Toward a Public-Spirited Public Management Economics

An Essay in Honor of John Kenneth Galbraith

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ABSTRACT

Economics shares with other approaches to human governance the potential to be “dismal, delusional, or dangerous” when dogma replaces reason in decisions about when to apply economic principles. A reading of the classical economic literature shows that even classical economics has not supported the indeed dismal, delusional, and dangerous turn that contemporary mainstream economics has adopted. What economists (and especially public administrators who engage the discipline) have forgotten is the original welfare economics tradition that has its roots at least in Adam Smith and other classic works in the field, and is far more relevant to public administration.

The final problem of the productive society is what it produces. This manifests itself in an implacable tendency to provide an opulent supply of some things and a niggardly yield of others. This disparity carries to the point where it is a cause of social discomfort and social unhealth. The line which divides our area of wealth from our area of poverty is roughly that which divides privately produced and marketed goods from publicly rendered services. Our wealth in the first is not only in startling contrast with the meagerness of the latter, but our wealth in privately produced goods is, to a marked degree, the cause of crisis in the supply of public services. For we have failed to see the importance, indeed the urgent need, of maintaining a balance between the two.

—John Kenneth Galbraith, The Affluent Society
In 2010 the decline of the MBA will cut off the supply of bullshit at source.

—Lucy Kellaway, *The Economist*

Economics shares with other approaches to human governance the potential to be dismal, delusional, or dangerous when dogma replaces reason in decisions about when to apply economic principles. Perhaps the most dramatic recent illustration of the delusional and unbalanced (in Galbraith’s terms, above) application of economic theory was presented by Alan Greenspan, the former chairman of the Federal Reserve. In his best-selling autobiography, Greenspan was an unrepentant economic liberal, advocating continued deregulation:

Gradually, without fanfare, the voluntary promptings of individuals in the marketplace have displaced many of the powers of the state. Much regulation promulgating limits to commercial transactions has quietly been dismantled in favor of capitalism’s market self-regulation. (2007, p. 502)

Greenspan’s world in 2007 was a narrow place, facing a dichotomous choice between this increasingly self-regulated capitalism of “free-spirited cowboys” (p. 279), and the alternative of “Lenin and Stalin’s communism . . . Mao’s Cultural Revolution . . . North Korea or Cuba” (pp. 503–504). Then came the current global recession, widely blamed on unregulated cowboy capitalism (Ahamed, 2009b; Bernanke, 2009; Greenspan, 2008; “The Other Worldly Philosophers,” 2009; Volcker, 2008; “What Went Wrong,” 2009). To his credit, Greenspan has since at least been willing to admit his mistake. Barely a year after the publication of *The Age of Turbulence*, in testimony before Congress, he stated, “Those of us who have looked to the self-interest of lending institutions to protect shareholder’s equity (myself especially) are in a state of shocked disbelief” (Greenspan, 2008, para. 5). Reregulation, he now agreed, was called for.

Rather than focus on the contemporary crisis, this article takes instead a theoretical and historical perspective, arguing that even economics has not supported the indeed dismal, delusional, and dangerous turn that contemporary mainstream economics has adopted. The article especially seeks to identify four major areas in which contemporary economics has adopted an approach inconsistent with classical economics, with the original welfare economics tradition, and with the values and purposes of public administration. Contemporary economics has:

- ignored Mill’s observation that production is different from distribution, with the latter being largely an economic concern and the former a political one (e.g., Galbraith, 1958, pp. 251–269);
- sought to remove egalitarian normative considerations from economics (Galbraith, 1970, pp. 469–478);
• dismissed the concept of the diminishing marginal utility of money and so concern for inequality (e.g., Galbraith, 1994, pp. 210–218); and
• inadequately incorporated recognition of the limits of economics, especially in equilibrium analysis (e.g., Galbraith, 1973, pp. 11–50).

These are views that John Kenneth Galbraith emphasized throughout his career as economist and especially public intellectual. Rather than a summary and presentation specifically of his work, this article seeks instead to present this Galbraithian economic perspective as more appropriate to public administration. The following section presents the public-oriented elements of Adam Smith’s invisible hand, the widely misunderstood foundational metaphor of conventional mainstream economics. This is followed by other elements of the public orientation in classical economic thought: John Stuart Mill’s separation of distribution from production, Léon Walras’s separation of normative from positive concerns, Alfred Marshall and Arthur Cecil Pigou’s assertion of the diminishing marginal utility of money, and the limits of equilibrium analysis identified by John Maynard Keynes and others. The mainstream rejection of this original public welfare economics tradition is discussed, followed by a Galbraithian critique of conventional economics. The article closes by discussing the role of cognitive politics in maintaining the status quo, both in contemporary economics and especially in popular discourse, and urges the field of public administration to contribute to a counterdiscourse more appropriate to the original welfare economics tradition.

