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Retrospectives
The Economics of Leon Hirsch Keyserling

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This feature addresses the history of economic terms and ideas. The hope is to deepen the workaday dialogue of economists, while perhaps also casting new light on ongoing questions. If you have suggestions for future topics or authors, please write to Joseph Persky, c/o *Journal of Economic Perspectives,* Department of Economics (M/C 144), The University of Illinois at Chicago, Box 4348, Chicago, Illinois 60680.

Introduction

Leon Hirsch Keyserling (1908–1987) obtained a B.A. in economics from Columbia University (1928) and a law degree from Harvard (1931). Although he worked on a Ph.D. in economics at Columbia, absorbing the liberal economics tradition for several years under Rexford Guy Tugwell (1932, 1935), Keyserling never completed a Ph.D. As he often said in interviews, writing and lobbying for various housing acts and the Wagner Act of the 1930s, together with the Employment Act of 1946, along with many other publications and official activities, got in the way of completing his dissertation.

The list of Keyserling's activities is formidable. From 1933 to 1937, he was legislative assistant to Senator Robert Wagner (D, New York), whom he aided in drafting a $3.3 billion public works bill and the wage and collective bargaining sections of the National Industrial Recovery Act in 1934; portions of the Amendment to the National Housing Act (the Federal Housing Administration) in 1934–1935;

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portions of the Social Security Act and the National Labor Relations Act (Wagner act) in 1935; and the U.S. Housing Act in 1937. He also found time to do research on educational reforms at the Rockefeller Foundation in 1934, and to serve as a writer for the Democratic Platform Committee under Senator Wagner for the re-election of Franklin Roosevelt, and other related Congressional testimonies, bills and writings (Brazelton and Wehmeyer, 1989, p. 46). He then was acting administrator and general council to various housing agencies. He drafted the executive order creating the National Planning Agency (forerunner of the Department of Urban Development) in 1946, and helped to draft the General Housing Act of 1949. In 1978, he was draftsman for the Full Employment and Balanced Growth Act, also known as the Humphrey-Hawkins Act.

One of the bills that Keyserling was active in pushing for, the Employment Act of 1946, turned out to be central in bringing him to the attention of the economics profession. That bill created the Council of Economic Advisers (CEA) in the White House and established that the federal government had a role to play in the maintenance of high employment and price stability. Keyserling was appointed to the original CEA by President Harry Truman in August 1946, and after the resignation of the first chairman Edwin Nourse, who took the behind-the-scenes role of the CEA so seriously that he refused to testify before Congress (Gates, 1968; Stein, 1996, p. 8), Keyserling became the second chairman of the CEA in May 1950 (Stein, p. 5). He served as chair until Truman left office in January 1953. He remained active in public policy circles, especially as the author of 36 booklets for the Conference on Economic Progress (a privately funded "think tank" that published studies related to Keyserling's views) and in his numerous testimonies before Congressional Committees—from 1953 until 1983.[1] Keyserling died in 1987.

Keyserling's economic views remain interesting today. Keyserling gave the Truman administration its "economic philosophy" of the Fair Deal, as Alonzo Hamby (1973, p. 295), a biographer of Truman, has pointed out. Clark Clifford (1993, p. 85), who was in Truman's inner circle of advisors, referred to Keyserling (a fellow member of the influential "Monday Night Group" which met in an apartment in the Wardman Park Hotel), as the "intellectual of our circle, a respected but refreshingly controversial economist." Keyserling helped to create and shape the CEA, one of the primary institutions through which the economics profession has influenced economic policy. His period of highest political influence occurred at a fascinating time for the economics profession, with the confluence of events like

[1] The Conference on Economic Progress was a foundation based in Washington, D.C., and funded by private contributors. Many of Keyserling's works for the conference were done with the assistance of his wife, Mary Dublin Keyserling, an economist in her own right (Brazelton and Wehmeyer, 1989; Wehmeyer, 1996), who had served as Executive Director of the National Consumer's League, and later, as an assistant to Eleanor Roosevelt and the Office of Civil Defense, and the Foreign Economics Administration of the Department of Commerce. After the Truman era, she served as a director of the Department of Labor's Women's Bureau during the Johnson years, and later, with the National Consumer's League. Most of the works of Leon Keyserling and some of Mary Keyserling can be found at the Truman Memorial Library, Independence, Missouri.

the Depression and World War II coming together with the new Keynesian thinking. Keyserling is a particularly vivid example of how one person combined an academic background with a non-academician's emphasis upon pragmatism. Finally, it is fascinating to consider the contrast between Keyserling's views on economic growth, countercyclical macroeconomic policy, and government economic policy in the 1946–53 period and the conventional wisdom of the 1980s and 1990s.

