The End of Laissez Faire: 1985 Style

by

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The title and the subject hark back to two pamphlets: The End of Laissez-Faire by John Maynard Keynes which was published in 1926 and A Positive Program for Laissez-Faire by Henry C. Simons that appeared in 1934. These two pamphlets of more than a half century ago, reflect the troubles of their times [for Keynes the failure of Britain to attain prosperity in the 1920's and for Simons the great collapse of the American and world economy between 1929 and 1933]. Nevertheless they address issues that are vital today, for laissez-faire is a kissing cousin to "getting government off our backs", which was the slogan even as it was not the reality of the now so clearly failed Reagan administration.
If laissez-faire would not do some fifty and sixty years ago, we must wonder why it became the "specialty of the day" in the 1980's. How did it become a successful political position and what are likely to be the consequences of the attempt at implementation?

A word about Keynes and Simons. Even in 1926 Keynes was a great, world renown success. As a result of his later work he gave rise to the adjective Keynesian, which is applied to economic policy and analysis. Ever since The General Theory of Employment, Interest and Money appeared in 1936, there has been a continuing discussion of what Keynes really meant: When Nixon was President he declared himself a Keynesian; today in some circles, unfortunately including many poorly educated products of our graduate schools, "Keynesian" is a pejorative word.

The End of Laissez Faire was written before Keynes discovered Keynesianism; at that time his monetary theory was still the "old" quantity theory. He was active in politics - advising Lloyd George in political campaigns - in the City - London's financial community - and in Britain's intellectual circles - he was a "member" of the Bloomsbury set. The pamphlet is an early exploration by Keynes of why economic theory does not lead to laissez-faire as a "scientific" philosophy of economic policy.
In contrast to Keynes, Simons has little or no popular reputation and I feel certain that most new Ph.D.'s in Economics know not of him. He was an academic of rather modest stature at the University of Chicago; an academic without a Ph.D. whose greatest claim to public and academic fame was that he was on the faculty at the University of Chicago. He was highly regarded by his colleagues and students as an articulate critic and analyst of public policy and the author of academic scribblings that dealt with public policy.

In his Positive Program for Laissez-Faire Simons argues that it is necessary for government to set an environment in which the operations of free markets leads to a socially desirable outcome. This pamphlet was written when the reaction to the great collapse made everything 'negotiable'. Simons' work has little immediate impact. It is now important for it is one of the sources of what is now known as the 'Chicago' school. Milton Friedman, George Stigler, Arnold Harberger and even the rational expectations school owe much to him. Furthermore as will be argued the underlying thrust of Simons' view is an industrial organization complement to the aggregate economics of Keynes.

There was a Keynesian Revolution in economic analysis and policy that reached fruition in the first two decades after World War II. We have witnessed a "classical"
government interventions that promote inequality and inefficiency.

This is made clear when Smith argues that laissez-faire frees the Sovereign of an onerous task for which it is ill suited: with laissez-faire

"Every man... is left perfectly free to pursue his own interests in his own way, and to bring both his industry and capital into competition with those of any other man or order of men. The Sovereign is completely discharged from a duty, in the attempting to perform which he must always be exposed to unnumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient: the duty of supervising the industry of private people" (Wealth of Nations Book IV Ch.9.)

Smith is always arguing against interfering in the details of the economy, against setting rates, prices and permissible qualities; in particular against directing or allocating "industry (i.e. labor) and capital". But there are other dimensions to the performance of an economy aside from those that involve the details of what is produced and how it is produced. Does laissez-faire apply to these "other dimensions"?

Smith's twin doctrines of the frequent power of the invisible hand and the limited competence of the sovereign are the product of a philosophical tradition that stretches back to Hobbes, Locke and Hume. In the 17th and early 18th century the doctrines of individualism, social contract and empirical scepticism undermined the authority of Kings and of established religion. We need only recall
that our Revolution and our Constitution own much to Locke to appreciate the force of individualism as a political doctrine.