**ADAM SMITH’S INVISIBLE HAND**

Though economic thought did not begin with Adam Smith (see Robbins, 1998), his *Wealth of Nations* is almost universally acknowledged as the first major, systematic study of economics and is surely one of the best-known books in the world. It has not, though, necessarily been one of the most read books in the world. As Galbraith suggests, “With *Das Kapital* and the *Bible*, *Wealth of Nations* enjoys the distinction of being one of the three books that people may refer to at will without feeling they should have read it” (1979, p. 90).

The famous invisible-hand quotation is a good example of the way Smith is used to argue that the invisible hand of markets works better than the visible hand of government. The key passage asserts that when an individual directs his industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his
intention. . . . By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. (Smith, 1976, pp. 477–478)

Beyond the entire paragraph (and context) being a qualified statement, as applying to the support of domestic industry over imports, as well as to “many other” but not all “cases” (Finer, 1945, pp. 70–71), note that the justification of the invisible hand is—and this is a theme that this article seeks to emphasize—to promote the public interest. *Ipso facto*, if the invisible hand is seen to not be leading to the public interest, it might be restrained or redirected by government.

Smith is also widely cited as an advocate of limited government. In another oft-cited but poorly understood passage, only “three duties of the sovereign” (1976, vol. 2, p. 208) are identified: defense, justice, and major public works (pp. 213–244). So far, so minimalist. But for Smith public works included both physical infrastructure (pp. 245–253) and certain public institutions, by which Smith includes especially education. Beyond the public good nature of this, Smith also notes that “in the progress of the division of labour” (vol. 1, p. 302) the worker “becomes as stupid and ignorant as it is possible for a human creature to become. . . . But in every improved and civilized society this is the state into which the laboring poor, that is, the great body of the people, must necessarily fall, unless government takes some pains to prevent it” (vol. 1, p. 303).

This still leaves a fairly minimal state: defense, justice, major public works, and education. Subsequent classical economists will expand this, and so it is worth noting four things before moving on. First, justice opens the door to a regulatory function of government. Second, the logic of public works and education opens the door to state involvement in the provision of public goods, those “which, though they may be in the highest degree advantageous to a great society, are, however, of such a nature, that the profit could never repay the expence” (vol. 2, p. 244) of private investment. Third, Smith’s eighteenth-century context has since been routinely ignored. Smith’s hero was not economic conservatism, fighting the bête noire of European social democracy or what Americans refer to as “liberalism.” Instead, his hero was economic liberalism, his villain was mercantilism, an antitrade economic nationalism (Galbraith, 1994, p. 5; Finer, 1945, pp. 68–70).

Fourth, though the division of labor (Smith, 1976, p. 7) and free exchange—“the propensity to truck, barter, and exchange one thing for another” (p. 17)—largely provide the answer to Smith’s inquiry concerning the nature and causes of the wealth of nations, Smith clearly sees problems with his political economy. The deleterious effect on workers of the specialization inherent in the division of labor is mentioned above. Smith further sees monopoly resulting from private collusion as at least as great a threat to free exchange as government meddling. For instance, in price negotiations between labor and management:
It is not, however, difficult to foresee which of the two parties must, upon all ordinary occasions, have the advantage in the dispute, and force the other into a compliance with their terms. The masters, being fewer in number, can combine much more easily; and the law, besides, authorises, or at least does not prohibit their combinations, while it prohibits those of the workmen. (p. 74)

As a result, downward pressure on wages is restricted only by the need to keep workers alive, though this must “upon most occasions be somewhat more; otherwise it would be impossible for him to bring up a family, and the race of such workmen could not last beyond the first generation” (p. 76). This is not as heartless as it reads, and Smith was describing, rather than advocating, in this passage. It should also be noted that Smith’s other major work, his earlier *The Theory of Moral Sentiments*, takes a dim view of the “disposition to admire, and almost to worship, the rich and the powerful, and to despise, or, at least, to neglect persons of poor and mean condition” (1979, pp. 61–62). This earlier work includes a defense of self-interest (pp. 300–304; see also Heilbroner, 1972, pp. 42–59) so long as this features “the habits of economy, industry, discretion, attention, and application of thought” (1979, p. 304). These moral sentiments are also evident in *The Wealth of Nations*: “prodigality and misconduct” are criticized, while parsimony is lauded (1976, pp. 358–360). As well:

No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable. It is but equity, besides, that they who feed, cloath and lodge the whole body of the people, should have such a share of the produce of their own labour as to be themselves tolerably well fed, cloathed and lodged. (p. 88)

So for now note that while Smith saw his political economy as superior to mercantilism, a “city on the hill” it was not.

