism can function well only if a constrained domain of reasonably likely outcomes over a meaningful horizon exists. Over the past decade the range of outcomes in the near, let alone the more distant future, that have to be contemplated in decision making has increased. Under these circumstances the normal functioning of the economy breaks down; all those decisions that are made today with the more or less distant future in mind have tended to become erratic or highly dependent upon political guarantees.

An economic order that is inequitable and inefficient may survive. An economic order which is so unstable that decisions become irrational cannot.

Over the past decade the economy has exhibited a tendency towards ever greater instability. Unless we understand why this instability exists we cannot even attempt to handle the problems of our time. Policy in the absence of a theoretical explanation of instability becomes a striking out at unknown magical forces: WIN buttons and other incantations might be effective.

A second crisis is in economic theory. A theory which has to assert that which is happening cannot happen is not a good basis for action. A theory which makes the dominant, most easily evident observations about the economy the work of devils or villains rather than the systemic result of the economic mechanism may satisfy the wishes for a scape goat to be held responsible for what ails us, but such a theory offers no useful guide to a solution of the problem. The neoclassical synthesis -- the economists label for the existing standard body of economic theory -- may be a beautiful logical structure (incidentally it is not, for as the Two Cambridge Debate has shown, the premises of the neoclassical theory, in spite of an impressive mathematical structure, contains logical flaws) but it is not able to generate a meaningful explanation of what is happening. Only an economic theory which makes the possibility of a financial crisis something that emerges out of the normal functioning of the economy and which can explain why one period is susceptible to a financial crisis while another is not will do.

A third crisis is in economic policy. Only yesterday -- in the glory Kennedy-Johnson days when so called Keynesian economists were policy advisors -- claims were being put forth that the business cycle of history has been conquered. The age of physical and biological science had given us atomic energy, moon shots, and a virtual elimination of polio. The age of economic science was to give us virtual unlimited and continuous economic growth. In fact a

common assertion of those days was that not only was the business cycle eliminated but it was now possible to fine-tune the economy. After the Kennedy-Johnson "Keynesian" economists were replaced by a cadre of more conservative economists in the Nixon-Ford years, the claim that the economy can be fine-tuned was maintained. The major difference between the two sets of economic policies and economic advisors was in the techniques to be used and perhaps, although this is not mentioned, for whose benefit the fine-tuning would take place. The dreams of yesterday are in striking contrast to the disarray of today. The recessions of 1969-70 and 1973-75 were interrupted by an inflation at record rates. Two threatened financial crises within a five year span is not evidence that a capability to fine-tune exists. Nevertheless the evidence of the past decades indicates that the authorities do have the power to abort a threatened debt-deflation: policy while it has not eliminated the thrust towards business cycles has succeeded in changing its shape.

D. For Whom and What Kind

Even though an economy that is not equitable and that is not efficient can survive, once economic policy is accepted as a determinant of what happens then the questions "For whom will policy be used?" and "What kind of output will be fostered?" cannot be evaded. Once it is admitted that institutions are both man-made and at least in part the result of conscious decision, the question has to be faced as to what are the implications of institutional arrangements for economic performance and for social outcomes. We cannot evade the "for whom" and "what kind" questions. Furthermore because the infact market institutions are in good part the result of economic evolution and policy decisions, we cannot evade these questions by appealing to some abstract market mechanism as the determinant of what happens. But this means

that policy has to be a reflection of an ideological vision: a vision of the contours of a good society has to inspire policy. And it is evident that in addition to the three crises in economics we now have a failure of vision: a crisis in the aims and objectives that economic policy is to serve.

Perhaps we can do little better than to go back some fifty years when Keynes defined the political problems as a need

to combine three things: economic efficiency, social justice, and individual liberty. The first needs criticism, precaution, and technical knowledge; the second an unselfish and enthusiastic spirit that loves the ordinary man; the third, tolerance, breadth, appreciation of the excellencies of variety and independence, which prefers, above everything to give unhindered opportunity to the exceptional and to the aspiring.*

and bring this triad of efficiency, justice, and liberty up to date.

Whenever a number of goals for a society are stated, it is naive to assume that they are always mutually consistent. It is most likely that an organization of society that emphasizes one goal will have to compromise some other goal. Thus a priority or a weighting scheme among the goals needs to be established. My personal preferences are to maximize individual liberty in the personal freedom -- democratic rights dimensions. I do not view individual liberty as extending to property rights as having as strong a claim to our emotions and loyalties as individual liberty extending to political and individual rights. Thus on political and social freedom I tend to be uncompromising, but I see no demonstrated relation between political and social freedom and so-called property rights especially as property rights are extended to that peculiar creation of the state: the modern corporation.