By means of the invisible hand doctrine Smith and his followers—Ricardo and Bentham—socialized individualism and laissez-faire. Whereas earlier users of the phrase had argued in terms of the well-being of those whose enterprise was constrained by regimes of intervention, Smith transformed the doctrine of laissez-faire into a social view; laissez-faire was not necessarily good for the individual enterpriser or laborer—it was a social good. The gains from laissez-faire more than offset the losses to the initially privileged and protected, the original versions assumed that the gains to some and the losses by others could be measured and compared.

However, the "socialization" of laissez-faire had implications that undermined laissez-faire. If the aim of government, of society, is to achieve the greatest good for the greatest number [Bentham] than how can one be sure that the existing distribution of payoffs from work and property achieves such "greatest good"? "If one's additional utility from income declines as one's income rises, then would not a "Robin Hood", who shifted income from the wastral rich to the deserving poor, lead to a bettering of the social
outcome?" This is a question that naturally follows from Bentham.

Intervention, which is thrown out by the well being that results from the haggling and haggling of competitive markets, returns by way of the questionable efficacy of the market determined income distribution in achieving "the greatest good"; "progressive" income taxation and a progressive distribution of the services that tax receipts fund is seemingly supported by the science and philosophy of Bentham and the post-Bentham economists.

In Smith's and Ricardo's vision competition leads to market conditions in which a "social best" is achieved. But competition also has the effect of destroying industries and firms that do not adapt to changing market conditions. There is a large element of "the survival of the fittest" in market capitalisms - and there is also a good deal of building market positions that protect against being declared unfit in the competitive struggle.

The input of Darwin - perhaps as interpreted by Spencer - put new light on competition, for "competition" could result in the survival of a few. A quest for and success in achieving market "monopoly" power is as much an attribute of market economies as the generation of conditions in which prices constrain units to behave, usually unknowingly as Smith put it, in the social interest.
By the beginning of the twentieth century doctrines of the market determination of prices, outputs and income distribution had to confront the existence of market power by firms and potentially by labor. Monopoly, which in Smith's day seemed to be largely the result of state interventions or collusion, became, in the days when Morgan and Rockerfeller were rising high, the result of market processes. Measures to control and constrain market power developed. Anti-trust and monopoly regulation became the legislative agenda. These developments lead to two paths: one is that of Henry Simons, which takes the forms of a detailed program of state intervention to create conditions within which market processes are to be given free reign to determine the details, the second to Kenneth Galbraith and doctrines of countervailing power, which envisage the proper role of government to be the development of interest groups with market power that negotiate the proper operation of the "systems" that determine income distribution, prices and outputs (employment).

The utilitarian doctrines of Bentham led to a rationalization of intervention because the social good was defined by a summation of individual utilities. This egalitarian bias was eliminated by questioning the comparability of utilities among persons. The "poor" living in quite brutal circumstances had brutish tastes; the Educated and refined consumed not only fine wines and
brocades but also art and poetry; the educated and refined were in general the supporters of culture. One could not say that a shift in income from rich to poor would add to the world's happiness. Interpersonal comparisons of utility were on their way out by the time the 20th century rolled around. Analytical techniques for determining conditions in which a "best" can rule even if interpersonal comparisons are ruled out were developed.

Over the past thirty-five years the implications of achieving the best outcome consistent with an initial externally given distribution of resources, income or wealth have been drawn out by theoretical economists, often of a mathematical bent. The proposition that takes a jargonized form; "a competitive equilibrium is a Pareto optimal" has been used to rationalize and defend the "market mechanism" as the device for determining what happens to prices, products, income distribution and the survival of industries and regions. The incompetence of the Sovereign - or the incompetence of a sovereign congress that is of necessity sensitive to constituent interests - has been wedded to the presumed "optimality" seeking character of the market to promulgate a new doctrine of laissez-faire. Instead of the father, it is now the market that "knows best".