**JOHN STUART MILL AND PUBLIC DISTRIBUTION**

For an economics with a public focus, Mill’s great contribution was to separate out the study of production—which had been the focus of economics to date—from distribution. Austrian School adherent and Hayek disciple Lionel Robbins, no sympathizer with Mill’s views, puts it this way:

Mill divided production and distribution in his work as he does because he believed that the so-called laws of production which he wished to elaborate were of universal applicability, whereas the laws of distribution, which he proposed to go into in the section headed “Distribution,” were to some extent guided by institutional arrangements. (Robbins, 1998, p. 224; see also Mill, 1965, p. 21)
From this basic breakthrough of separating distribution from production, which Robbins perhaps cattily described as “the one distinction that [Mill] introduced which you won’t find in Adam Smith” (Robbins, 1998, p. 224), Mill went on to considerably expand the economic role of government (see also Ricardo, 1962, p. 57). Mill put the issue of the role of women onto the economic policy agenda (p. 765), though it took over a century for mainstream American economics and public administration scholars to follow up on this (Candler, 2006). Adam Smith’s mass education remains important (Mill, 1965, pp. 107–110), and what later came to be referred to as “consumer sovereignty,” or perhaps the “wisdom of markets,” was questioned (pp. 947–948). Taxing the rich to fund social programs for the poor was economically sound (pp. 88–89), and a theme taken up later by others was to question the logic of inherited wealth (pp. 221 & 887). Mill even went on to ponder the possibility of less private, and more communal, forms of economic organization (pp. 202–209). As suggested from the above, the institution of private property, especially, came under more critical assessment from Mill than from either Smith or David Ricardo:

The social arrangements of modern Europe commenced from a distribution of property which was the result, not of just partition, or acquisition by industry, but of conquest and violence: and notwithstanding what industry has been doing for many centuries to modify the work of force, the system still retains many and large traces of its origin. (p. 207)

Mill’s more positive perception of government—as the agent tasked with correcting social imbalance resulting from market forces—is due to the progress of democracy in England since the days of Adam Smith. This was also noted earlier by Ricardo: for people “to be made happier they require only to be better governed and instructed” (1962, p. 56). A combination of factors including education, transport, and communication improvements, and the effect of factories and cities in bringing workers together (Mill, 1965, pp. 762–765), echoed by Marx and Engels (1992, pp. 8–12) in The Communist Manifesto of the same year, had led to “the patriarchal or paternal system of government” being one to which the working classes and poor “will not again be subject” (Mill, 1965, p. 762). In short, “In attempting to enumerate the necessary functions of government, we find them to be considerably more multifarious than most people are at first aware of” (p. 800; see also pp. 947–960).

LÉON WALRAS AND NORMATIVISM

For the purposes of this article, Léon Walras is important for introducing into mainstream economics Hume’s distinction between “what is . . . and what ought to be” (1969, p. 60). This was to develop into positive (is) and
normative (ought) approaches to economics (Lipsey, 1963, pp. 4–5). Walras described these as applied economics and social economics, with the former an applied science of economic production and the latter a study of the justice of economic distribution (1969, pp. 74–79), which reflects what this article argues is the bifurcation in economics away from a public focus. Marshall and Pigou (see below) especially diverged on this distinction. Marshall sought to banish the latter from economics, as “economics are statements of tendencies expressed in the indicative mood, and not ethical precepts in the imperative” (1961, p. vi). Pigou, on the other hand, declared Marshall’s economic facts “to be the servant of the social sympathies” (1962, p. 5). Though his Economics of Welfare focused on economic welfare (p. 11), Pigou subordinated this to welfare on the whole (pp. 11–20).

Walras is also recognized as a pioneer in the development of general equilibrium theory. His approach was especially important for what it did not contribute to economics: the concept of static equilibrium. Instead, Walras’s general equilibrium was a dynamic process that he referred to as the “continuous market.” This had two key characteristics. First, the market was “perpetually tending towards equilibrium without ever attaining it” (1969, p. 380). The process was one of “groping,” implying an imprecise trial-and-error process. Worse, in Walras’s dynamic conception of markets, while the market groped toward equilibrium, driven by the inexorable price signals resulting from the interplay of supply and demand, the market was being buffeted by outside forces that caused both supply and demand schedules, and so equilibrium, to shift constantly. Equilibrium was therefore a moving target, and “there never is a day when the effective demand for products equals their effective supply and when the selling price of products equals the cost of the productive services used in making them” (p. 380). The second characteristic of Walras’s market equilibrium was that the groping could be overwhelmed and “thrown into violent confusion by crises, which are sudden and general disturbances of equilibrium” (p. 381; emphasis in original).