*J.M. Keynes, *Essays in Persuasion*, Vol. 9 of The Collected Writings of John Maynard Keynes, p. 311.

In the light of the vast increase in the ability to produce that has taken place over the fifty years since Keynes wrote -- the U.S. Gross National Product was over \$6,600 per capita in the recession year of 1974 -- the goal of economic efficiency can perhaps be compromised: Being rich, we can afford to give up some output to achieve social justice and individual liberty. Historical evidence indicates that individual liberty is well served by an economic order that maintains and encourages decentralized market processes. Social justice and individual liberty are both compromised by the existence of high centers of private power and vast differences in wealth. It follows that a policy thrust that is willing to forego some of the presumed advantages of giant firms and high financial organizations (these advantages may or may not in fact exist) seems highly desirable for such a policy thrust will increase the efficacy of decentralized markets and decrease the concentrations of private wealth and power. In the light of the experience of 1973-76, when the difficulties of giant corporations and high financial empires were central to the instability that plagued the economy, if economic efficiency includes as one of its dimensions the avoidance of instability, then efficiency might very well call for either a transformation of the very largest concentrations of private economic and financial power into bodies that are more overtly public or the devolution of the private centers of massive power and wealth into units of a more manageable size.

Social justice is perhaps best served by measures that assure dignity and independence to individuals. Dignity and independence are best served by minimizing dependency, whether the dependency be upon centers of private power or upon political power centers. Thus I have a strong bias in favor of universal rights and the maintenance of minimum standards: adequacy is a vague concept

relative to a social minimum. Dignity is served by an economic order in which income is received either by right or by fair exchange. Thus to foreshadow specific economic policy proposals, income from work should be the major source of income even to the poorest. The existing dependence upon permanent and expanding regimes to transfer payments is demeaning to the recipients and destructive of society. Social justice and individual liberty are best served by an organization of opportunity in which a social minimum is achieved by all except the clearly handicapped by means of the fair exchange that income from work implies: the actual achievement of full employment with an expanded labor force should be a major objective of economic policy.

E. The Nature of Policy

Economic policy therefore requires a statement of goals and an awareness of economic processes. But the processes of any economy are dependent upon the institutional organizations. Thus economic policy has two dimensions: (1) the design of institutions and (2) operations within a set of institutions in an effort to achieve the best possible or targeted results. Institutions are both legislated and the result of evolutionary processes. Institutions once legislated take on a life of their own and evolve in response to market processes. We cannot, in a dynamic world, expect to once and for all resolve our problems of institutional organization. On the other hand, we cannot always be engaged in the practice of radically changing institutional arrangements by legislation. Once institutional arrangements are set, usually in response to a crisis and hopefully embodying the day's best perception of processes and goals, they should be allowed a run of time in which institutional details are allowed to evolve; over this time span policy should be restricted

to operations within the institutional structure. Only as an economic and social order shows signs of not delivering an adequate performance does it become necessary to engage in programs of thorough-going institutional reform.

In the difficult times in which we live, we need to recognize that the major contours of the present institutional set up of our economy are relatively young. Our economy was set in the Roosevelt Reform era: in particular the major outlines of what is were set in the second New Deal of about 1935. This second New Deal was a reaction to the failures of the emergency legislation of 1933 to lead to full recovery, together with a spate of Supreme Court decisions that ruled out of order various institutions and arrangements of the first New Deal. Whereas our institutional set up is mainly the remnants of the early years of the Roosevelt era, our perception of how the economy functions is radically changed by our interpretation of the Keynesian Revolution. Even though Keynes' great work The General Theory of Employment, Interest and Money cast a shadow before it appeared in print, it is true that it did not appear until 1936. It could not have really affected the institutional reforms that were already in the legislative mill when it appeared.

Much discussion exists in the literature as to what Keynes really was about: there are various schools of Keynesians -- conservative, liberal and radical -- those who believe that what Keynes offered were merely some refinements of pre-existing economic theory and those who believed that what Keynes offered marked a sharp break with the standard economic theory. But regardless of the view as to what Keynes was about, it must be agreed that, to the extent that the existing institutional arrangements were in the main set in legislation in years prior to 1936 or even 1938, the legislation determining our institutional set up could not have been enlightened by perceptions

drawn from the Keynesian Revolution. To the extent that the Keynesian Revolution in economic thought has implications for the institutional structure of our economy there cannot have been a Keynesian Revolution in the legislated design of economic institutions. All that we can possibly have had over the past twenty years were Keynesian policy operations within a legislated economic structure that is mainly pre-Keynesian in its intellectual foundations: we have had a pre-Keynesian structure evolving under the conservative Keynesian policy influences of the post-war era.