Keyserling's Economic Policies

As one would expect of someone coming to maturity during the Depression, Keyserling's greatest concern was continued economic growth. As one would expect of someone with academic training in economics at this time, he drew upon growth theorists who were active during the 1940s such as Evsey Domar and Roy Harrod, and he of course drew upon the then-recent insights of John Maynard Keynes. Keyserling felt strongly that continual economic growth should be emphasized as a chief policy goal, since he saw growth and social welfare and equity as tied together. Keyserling was a believer, despite the grim experience of the 1930s, that the potential of the American economy was unlimited, and that with proper combination of countercyclical and long-term economic policy, economic growth could produce and maintain abundance for all (Hamby, 1973, p. 301; Stein, 1996, p. 14).

The Triangle Economy

In thinking about growth policy, Keyserling at times looked upon the economy as a triangle with three sides: consumption, investment, and government. As the economy expanded, he believed that all three sides must grow in proportion and that the goal of economic policy was to aid in this proportionate growth when necessary. The idea of proportionate growth between C, I, and G is not a new or radical concept in economics. As a matter of observation, it has often been noted that the ratio of C, I and G changed little over the longer term, and that short-term fluctuations in these variables were often associated with recession. In addition, growth models of the time like those of Domar and Harrod pictured the economy as expanding in this proportional way, with various interplays between the different sectors.

The argument that the various sectors of the economy must grow in relation to one another led in turn to thinking about the issues and tools of economic policy. For example, trends in collective bargaining could affect wages, prices and profits. Tax changes and the resultant deficit and the manner in which the debt is managed would influence C, I and G and their growth rates in relation to one another (Brazelton and Wehmeyer, 1989, p. 209). In Keyserling's view, consumption demand comes (primarily) from real wages (Keyserling, 1957, 1958a, 1964b, p. 91f; 1983, p. 18); funds for investment come from current profits; and government spending is determined by the political system. Thus, specific public policies to affect wages, profits and government spending could be helpful for keeping the sides of the economy in proportion to one another.

To the modern eye, the triangle approach raises a number of immediate questions. For example, why doesn't the triangle have a side to represent the foreign sector of the economy? Keyserling in the late 1940s and early 1950s could worry less about U.S. exports than do economists today; not only was trade a smaller share of the U.S. and world economies, but the United States was the world's unchallenged export power after having escaped the devastation of World War II. If Keyserling had had to worry about the trade balance, he might well have devoted more time to the problem of stimulating exports as well.

At a more general level, how does one know the ideal proportions of such a triangle economy? Might these proportions change over time? Without answering these questions, how can one know whether there is a problem, or what policy will best address the problem? Keyserling recognized that the shape of the triangle would change over the business cycle and might change over the long-term, as well. But as a pragmatic policymaker rather than a theorist, he was more interested in using the triangle as a trigger for economic policy than in justifying it in theoretical terms.

There is also some evidence that among the three interdependent sides of the triangle, Keyserling saw consumption as the most important; not only as valuable in itself, but as leading to the business profits which in turn generated investment. An underlying implication here (to which we will return), is that investment is determined by consumption levels, rather than by the amount of loanable funds. To put it another way, it is consumption and its maintenance through sustained growth in real wages that is most important to Keyserling, not profit rates by themselves (Keyserling, 1987; Brazelton and Wehmeyer, 1989, p. 213). This philosophy also led Keyserling to put a policy stress on fiscal policy (taxes, expenditures, disposable income) rather than upon monetary policy, although he always believed in the desirability of low interest rates.

Key Microeconomic Sectors

To Keyserling, the balance between consumption, investment and government was a necessary condition for growth, but not a sufficient condition. His view of the determinants of growth also identified the possibility that certain microeconomic sectors might be in short or excess supply in relation to the rest of the macroeconomy. For example, if steel were in short supply in terms of growth needs, then steel profits must be allowed to increase so as to increase the supply of steel, and public policy might help accomplish this goal via selective monetary and fiscal policy tools, as discussed below in terms of housing.