MARSHALL AND PIGOU: THE DIMINISHING MARGINAL UTILITY OF MONEY

The next three economists discussed—Alfred Marshall, Arthur Cecil Pigou, and John Maynard Keynes (considered in the following section)—were contemporaries, though with Marshall unabashedly “our leader, practically unchallenged . . . he was ‘the master’” (Pigou, 1939, p. 219). The early twentieth-century era of Marshall, Pigou, and Keynes is important because it is the period during which economics bifurcated. Mainstream economics stripped the public focus from even Marshall’s economics, while Pigou and Keynes pioneered what came to be known as “welfare economics”: economics with a public focus before this, too, came under attack.
Marshall picked up where John Stuart Mill left off. He praised Mill’s “admirable” *Principles of Political Economics* as “the first important indication of the new movement” and “a marked change in the tone” (1961, p. 764) in economics, with more focus on the human element and “a higher notion of social duty” (p. 765). He also echoes Mill’s critical perspective on the nature of property:

> It is true that many of the largest fortunes are made by speculation rather than by truly constructive work: and much of this speculation is associated with anti-social strategy, and even with evil manipulation of the sources from which ordinary investors derive their guidance. (p. 719)

The invariably benign nature of the invisible hand was questioned:

> It has been left for our own generation to perceive all the evils which arose from the suddenness of this increase of economic freedom. Now first are we getting to understand the extent to which the capitalist employer, untrained to his new duties, was tempted to subordinate the wellbeing of his workpeople to his own desire for gain; now first are we learning the importance of insisting that the rich have duties as well as rights in their individual and in their collective capacity. (p. 750)

Beyond these polemics, Marshall critically sought to provide theoretical justification for his interest in equality through the concept of the diminishing marginal utility of money. Asserted repeatedly throughout *Principles of Economics* (pp. 19, 96, 136–137, 474, 502), the point was succinctly stated as involving “the consideration that a pound’s worth of satisfaction to an ordinary poor man is a much greater thing than a pound’s worth of satisfaction to an ordinary rich man” (pp. 130–131), a theme also developed by Pigou.

With Pigou came the branch of economics known as “welfare economics” (Mishan, 1960, p. 203), a critical development in the story related in this article. Pigou’s 1920 *The Economics of Welfare* identified a key difference with the classical economics of the day in that Pigou followed the concerns for the poor of Smith (1976, p. 88), Ricardo (1962, pp. 56–57), Mill (1965, pp. 762–765), and Marshall (1961, pp. 560–563) by adding to Smith’s interest in “the wealth of nations” a concern for social improvement (Pigou, 1962, p. 4) and for “the absolute share of that dividend that accrues to the poor” (p. vi).

Central to this view was Marshall’s diminishing marginal utility of income (Pigou, 1962, pp. 84 & 742–745; 1964, p. 35). As a result, policy that redistributed the income of the rich through social programs that benefit the poor was desirable (Pigou, 1962, pp. 87–97), especially given that voluntary altruism was unlikely to provide adequate resources for this (pp. 712–713). Rather than a drag on productivity, investments in education and the development of human capital were likely to increase national income (pp. 742–753). On a similar equity note, he returns to Mill’s concerns about the economic status
of women (pp. 564–570) and may have originated the pithy observation that unpaid household labor is ignored in economics, so “if a man marries his housekeeper or his cook, the national dividend is diminished” (p. 33).

Inherited wealth again came in for special attention, as these unearned rewards were economically inefficient (pp. 649–651) and “very heavy death duties could probably be levied on large fortunes . . . without . . . exercising any large influence in discouraging rich men from saving” (pp. 718–719). Challenging subsequent criticisms that the coercion (p. 713) involved in redistribution might offend community values, he pointed out that selfishness and unearned privilege similarly may be seen as immoral (Pigou, 1964, p. 16).

Smith’s eighteenth-century historical context is again updated. In a brief discussion of Adam Smith’s pessimistic attitude toward government intervention in the economy, Pigou argues that Smith’s world was one in which government did little of social benefit. By the early twentieth century, government could provide services that helped the poor, and so Smith’s argument would not hold. So the rapacious monarchy of Adam Smith, as well as Marx and Engels’s view that “the executive of the modern State is but a committee for managing the common affairs of the whole bourgeoisie” (1992, p. 5), no longer apply. Instead, “The broad result is that modern developments in the structure and methods of governmental agencies have fitted these agencies for beneficial intervention in industry under conditions which would not have justified intervention in earlier times” (Pigou, 1962, p. 335).

Therefore it was the visible hand of government that came into its own as a positive social actor in Pigou’s analysis. Beyond equity concerns and the benefits of education, externalities (pp. 173–203) and natural monopolies (pp. 381–408) may require government attention, and like Marshall, Pigou notes the limits of economic analysis (pp. 11–20). Protection of “the interests of the future in some degree against the effects of our irrational discounting and of our preferences for ourselves over our descendants” (p. 29; emphasis in original), as well as environmental conservation (p. 30), also get added to the growing list of appropriate government activities.

**JOHN MAYNARD KEYNES AND THE LIMITS OF EQUILIBRIUM ANALYSIS**

Finally, John Maynard Keynes revolutionized the way economics thought of government by especially emphasizing the occasional need for government to intervene when markets exhibit the “general disturbances of equilibrium” noted by Walras. As is well understood, the world economy faltered toward the end of the 1920s and entered into a deep recession in the early 1930s. Economic theory called for a hands-off approach, arguing that the economy was self-correcting through the natural interplay of supply and demand (Galbraith, 1994, p. 50). After four years of uncorrected depression, this view became
increasingly untenable, not least the assumption of stability in the free-market model (Galbraith, 1952, pp. 65–73). Keynes presented his alternative in The General Theory of Employment, Interest and Money, a book that a young Paul Samuelson described as “a badly written book, poorly organized . . . arrogant, bad-tempered, polemical . . . When it finally is mastered, we find its analysis to be obvious and at the same time new. In short, it is a work of genius” (Samuelson, 1946, p. 190; see also Pigou, 1936).