To determine whether laissez-faire is an adequate guide to policy would be rather straightforward if the economic issues were solely those defined by orthodox price
theory. The propositions that "a competitive equilibrium is Pareto optimal" and that "markets lead to the fittest surviving" would lead to an empirical search for market failures and for policy interventions that create devices which make markets effective in those cases where, in the state of nature, markets fail or monopolies develop. If a situation in which "no one's lot can be approved without making someone else worse off" does not result from market processes, then intervention may be acceptable if devices that are within the capacity of the sovereign to administer can be developed. Simons' **Positive Program** remains one of the best statements of interventions that are motivated by the perceived failure of markets to function as they are **supposed to**.

David Stockman has recently gone on record as holding that government intervention is not desirable to ease the debt burden on farmers because in each case the debts are the result of contracts entered upon by "consenting adults". This is a doctrine that views poverty, unemployment or overindebtedness as a "fault" of the poor, the unemployed, or the debtor. Any tragedy - be it an accident or a run of bankruptcies in agriculture - can be viewed either as the fault of the individuals concerned or the result of system characteristics. The poor or the bankrupt farmer can be viewed either as "being guilty" or as "victims" of a system.
Let us say price stability requires that 7% of the labor force be unemployed at "peaks" of prosperity and that 11% be unemployed at business cycle troughs and these troughs need occur every four to five years. Such a system will produce a greater percentage of "poor" than an economy which can achieve price stability with unemployment ranging from 3% to 7%. A similar argument can be made for indebted farmers; a mode of financing farming which was put in place with interest rates of around 6% may not be viable if interest rates are around 12%" if "price level stability requires 12% interest rates, then the farmers are "victims" of a system malfunctioning rather than guilty of entering unwise contracts as "consenting adults". The doctrines of laissez-faire and the associated view that the market selects the fittest for rewards has no place for victims; if the market knows best and if market processes punish some, than those punished must be guilty.

Perhaps one way to understand the New Deal and the acceptance of reform in those times is that so many were "punished" in ways that seemed irrational that the view that the system creates victims was generally accepted. Today fifty years after the Great Depression with only selective victimization the norm, the view that the losers must be guilty (of something) is dominant.

Capitalism's evolution over the two centuries of the American constitution has not been smooth. The course
through time of our economy has been marked by booms and slumps, and by good times that are followed by bad times. Finally fifty five years ago, the great engine of material progress and production was brought to a halt by the Great Depression. "What is there about the actual capitalisms that lead to these periodic breakdowns; these depressions of history?" This question motivated the research activity of many of the leading economists in the epoch that saw the industrial revolution, the settling of our West, and the emergence of United States as the world's dominant economic power.

Even as the political philosophers of the first half of the 19th century were drawing the betterment and progress lessons from laissez-faire as demonstrated by presumed universal principles of Political Economy, hard facts of urban poverty and the impoverishing effects of depressions -the Hard Times of Charles Dickens -were becoming evident characteristics of economies with capitalist modes of production. Early on, this was seen by Marx and he predicted ever worsening business cycles. Some fifty years ago we could not have said that Marx was wrong - the business cycles from the 1870's to the great collapse of the 1930's seemed to confirm his views of ever worsening losses. To give part of my story away, it is the era of big government, interventionist capitalism of the past fifty
years that has disproven the in general predictions of Marx of ever worsening "crises" of capitalism.

Over the century prior to the Great Collapse of 1929-1933 the economy regularly suffered from depressions - of varying severity and depth. The existence of an apparent rhythm to capitalism gave rise to research programs to explain "business cycles". The research program of economics as a discipline some 75 to 50 years ago was largely dominated by a search for an explanation of business cycles. The "eminent"s in the discipline -Frisch, Tinbergen, Schumpeter, Mitchell, Hayek, Keynes - were trying to explain business cycles.

We can visualize the economic turmoil that gave rise to the research programs in business cycles by referring not the *The Great Depression* but to the Kansas "epic" "The Wizard of Oz". I will use the film version: the theme of which is set by Dorothy singing "Somewhere Over the Rainbow" - a vision of a better "world" - a "utopia".