Indeed, in the years after World War II, housing was also seen as a key sector; not only for its own sake, but because of the complementary goods such as furnishings and the resulting employment (and wages) that would help to maintain a high consumption, high growth economy (Keyserling, 1972). Also, of course, housing was a labor intensive industry whose expansion would increase the demand for labor, capital, and infrastructure such as highways. Thus, it was a perfect selective vehicle to encourage growth, especially in a recession. In terms of fiscal policy, government expenditures could be directed selectively towards housing. In terms of monetary policy, selective low interest rates could stimulate consumers' demand for housing and housing loans, along with action by the Federal Housing Administration and Veterans Administration loan systems.

Business cycles will occur, whether from endogenous or exogenous causes. For our purposes, let us separate the business cycle into two parts: the contraction and the inflation. It has been obvious to most economists since Keynes that a contraction can be due to inadequate demand and that expansionary fiscal and monetary policies can be a useful policy response. Keyserling agreed, although he would have emphasized that the mechanism through which this policy occurred best and most equitably was a boost in consumption that then stimulated profits and investment.

However, Keyserling's views on inflation were more unorthodox. The typical aim of anti-inflationary policy is to decrease demand because inflation is viewed by many as too much money chasing too few goods. However, Keyserling (1980) viewed such tightening—say, through higher interest rates—as counterproductive, for several reasons. Higher interest rates raise the cost of capital, which will reduce profits or be passed on to the consumer. Also, as the tight money policy decreases output, many individual firms will end up producing at less than the efficient scale of production, so that the average cost of production rises, which again will reduce profits or be passed along to the consumer. Thus, anti-inflationary policy increases per unit cost, putting an upward bias on prices, especially as the real world is not one of competitive markets, but rather, one of administered pricing (Keyserling, 1973; 1975; 1979; 1980). Moreover, increasing unemployment to control inflation is hardly a way to maintain equity and to maximize social welfare.

Instead, Keyserling (1964a, p. 86f) proposed using selective credit controls or interest rates to combat inflation. These selective measures would aim at holding back sectors of the economy that were expanding too rapidly, but also at stimulating areas of the economy that were lagging. The second may appear counterintuitive, but these policies are based upon Keyserling's belief that shortages, administered prices, and the slow growth of output are the main causes of inflation, not excess demand per se (Brazelton and Wehmeyer, 1989, p. 235; Keyserling, 1964a; 1973; 1975; 1979; 1980).

This anti-inflationary policy may sound radical. But such eminent economists as James Tobin (1986) have also pointed out that high interest rates increase business costs, increase the costs of the public deficit (and debt), increase unemployment, decrease present output, and discourage long-term growth. For Tobin (p. 6), a more realistic anti-inflationary policy would call for "annual economy-wide guideposts for wages and prices, with compliance induced by tax based rewards and penalties. . . ." In the same spirit, Keyserling also called at times for voluntary wage/price guidelines (Brazelton and Wehmeyer, 1989, pp. 215–219).

Truman's biographer Alonzo Hamby (1973, p. 301) described Keyserling's beliefs on anti-inflationary policy in this way:

> Economic policy should concentrate less on prices as such and more on the relationship between wages, prices and profits; it should work for the optimum balance between consumer purchasing power and corporate income in order to maintain full employment and expansion. The New Dealers, he believed, had turned too frequently towards controls to fight inflation. Selective controls might be necessary at times, but the way to deal with inflation was to enlarge productive capacity to meet demand. Fundamentally, . . . Keyserling was willing to trade a mild inflation for growth. Such an alternative was greatly preferable to the achievement of price stability via a "downward correction" or recession. Higher unemployment and lower production solved few problems and worsened many more. "The idea that we can protect production and employment by reducing them 'a little bit' is about as safe as the ancient remedy of blood-letting."

Monetary Policy

Keyserling believed in fiscal policy more than in monetary policy, but realized the effectiveness of both depending upon the circumstances. In his view, monetary policy should therefore be based upon growth considerations, which meant keeping interest rates low to encourage consumer spending and investment.

In the period 1946–52, the Federal Reserve kept interest rates low by agreeing to buy government bonds at the prevailing rate of interest, thus providing extra liquidity to the markets whenever interest rates went above the desired level. This policy led to sizeable increases in the money supply, but few economists were concerned. After all, the economy was also growing rapidly, and at least prior to the Korean War, without much inflation. Moreover, many economists were fearful after World War II that the U.S. economy would return to the Depression.[2] However, after the beginning of the Korean conflict, and subsequent emergence of inflation, the Federal Reserve reached an "Accord" with the Treasury no longer to peg interest rates on government bonds, and thus to let interest rates rise as an anti-inflationary measure. To Keyserling, this was an error for all the reasons described earlier: it decreased investment, current output, and future growth potential; it increased per unit costs; and it penalized all sectors when only some were inflationary. Keyserling once told me that the Accord was one of our greatest policy mistakes. However, Keyserling was not in favor of expanding the money supply or the budget deficit without limit as a tool for expanding the economy; for example, he was critical of such increases in the money as in the Weimar Republic and such increases in the deficits as in the 1980s in the United States (Keyserling, 1964b, 1978; 1980; Brazelton and Wehmeyer, 1989, p. 315).