Keynes did make his point more clearly in a famous open letter addressed to then-U.S. President Franklin Roosevelt:

Broadly speaking, therefore, an increase of output cannot occur unless by the operation of one or other of three factors. Individuals must be induced to spend more out of their existing incomes; or the business world must be induced, either by increased confidence in the prospects or by a lower rate of interest, to create additional current incomes in the hands of their employees, which is what happens when either the working or the fixed capital of the country is being increased; or public authority must be called in aid to create additional current incomes through the expenditure of borrowed or printed money. In bad times the first factor cannot be expected to work on a sufficient scale. The second factor will come in as the second wave of attack on the slump after the tide has been turned by the expenditures of public authority. It is, therefore, only from the third factor that we can expect the initial major impulse. (1933, para. 5; emphasis in original)

Samuelson called the key element in Keynes’s analysis “effective demand” (1946, pp. 188–189). This challenged the early nineteenth-century law of demand of Jean Baptiste Say, which has been (perhaps mis-)interpreted as asserting that “supply creates its own demand, and therefore there can be” (Robbins, 1998, p. 202) neither over- nor underproduction, and so no recession (Heilbroner, 1972, p. 98). Instead, Keynes pointed out that income not reinserted into the economy results in a reduction of demand and the possibility of Walras’s “sudden and general disturbances from equilibrium” (Walras, 1969, p. 381). And so Keynes’s famous conclusion:

The outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes. The State will have to exercise a guiding influence on the propensity to consume. Furthermore I conceive that a somewhat comprehensive socialisation of investment will prove the only means of securing an approximation to full employment. (1936, p. 378)

Though this, again, is widely misunderstood, seen as evidence that Keynesianism purportedly equals socialism. The passage above continues:
though this need not exclude all manner of compromises and of devices by which public authority will co-operate with private initiative. But beyond this no obvious case is made out for a system of State Socialism which would embrace most of the economic life of the community. It is not the ownership of the instruments of production which it is important for the State to assume. If the State is able to determine the aggregate amount of resources devoted to augmenting the instruments and the basic rate of reward to those who own them, it will have accomplished all that is necessary. (p. 378)

It is also important to note that Keynes’s macroeconomic policy was meant to be budget neutral: borrowing to maintain demand and so cushion recessions, while then running surpluses in the good years to pay off these debts (Galbraith, 1994, p. 103). As well, economists have recognized that automatic Keynesian stabilizers—automatic changes in tax receipts, unemployment insurance, and other welfare transfers—have been built into most modern economies (Samuelson & Nordhaus, 1985, p. 175).

While the debate continues about the causes of the Depression, as well as the reason it finally ended, economics and public policy came out of this experience adopting the Keynesian approach, which diagnosed the problem as inadequate demand and the solution as increasing government demand to compensate as necessary. Or, as Liaquat Ahamed recently put it:

European central bankers . . . had long absorbed the lesson that while most of the time the economy works very well left in the care of the invisible hand, during panics that hand seems to lose its grip. Markets, particularly financial markets, became unthinkingly fearful. To reestablish sanity and restore some sort of equilibrium in these circumstances required a very visible hand to guide the invisible hand. (2009a, pp. 502–503; see also Samuelson, 1946, p. 192)

THE REACTION

So far note that while Pigou and Keynes are generally seen as somewhat to the left of the economic mainstream, even the establishment figure Marshall reads like an economist who remains moored in a social science with a public focus. However, it is likely that the bifurcation in economics—away from the public welfare focus evident from Smith to Marshall—had its origins in four sources, all located in Marshall’s work.

The first was a reaction to Marshall’s decreasing marginal utility of income. The second was his elegant presentation and popularization of the logic of markets, through the derivation of the supply and demand functions and their interaction at producing market equilibrium. He especially added to this the notion of “surplus,” eventually expanded to consumer and producer surplus.
Marshall’s market equilibrium, which he described as “a position also of maximum satisfaction” (1961, p. 470; emphasis in original), was then treated as sacrosanct by subsequent economists who overlooked the third origin of the split in economics: the limits of economic analysis. These limits are myriad, from various forms of market failure to important considerations that economics especially fails to address. Finally, Marshall identified Walras’s distinction between positive and normative economics, but then dismissed the latter from economics, declaring, “Economics are statements of tendencies expressed in the indicative mood, and not ethical precepts in the imperative” (1961, p. vi).