The hard working virtues of Aunt Em and Uncle Henry are as "nothing" to the vision of a better world. When the "wicked holder" Elvira Gulch - (banker) - threatens Dorothy's dog Toto, Dorothy runs away to find the better world. The tornado lifts her in euphoric waves to Oz: where Dorothy is created as a "heroine", a liberator. The good witch then instructs her to follow the yellow brick
road - the gold standard of course - to Emerald City - the Utopia - where wishes are fulfilled. Incidentally the slippers which protect Dorothy are ruby in the film; they are silver in the book. On her way she finds her trio: the scarecrow = farmers, the tin man = labor and the cowardly lion = William Jennings Bryan (or maybe the intellectuals, the Wizard comes from Nebraska) and they're off marching to a better world. After the well known trials - the barriers placed in their way by the wicked (banker) witch of the west, they arrive in Emerald City - the apparent Utopia of their dreams.

The Utopia is false, a mere facade. The yellow brick road - the gold standard - did not lead to the ideal society. However one more barrier remains that prevents Dorothy's return to what she now recognizes as the virtuous society of hard and rewarding work, Kansas and Aunt Em. The barrier is the wicked witch of the west, the banker. Dorothy and her friends liquidate (literally!) the banker-witch and by tapping her "silver" shoes, Dorothy returns to Kansas where hard work provides a true "practical best".

The Wizard of Oz might serve as a tract for our times. Once again a "debt trap" engulfs American agriculture, once again easy roads to Utopia are being advanced, be it monetarism, supply side economics or a return to gold, and once again the virtues of work (full employment) are denigrated. Furthermore the wicked witches
of the west - the bankers - are seemingly riding high, even though they require the help of a supportive government to survive their mistakes.

In Dorothy's time, as in ours, the farmer's proximate problem was the lack of credit availability (high interest rates) and the farmer's pledging their land for credits. This was feasible as long as land prices rose, so the debts did not have to be paid and interest could be folded into the debt, but disastrous once land prices stabilized or fell. After the fact, the indebtedness of farmers in Dorothy's time and in our's is a form of Ponzi finance - a financing practice in which unpaid interest is capitalized into debts that can be validated only if the profits from owning these assets are capitalized into asset prices that at present seem impossible to attain.

Although Wilson's first term saw the Federal Reserve Act and the passage of various devices to promote free markets, the attitude toward government up to the 1930's remained that of Thomas Jefferson:

...a wise and frugal government, which shall restrain men from injuring one another, which shall leave them otherwise free to regulate
their own pursuits of industry and improvement, and shall not take from the mouth of labor the bread it has earned. This is the sum of good government and this is necessary to close the circle of our felicities. [Jefferson; First Inaugural Address.]

The Wilson interventions in the markets can be interpreted as restraining "men from injuring one another" in a market regime where units have power.

The substance of this precise and beautifully phrased statement by Jefferson could well have been made by President Reagan; the style is beyond our recent presidents. However 1801 is not 1985. In 1985 we have the experience of 184 years of capitalism in America that Jefferson did not have. We have discovered that the "fruits of labor" cannot be earned unless the market mechanism is controlled and constrained so that depressions do not occur. We must recognize that markets were freer in the 1920's than in the years since World War II; and that taxation was intrusive and quite likely poorly designed in these post World War II
years. Nevertheless the economy was much more resistant to depressions after the 1930's than before. It is known that a big government economy requires intrusive taxation; it violates the rules derived from abstract, highly mathematical economic theory for achieving allocational efficiency. But what if a big government economy promotes a stable economy whereas small government causes instability.

Franklin Roosevelt became president 82 years ago. He was inaugurated in the midst of the most severe economic crisis our country ever experienced. It was obvious to all that something was very wrong with their capitalism in general or with the particular form of capitalism that ruled in the United States. Roosevelt was faced with separable problems which we may call recovery and reform; to expedite a recovery from the Depression and to reform the economy so that a Great Depression would not again happen.