There are two "dimensions" to a strategy for economic policy: One "Dimension" has to deal with the institutional structure, the other has to do with operations within the institutional structure. The fundamental legislation with regard to banking institutions, Central and Commercial banks as well as non-bank financial institutions, labor organizations, and corporate rights and privileges are elements in the policy mix that deals with the institutional structure. Fiscal and monetary policy are the major elements of economic policy operations that take place within an institutional structure.

When an institutional structure is apt then the within the institutional structure operations will suffice to achieve an adequate working of the economy. When, because of evolution and incremental changes in the underlying structure, a situation in which the operations within the structure no longer lead to an adequate workings of the economy arises -- perhaps because standards as to what is adequate have changed or perhaps because of the effects of subtle institutional evolution -- then institutional reform is called for.

The emergence of chronic instability -- due to the fragility of the financed system -- over the past decade is the result of cumulative changes in financial relations and in institutional usages and forms over the years

since World War II. As a result of the unintended and perhaps unnoticed changes in institutions, and because of the effects of successful functioning of the economy in inducing speculation and hence instability, it is quite apparent that now -- late 1976 -- the rules for monetary and fiscal policy that were established mainly on the basis of the experience and the data of the 1950's no longer apply. The evolutionary properties of the economy have led to changes in the underlying structure so that the established rules are no longer valid. It now seems clear that there does not exist any set of monetary and fiscal manipulations which can reestablish the relative tranquility that ruled in the 1950's and early 1960's. If we are to once again achieve an era of relative tranquility and smooth progress it is necessary to engage in some quite fundamental institutional changes -- we need another era of thorough-going reform similar to that which took place during the first six years of Roosevelt's terms: Reforms which embody the evidence from the past years of instability and are enlightened by a theoretical vision which fully appreciates the roots of the instability that is now so evident.

F. New Era of Reform

One basic premise that should underlie a new era of reform is that a decentralized market mechanism -- the free market of the conservatives -- is an efficient way to handle the myriad of details of economic life and that the financial markets of capitalism, especially in the context of production processes that utilize capital-intensive techniques, are inherently disruptive, in that they lead to instability and thus inefficiency. Thus while admiring the properties of free markets, economic reform must be based upon a recognition that the domain in which free markets are effective and desirable is restricted. To do better than we have been doing over the past decades we have to invent

economic institutions which minimize the speculation in those aspects of production which require massive capital investments. It is a paradox that capitalism is flawed because it cannot readily assimilate production techniques that use large scale capital-assets.

In fact we have introduced many devices into our economy to constrain and contain the inefficiency and instability that is associated with the use of large scale capital-assets in production in a capitalist economy. The Central Banks of the world -- our Federal Reserve System -- owe their existence to the instability of asset values under capitalism. Those who expect the Federal Reserve to act as a determiner of income tend to forget that the Federal Reserve was brought into being to act as a lender of last resort. The organization of industries into the quasi-cartels of oligopoly is a way of regulating markets so that risks of large scale movements in capital-asset values are constrained, although in a financial environment that allows for speculative finance stability through cartelization turns out to be elusive. Our trade-union, minimum wage, and unemployment compensation institutions have the effect of preventing a large fall in money wages from taking place whenever substantial unemployment exists -- thus tending indirectly to maintain capital-assets values as long as policy constrains unemployment rates. Much of the intervention in various industries by government -- those aspects of our arrangements that may be characterized as "socialism for the rich" are best understood as devices to constrain and attenuate uncertainty -- particularly as uncertainty affects capital-asset values.

If we are to undertake new directions in economic policy we need to demythologize economic theory: We need broadly based understanding of an economics that is relevant to our time and our place. Thus one dimension of our effort will be an exposition of the current standard theory, to be

followed by an exposition of a version of economic theory that is consistent with the exhibited instability of our economy. This will be followed by an analysis of our current economic structure and its roots in the Roosevelt resolution to the problems of the Great Depression as then diagnosed.

One aspect of our recent past is that the economy seemingly worked well in the first two decades after World War II and has been working badly only over the third decade. An explanation of how a robust economy is transformed into a fragile system follows.

All of the above is prelude to the main thrust of this work: The preparation of an agenda for reform that will attack not only the apparent malfunctioning of the economy but which also holds out hopes for a solution of the overriding social concerns. As an agenda the proposals for reform will be painted with a broad brush: The details of programs need to be hammered out in The Congress, The Administration and hopefully in Public debate. "Whether goes the economy" should be a main concern of public debate -- and only an enlightened public can guide and direct reform. It is to these concerns that we now turn.