Within mainstream economics, Keynes’s The General Theory created a good deal of cognitive dissonance because of its rejection of a good deal of the accepted wisdom in the field (Finer, 1945, p. 135; Galbraith, 1958, pp. 96–104). As a result, for some the reaction against Keynes reflected simply a new assertion of the classical tradition: neoclassical economics (de Paula, 2005, pp. 29–32; see also Galbraith, 1994, pp. 40–45). The reaction went beyond Adam Smith’s championing of an invisible hand leading to optimal social outcomes. Von Mises especially sought to “convert the theory of market prices into a general theory of human choice” (1949, p. 3). Central to this was methodological individualism (pp. 41–44) with its assumption that “human action is necessarily always rational” (p. 18) to the individual actor, and so government intervention was less likely to lead to outcomes that benefit the public than would the aggregated private decisions of citizens themselves (Galbraith, 1958, pp. 11–18; Hayek, 1944, pp. 75–79).

Equally important for the neoclassical reaction, economics and politics were causally linked. As Hayek succinctly put it:

If “capitalism” means here a competitive system based on free disposal of private property, it is far more important to realize that only within this system is democracy possible. When it becomes dominated by a collectivist creed, democracy will inevitably destroy itself. (1944, pp. 69–70)

This no doubt had its origins in part in the double threat of repression faced by early twentieth-century Austria from both Nazi Germany and Soviet communism (Galbraith, 1994, p. 40; Hayek, 1944, pp. 167–180). Indeed, as Von Mises asserted, if his new, hegemonic economic theory of human choice were to be disregarded, we “stamp out society and the human race” (1949, p. 881).

This was the mainstream economic reaction to the welfare economics of Pigou. The less-known reaction came from within welfare economics itself. Hicks termed this the “new welfare economics” (1939, p. 698). Central to the new welfare economics was the rejection of the possibility of interpersonal comparisons of utility, and so the diminishing marginal utility of money (pp.
Robbins was especially central in this rejection despite the centrality of marginal analysis in general equilibrium theory. For Robbins, marginal analysis only applied to each individual’s preferences so that the thousandth pound earned by a worker was more valuable, as applied to satisfy more fundamental wants, than the thousand and first. However, for Robbins (1952, pp. 137–141) one could neither compare nor aggregate the utility gained by person A from her thousandth pound to that enjoyed by person B from his thousand and first pound.

Instead, for the new welfare economics the critical issue is Pareto optimality: allocation of resources at a point where it is impossible to make any person better off without making another person worse off. When this is not the case, then the possibility of compensation was required, that is, if the benefits to winners were greater than the losses borne by losers, aggregate production increases (Kaldor, 1939, pp. 550–551), and such policy should be pursued. As a satisfied, positivist Kaldor put it: “Here the economist is on sure ground; the scientific status of his prescriptions is unquestionable” (p. 551). Economists should, though, avoid questions of whether such compensation should be paid because questions of income distribution were normative, and so should remain outside the realm of economics (pp. 551–552; see also Hicks, 1939).

So in short, rather than the normative, original welfare economics assumption that those poor in money need additional money more than do those who are rich in money, the new welfare economics implicitly posited the equally normative, counterintuitive position that poverty did not imply greater need than wealth did.

A GALBRAITHIAN CRITIQUE

From the above discussion, one can identify at least four key areas in which mainstream economics adopts a perspective that is inconsistent with the public focus of public administration. First, a fundamental problem with classical economics is simply the myriad market failures and so the lack of perfect competition (Galbraith, 1952, pp. 13–43). Krugman and Wells go further, pulling various noneconomic considerations into their three caveats to a market equilibrium leading to socially optimum results: an efficient equilibrium may not be fair, markets sometimes fail, and “even when the market equilibrium maximizes total surplus, this does not mean that it results in the best outcome for every individual consumer and producer” (2009, p. 109; emphasis in original). More broadly, many observers refer to the distorted incentives within modern capitalism itself. Robert Reich presciently referred 25 years ago to the disturbing trend toward “paper entrepreneurialism” (1983, pp. 140–172), “the bastard child of scientific management. . . . Its strategies involve the manipulation of rules and numbers that in principle represent real
assets and products but that in fact generate profits primarily by the cleverness
with which they are employed” (p. 141).

Related to this, the second problem with contemporary economics is that
equilibrium theory is applied without recognition of these limits (Finer, 1945;
Galbraith, 1973, pp. 11–50). Instead, Walras’s general market equilibrium is
reified. Consumer and producer surplus are identified as shaded areas in the
left quadrant of the “x” formed by the intersection of supply and demand
curves, and any deviation (especially as a result of public action!) from market
equilibrium is shown as reducing this surplus and so resulting in “deadweight
loss” (Krugman & Wells, 2009, pp. 180–182; Samuelson & Nordhaus, 1985,
pp. 431–432), in which “economic efficiency would be violated and ineffi-
ciency would result” (Gwartney, Stroup, & Sobel, 2000, pp. 75–76). Again,
the limits of market equilibrium, and the importance of noneconomic factors,
are ignored in these efficiency judgments.