Unfortunately the "economic theory" of that day could not explain what had happened. No allocation oriented theory can explain the Great Depression except in terms of the great incompetence by political leaders. The allocation oriented theories with their abstract mathematical constructs cannot explain the endogenous development of business cycles -- they rely upon shocks, disturbances and administrations marching to strange drums. In the absence of guidance from theory, in Roosevelt's time experimentation
was necessary; furthermore the experimentation was to be carried out in the absence of data.

The only data that was solid was price data such as the prices of outputs and of stocks. The depression was clearly associated with output prices, wages and stock prices that had fallen very far from their 1929 level. The absence of data together with the lack of a theory that explained employment meant that a major emphasis of the first New Deal of 1933 was to get prices at least part way back to the levels that had Ruled earlier. Unfortunately, an inflationary bias to the economy was introduced by the legislation of the 1930's -- but in a peculiarly fortunate way inflation though chronic after 1933 really did not become acute until after the 1970s were well under way.

Even though business cycle theory was a major research interest of economists from Marx's time to the Great Depression, no great theoretical breakthrough in understanding business cycles had been achieved. The well trained non-Marxist economists of the time, such as Hayek, were engaged in trying to fit an explanation of the business cycle into the theoretical framework that had been developed to explain the way the invisible hand led to a social "best."

Nobel Laureate Paul Samuelson has described the "schizophrenic" situation that existed at "Chicago" during
the early 1930's. In the "price theory" courses a nice thought logical system was developed which had no place for the chaotic developments that were so evidently going on, whereas in the money and business cycle courses much detail of what was happening was studies -- but the "price theory" material was ignored.

The main theoretical break through, which led to a deeper understanding of what takes place during business cycles than had hitherto been possible occurred in 1936 when Keynes' The General Theory of Employment Interest and Money, which integrated the financial markets of a capitalist economy with the profit seeking, productive activity of entrepreneurs to determine the aggregate employment and output of the economy. The concern was no longer the seeking of better or the best in bundles of goods or how to produce most cheaply with given resources but rather the behavior of profit seeking entrepreneurs who offer employment and who invest, i.e. create resources. The investment often requiring external finance which means that Wall Street was a central part of the economy. This term General in the title to Keynes book is perhaps misapplied. The reference is not to an abstract economy with undefined institutions, the reference in the theory of employment is to a capitalist economy with sophisticated and precise though evolving financial institutions.
What Keynes gave us was an investment theory of business cycles and a financial theory of investment. In this financial theory of investment, the economy is characterized by the use of debts to finance control over capital assets. The ostensible owners of capital are often in debt in order to become possessed of them. But debts involve an exchange which can be characterized as money today for money tomorrow; and of course each today is a tomorrow for many yesterdays. Thus over each period of time debts are coming due because of prior contracts; these due payments are an account of principal and interest.

The fundamental negotiation in such an economy is between the business men and the banker [between Aunt Em and Uncle Henry and the Witch/Banker of the film.] The fundamental questions in the negotiations are how are the funds going to be used and how is the debtor going to repay the banker. The answer for business is out of profits that will be earned. For any liability structure of business as a whole there is a minimum total of profits that assures that the flow of profits to the various enterprises will enable almost all of them to fulfill their payment commitments.

The successful performance of an entrepreneurial capitalism with sophisticated financial practices depends upon the adequacy of aggregate profits and their distribution. The primary action of the economy can be
visualized As the fulfillment of payment commitments to bankers by business men and the creation of new debts as business men and bankers agree on deals. The level at which investment takes place depends upon the extent to which financing is forthcoming, which in turn depends largely on the extent to which business men and bankers believe profits will be forthcoming.

"Profits" rule the roost in a capitalist economy. What determines profits?" is the question that follows from this ruling of the roost. When the study of business cycles was mainly data oriented - when what happens in business cycles was known even as there was no theory that explained the importance of the "facts" - one known characteristic of business cycles was that profits fluctuated much more than other facets of the economy. When the Great Depression was studied in detail by organizations such as The National Bureau of Economic Research and The Twentieth Century Fund in the years immediately after the great collapse of 1929-33 the concept of the "burden of the debt" was important, this burden being a ratio of debt to a relevant income. The burden of business debt exploded as profits first collapsed and then became negative over the course of the 1929-33 debacle.