Agricultural Income Supports

Throughout this century, farm output has generally soared, while farm incomes have often struggled. Agricultural policies since the 1920s have addressed

[2] For example, see Colander and Landreth (1996) for Paul Samuelson's expression of such beliefs at this time.

the problem of farm income by legislating ways of keeping farm prices at a higher-than-market "parity" price level. This price parity policy has been maintained up to the present, although in the mid-1990s, there has been some action in Congress to alter the program.[3] As Keyserling (1958c, p. 3; see also Brazelton and Wehmeyer, 1989, p. 142) pointed out, the higher prices led to overproduction, which in turn led to greater downward pressure on farm incomes.

Keyserling accepted the view that farmers were competitive sellers facing oligopolists on the buyers' side of the market, and thus at a competitive disadvantage. However, the appropriate solution was not to decrease competition between farmers with assured prices, but instead to subsidize the incomes of farmers. A similar plan was suggested by President Truman's Secretary of Agriculture Charles Brannon (Keyserling, 1955b, 1957, p. 1, 1965; Brazelton and Wehmeyer, 1989, p. 142). In Brannon's formulation, the farm family would receive income from their production of goods at market prices. Any difference between the income so generated and the level of a decent income related to the farm would be made up through an income subsidy. The market price would be free to fall, so the consumer would pay the lower market price, not the higher (as now) parity price. Keyserling (1958c, p. 5; see also Brazelton and Wehmeyer, p. 143) wrote of a program with "income goals for farm families, designed to reward appropriate production adjustments with a level of farm income and living standards moving gradually toward parity with that of other Americans." Of course, the question of how to assure income support without reducing incentives for efficiency gains remains a difficult one. Indeed, this was an important reason for the defeat of the Brannon plan; even some liberal and powerful Democrats such as Mike Monroney (D, Oklahoma) believed it to be socialistic, and others, such as Senator Albert Gore, Sr. (D, Tennessee), had introduced a price support system as an alternative (Creel and Burke, 1997, pp. 29, 87). The Gore alternative won.

Conclusion

From the perspective of the late 1990s, Keyserling's economics is a mix of the intriguing and the controversial. It may sound odd to modern ears that he talks about growth without much emphasis on technology and education. Targeting key sectors of the economy is out of fashion today; even if selective credit controls might have worked in the 1940s, one wonders how they would work in the modern financial world which permits nearly instantaneous arbitrage. Although a capitalist and a believer in America's economic potential, Keyserling had an underlying suspicion of market forces common to Depression-era policy makers. Thus, Keyserling

[3] It may be worth noting that the United Kingdom followed an income support program in agriculture until they were forced to abandon it and adopt a price parity program when they joined the European Union. Food prices in the United Kingdom subsequently rose.

(1966b; 1977; 1978; Hamby, 1973, p. 300) would develop a National Priority Budget for full employment, which included fiscal and monetary policy and also guidelines as to wages and prices and incentives or disincentives for various sectors. He saw such planning as essential for maintaining the needed proportionate long-term growth rates. Today, even among economists who believe that markets are often far from being perfectly competitive because of imperfect information and other issues, there is little support for the idea that a systematic federal economic plan would improve the growth prospects of the economy.

However, even more market-oriented economists of today would generally applaud Keyserling's arguments for a policy focus on farm income rather than farm prices, and admit that there is some truth in the view that the federal government has a role to play in stimulating the economy in times of recession. Perhaps the greatest controversy over Keyserling's views today is in the area of using monetary policy for fighting inflation. Surely there is some truth in the view that even countercyclical policy should be designed to maximize output and welfare in the long term. Even if selective credit and interest rate incentives may not be a workable solution, might not modern economists usefully consider whether there are policy tools that might hinder inflation while causing less injury to the entire economy than an across-the-board rise in interest rates? Also, might there be a role for antirecessionary fiscal policy to subsidize, say, mass transit through either expenditures or tax incentives as a replacement for the policies of previous decades that supported a full employment economy by aiding housing and highways? These are the sorts of questions that Keyserling would be asking today.

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