A third problem with contemporary economic interpretations of the classics
is its perception of the state. Both Adam Smith’s eighteenth-century state and
the communist/fascist fears of the Austrian school no longer apply (Galbraith,
1952, p. 28), feverish fears of contemporary fringe groups notwithstanding.
As Galbraith put it, “Reacting vigorously to the numerous trade restraints of
the mercantilist era in which he lived, Smith left the English-speaking world
with the durable impression that the state is the natural threat to economic
life. So, indeed, was the erratically interventionist state of his time” (1994,
p. 199). Central to the minimal state advocacy of contemporary mainstream
economics has been an advocacy of low taxes. Galbraith notes that:

For aid to the rich—the large reduction in marginal tax rates in 1981—
the Reagan cover was a declared need to stimulate more energy, initia-
tive, and investment. Effort by the already well-endowed was being
inhibited because of the high marginal rates. It was held in the more
extreme formulation that the energy released by tax reduction would
lead to enhanced economic activity, increased public revenues, a reduced
public deficit. This was the service rendered by the celebrated Laffer
Curve, which held that beyond a certain point taxes reduced economic
activity, income, and tax return. It held further, on no empirical evidence,
that the United States had passed that point, [so] lower taxes now would
mean more revenue. (1994, p. 214; see also pp. 51 & 78)

It is worth noting that Galbraith refers to repeated instances of marginal tax
rates even in the United States of 90 percent, “yet this did not visibly reduce
the incentive to effort on the part of the relevant rich” (1994, p. 119).

Tax cuts have especially been advocated, which is consistent with the doc-
trine of supply-side economics and which, as Galbraith argues above, claims
that high taxes discourage enterprise and so cuts in the marginal tax rate can,
paradoxically, yield higher tax revenue. Yet this has been widely debunked,
from economists as diverse as Paul Krugman (Krugman & Wells, 2009, p. 177), Paul Samuelson (Samuelson & Nordhaus, 1985, pp. 736–738), and even minimal supply-siders William Niskanen (2006) and James Gwartney (2008). Gwartney is at best able to declare that economists are divided, yet he acknowledges that the Reagan cuts failed to yield the expected increase in gross tax receipts and so instead resulted in large deficits (Gwartney, Stroup, & Sobel, 2000, pp. 307–310). He also accepts that at marginal tax rates of 40 percent and lower, supply-side tax cuts will be ineffective (Gwartney, 2008), while Samuelson and Nordhaus put the point at which supply-side cuts might work at 70 percent (1985, p. 737).

The fourth and most important problem with contemporary economics, though, lies in what Amartya Sen referred to as the “over-Paretian world of present-day welfare economics” (1963, p. 778) and the rejection of the diminishing marginal utility of income. As indicated, Robbins argued that one could not compare preferences of different people. Yet, especially in the context of continued advocacy of cuts in public revenue in a period of large public deficits (i.e., insufficient revenue), as Niskanen put it: “the costs . . . will be borne by someone sometime in the future” (2006, p. 556). It therefore becomes hard to argue that an additional dollar in tax cuts to a wealthy person today is more valuable than that dollar would be to future generations. And so, we arrive at Harsanyi’s argument that “interpersonal comparisons of utility are not value judgments based on some ethical or political postulates but rather are factual propositions based on certain principles of inductive logic” (1955, pp. 319–320; see also Pigou, 1951, pp. 289–293). Radomysler went further, noting that in a non-Pareto optimal situation with winners and losers, even if compensation were paid to offset losses to the poor, but the benefits to the rich were far greater, the increased income inequality might contradict social values of fairness (1946, pp. 119–121).

Inequality therefore returns as one of the evident limitations of neoclassical economics. Inequality in the United States, for instance, dropped precipitously through the 1940s, held steady from the 1950s through 1970s, then has increased considerably since 1980 (Krugman & Wells, 2009, pp. 485–489; see also Samuelson and Nordhaus, 1985, p. 567). Beyond the ethical question of great inequality, which Samuelson and Nordhaus note is intolerable “as judged by various ethical systems (whether these be Christianity, Judaism, Islam, or secular humanism)” (1985, p. 488; see also Galbraith, 1958, p. 39), inequality has also come to be seen as bad for economic stability. Even Pigou, it should be noted, recognized that at some point, the taxes necessary for income redistribution “are likely in some measure to check effort, enterprise, and the development of capital equipment; and so indirectly to reduce potential real income” (1951, p. 301). But short of this point, as the rich have less urgent need to spend than do the poor, they are more likely to withdraw demand from the economy in the face of recessionary forces (Galbraith, 1952,
pp. 82–83), which also explains why tax cuts are less effective at stimulating demand than is direct government spending (Romer, 2009).