The fundamental Keynesian insight, in the context of an inherited financial structure, is that business borrows to investment activity determines total demand and
profits, profits determine whether the payments on debts that were entered upon in the past are fulfilled and whether investment and financing decisions entered upon in the past were paid for investment then the business men and bankers who made "deals" in the past are encouraged to make additional deals; Investments are projected and financed.

This investment-indebtedness-profit connection periodically goes wrong. Debts increase relative to gross profits, interest rates can explode raising the carrying costs for asset holders, payment commitment on debts may become impossible to fulfill and asset prices can fall short of expectations. The above can combine to cause a collapse of investment, which leads to a fall in total demand and a decline in investment. A cumulative interactive process that leads to a business cycle decline and even an epidemic of failing financial institutions can ensue.

The links between indebtedness, investment and profits are straightforward for a "simple" economy which has but a small government, where international trade and financial linkages are minor, and whose workers are virtually in the position where if they don't work, they don't eat. The U.S. economy of 1929 approximated this model. The connections among indebtedness, investment and profits are more complex in an economy where government is big, international trade and finance are important and wealth is distributed widely so that workers can eat even
though they have no work. The U.S. economy since World War II has approximated this more complex model.

In the simple model cyclical swings in investment will lead to exaggerated swings in profits which, if the indebtedness situation is appropriate, may lead to cascades of debt failures. In a complex model the effect of fall in investment upon profits will be offset by an offsetting opening of a budget deficit, so that profits tend to be sustained. Furthermore, during periods of unemployment increases in the ratio of spending upon consumption to workers wage incomes will tend to sustain profits. An effect of big government and the large cyclical deficits it makes possible is that the cyclical swings in profits are not only attenuated but also somewhat out of phase with the swings in income. A big enough deficit—as in 1974-75—may lead to profits increasing even as income and employment are decreasing.

In a system with inherited indebtedness and debt financing of current demand the main object of stabilization policy is to insure that on the whole debt contracts are carried out and that debt financing is available for investment projects. A government deficit whose swings offset the swings in investment will tend to stabilize profit flows and thus prevent a collapse in debt validation and asset values. As a result, debt financing of new investment continues. If the swings in investment makes a
cascade of business and bank failures seem imminent, a policy mix, by which a lender of last resort (the Federal Reserve) refinances banks and a government deficit not only sustains but increases business profits, can contain the business and bank failures. The big government capitalism of the late 1960's through now is heavily indebted, so that a depression is possible. The capacity to generate serious depressions was evident in the recessions of 1969-1970, 1974-5, and 1981-2. Their recessions were contained by the Federal Reserve and other governmental financial units that bailed out threatened organizations, and by government deficits that sustained aggregate profits. Unfortunately, in the price and wage setting environment of the past two decades, the success in containing the thrusts to depressions was accompanied by what seemed like stepwise rising floors to unemployment rates in expansions, and decreasing rates of growth of output.

We are now only 9 quarters into an expansion which has seemingly seen a break in the inflation trend of the years since the midsixties. As yet it has not reversed the trend of stepwise rising lows in unemployment rate in expansions. It is not clear what is happening to the rate of growth of capacity, because the unemployment rate obscures the meaning of capacity.

The break in the trend of inflation is most interesting. The recession of 1981-82 was long and deep as
post World War II recessions go. It was accompanied by a significant decrease in the coverage and the power of unions. It was also accompanied by a significant appreciation of the dollar on the international exchanges. Some of the factors that decreased inflation may be transitory—such as the appreciation of the dollar and the unemployment rates—and some may be permanent, such as the weakening of trade unions.

As we look back over the recent history of our country, it cannot be argued that the experience vindicates laissez-faire. The recession of 1981-82 ended as quickly as it did because deficits sustained aggregate profits and had a cumulative effect that improved private balance sheets. The fragile position of many thrift institutions required the authorities to finance a significant restructuring of that industry, even as the Federal Reserve had to "clean up" the repercussions of the failure of Penn Square Bank in 1982 by a massive infusion of its credit into the Continental Illinois Bank of Chicago during 1984.