COGNITIVE POLITICS

The social imbalance that Galbraith identifies is especially evident in politics. This was inspired in part by Prime Minister Margaret Thatcher in the United Kingdom (de Paula, 2005, pp. 36–40) with her fears that as “the degree of intervention is greater, the government has become more and more remote from the people. The present result of the democratic process has therefore been an increasing authoritarianism” (Thatcher, 1968, para. 21; emphasis in original). President Reagan then followed this with his famous blanket condemnation of millions of public servants, from soldiers to teachers to social workers to fire fighters: “In this present crisis, government is not the solution to our problem; government is the problem” (inaugural address, 1981, para. 10).

What is often lacking in these discussions is the balance that Galbraith called for. This is not to reject what even Marx and Engels accepted was the “more massive and more colossal productive forces” (1992, p. 7) created by capitalism than by all other preceding history. Keynes, too, saw his somewhat comprehensive socialization of investment as “moderately conservative” (1936, p. 377) in its implications and identified a number of advantages of retaining a predominantly market-based economy (pp. 377–381; see also Heilbroner, 1972, p. 271). Reflecting a similar balance, Galbraith identified “the dark side” (1994, p. 103) of Keynesianism as the mounting debt resulting from borrowing during slumps, coupled with the civic irresponsibility and so political inability of raising taxes to run surpluses and pay down that debt in good times. Even Osborne and Gaebler, in their influential Reinventing Government, which heavily criticizes what they see as the traditional model of government by direct provision through a government agency, argue that those who advocate privatization “on ideological grounds—because they believe business is always superior to government—are selling the American people snake oil” (1992, p. 45). Hayek similarly conceded that “skilful timing of public works undertaken of a very large scale” (1944, p. 121) could be justified to ensure macroeconomic stability, Niskanen (2006) accepted the need for more taxes to pay down the legacy of Reagan and Bush debt, and Thatcher (1968) recognized that, for all the increased remoteness that she alleged, government was more honest than ever before.

This raises the question of why such antistate, implicitly laissez-faire attitudes remain so firmly entrenched? After all, even the conservative Cato Institute (2009) rates the United States one of the least regulated, least governed societies in the world. For Galbraith, the problem lies in cognitive politics. Despite the economic success of the post–World War II era, American business
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still stoked fears of socialism, statism, a police state, and other imagined ills (Galbraith, 1952, pp. 3–4). Beyond pecuniary motives of rent seeking, low taxes, and a permissive regulatory environment, under *laissez faire*, business reigned supreme, while in the Keynesian world business shared this prestige with government (pp. 82–83). Galbraith (1973, pp. 3–7) also argued that the economics profession had largely been captured by business interests. Similarly, Marshall Dimock (1990, p. 22) suggested that there has been a more or less conscious campaign among business leaders and conservatives to denigrate government, to reduce the likelihood that citizens would support government as an alternative to business, and especially to make government regulation of business less likely. As Krugman and Wells note,

On a number of issues powerful interests groups know what opinions they want to hear; they therefore have an incentive to find and promote economists who profess those opinions, giving these economists a prominence and visibility out of proportion to their support among their colleagues. (2009, p. 39)

The positive versus normative distinction in economics has especially been important in this. For Galbraith, the ostensible rejection of normativism (Lipsey, 1963, p. 4) served “to divorce economics from any judgment on the goods with which it was concerned. Any notion of necessary versus unnecessary or important as against unimportant goods was rigorously excluded from the subject” (Galbraith, 1958, p. 147). Northrup (2000), in an analysis of 19 introductory textbooks in economics, finds that while these texts typically present the positive-versus-normative distinction, the material that follows overwhelmingly presents a normative, *narrowly economic* view. The existence of extra-economic contributions to well-being may be recognized in the opening, the existence of market failures may be acknowledged, but the overall message is that, without these qualifications, market equilibrium produces socially optimal outcomes. Discussing the aftermath of the 1980s savings and loan debacle, Galbraith suggested

With time, the depressive effect of the real estate speculation, the banking troubles and the S&L disaster will come to an end. A new confidence leading on to the next episode of speculative euphoria will arrive. So it has been, so it will be. Thus does time work its therapy. (1994, pp. 230–231)

The therapy being worked by time is forgetfulness, and academic public administration has not helped remember these lessons of the past. Within public administration/policy, the original welfare economics tradition of Pigou has been lost. Smith and Larimer, for instance, equate welfare economics with methodological individualism and public choice (2009, pp. 107–112). Similarly, in a demonstration of truly Greenspanian poorly timed chutzpah, a
PA Times symposium in September 2007 posed and responded affirmatively to the question “Is [state-centered] public administration dead?”

As Galbraith noted, promarket economists have powerful backers in the business sector, just as private consumption is heavily advertised relative to public consumption. What the field of public administration might do is to reject the narrow economics that often is little more than a reflection of the values of the dominant economic interests in the community (Galbraith 1958, pp. 3–9). Rather than the neoclassical economics of the invisible hand of methodological individualism, market equilibrium, and consumer sovereignty, public administration should instead teach a public welfare economics of the visible hand of Pigou, Keynes, Krugman, and John Kenneth Galbraith.

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