The events of the 1981-82 recession and the financial restructuring that followed demonstrated once and for all the virtue of big government capitalism. However the proposition that big government capitalism with an active interventionist central bank is more efficient with respect to the downside stability properties of the economy than small government capitalism does not imply that the
existing big government capitalism is the best possible. Each particular big government capitalism consists of a spending program, a tax system and a structure of institutional regulations and interventions. Each particular big government capitalism will have macroeconomic characteristics such as its downside potential, its inflationary thrust, its openness to imports, and its financial stability properties. It also has microeconomic effects that affect income distribution and relative prices. All of the comments by supply siders about taxation and subsidies affecting the work, saving and investing behavior of individuals are relevant. Different structures of big government, with different effects upon incentives, are not only conceivable but should be considered.

To date, the Reagan Administration is not a small government administration - and it has no intention of becoming such an administration. First of all it is engaged in a rapid expansion of military expenditures; secondly the cumulative effects of the deficits will lead to a substantial rise in the government's outstanding debts. The transfer payment - interest on the public debt - has expanded relative to G.N.P. and will continue to expand unless there is a very sharp and sustained fall in interest rates.

The Reagan Administration is mounting an attack on the Welfare State and supplying of civilian services by the
government. If we wanted to be political we could assert that the Welfare State is being replaced by a Garrison State. But all of us should welcome the implicit Reagan questions: what kind of government, what size do we need?

Long ago Edmund Burke said "...One of the finest problems in legislation (...is...) to determine what the State ought to take upon itself to direct by the public wisdom and what it ought to leave with as little interference as possible to individual exertion" [Edmond Burke, cited by Keynes in the end of Laissez-Faire. Keynes attributes the citation of Burke to McCullough in his Principles of Political Economy]. Burke's statement succinctly expresses the political problem now facing our country, except that is has to be amended to recognize that a big government is necessary if downside instability is to be contained. When Samuelson and Neuhaus remark that "the single most surprising development of our age was the unpredicted vigor of market economies", [cited in New York Times, Sunday, February 18, 1985], it must be noted that this vigor was exhibited in the context of big government. None of the downswings of the economy that have taken place after World War II were allowed to run their "natural" course. We can run thought experiments about 1974-5 and ask what the economy would have been like if Franklin National had not been refinanced by the Federal Reserve and about 1984 and ask what if the Federal Reserve had not refinanced
the Continental Illinois Bank. Furthermore what if governments had been small so that the great deficits of 1975 and 1984 had not been there to sustain business profits.

To argue that big government and interventionist central banking are necessary if the cyclical instability that is characteristic of capitalism as we know it is to be constrained, and that laissez-faire can reach its full effectiveness as a device for achieving efficiency only if laissez-faire is not allowed to thrust the economy into a deep depression is not to argue that the structure of big government that Reagan inherited in 1981 or that he will leave to a successor in 1989 is desirable. It is quite likely that the structure of taxation and spending of 1981 was flawed in many ways – and it is to be hoped that we can do better than the inherently wasteful garrison state spending to contain the downside instability of our economy. We really should have a national debate that starts with the premise that big government is necessary, which recognizes that big government requires intrusive taxation that will affect behavior and then goes on to argue out the nature of the big government and taxation system we want.

I will make one start on that debate: We are at present substituting a Garrison state for a Welfare state, but hopefully a day will come when we will be able to dismantle the Garrison State. When that day comes – and we
all hope it will be soon - we should contemplate the
development of a resource development state that looks to
not only education as we know it but also to comprehensive
employment programs that serve to create human and non human
resources as the core of big government.

Out of a combination of the Jeffersonian ideal of
education for citizenship and the practical devices of
Roosevelt for putting unemployed human resource to work we
can construct a peacetime economy that provides a natural
environment in which free markets do what free markets do
best, take care of the details of economic life, even as
government assures that the downside instability inherent in
capitalism does not bring us to our knees as we were in
1933.