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ECONOMICS AND ECONOMIC POLICY

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Economics and Economic Policy*

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* Contribution to Report of the International Panel on Social Progress

1. Introduction: Two Axes

The emergence of economics as a self-standing discipline relatively independent of moral philosophy is commonly dated at the publication of Adam Smith's *Wealth of Nations* in 1776. In this founding tract, and in the subsequent quarter millennium of disciplinary discourse, economics has rarely been far from policy making. Economic frameworks have influenced economic policy making in the general and in the specific. In return, emerging policy dilemmas have shaped the discipline of the time and thus its analysis and prescriptions for future economic policy. It is this interplay between the discipline and the policy arena which this contribution attempts to explore. The exploration can be very limited given the space constraint and vast terrain to be covered, over 250 years of experience. The approach here is to illustrate the interaction through a small number of key issues and players over this period.

There are two fundamental questions which run right through this two and a half centuries of economics and economic policy. First, what is the appropriate way to capture the workings of the economy, at the micro and at the macro level? Second, what is the appropriate way to evaluate economic outcomes? Among the issues raised by the first are how best to describe the economic behavior of individuals and groups of individuals, and how best to describe the workings of economic markets. Among the issues raised by the second are the tradeoff between total national income (or its growth) and its distribution among individuals and classes, and indeed whether economic policy making should take into account non-economic outcomes in its design and assessment. These issues and their close cousins, will be seen to be present in the writings of great economists as they grapple with the relevance of their discipline for economic policy.

2. Adam Smith, The Corn Laws, and The Compensation Principle

To begin at the beginning:

“As every individual, therefore, endeavours....to direct that industry that its produce may be of the greatest value, every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it.....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.” (Adam Smith, *The Wealth of Nations*, Book IV, Chapter II, paragraph IX).

This paragraph, much quoted, much admired, and much reviled, captures the essence of the core of a particular line of economic argument. Individuals, acting in markets with free competition and no economic power, will in an uncoordinated fashion promote “the public interest”, which from the context and its economic setting in effect means the general economic wellbeing, or the “size of the economic pie.” It took two centuries for economists to refine and make precise this proposition, setting out the conditions under which it holds, now referred to in standard text books as “The Fundamental Theorems of Welfare Economics.”

But these very theorems, because they set out the conditions under which the proposition holds, also highlight its limited direct applicability in the real world. Nobel prizes in the modern

era have been awarded to economists such as Joseph Stiglitz (2002a) for advancing understanding of a world in which these conditions, of a free market, full information, and so on, are not met. But, despite this, the invisible hand metaphor continues to frame the instincts of economic policy makers, at least those who have been schooled in economics as a discipline.

The invisible hand proposition also holds in abeyance the distributional question—who gains or who loses from economic policy? Here policy makers have always been ahead of economists since they cannot afford to ignore distributional outcomes in the political arena. As a result, economists have struggled mightily to square the distributional circle. In the great Corn Laws debate of the 1830s and 1840s, those in favor of the repeal of tariffs on the import of corn certainly appealed to the invisible hand proposition. The Economist magazine was founded in 1843 to make the case for removing this interference in the market mechanism. But at its heart the issue was one of distribution. The Corn Laws benefited the landed classes, which the Anti-Corn Law League described as a "bread-taxing oligarchy, unprincipled, unfeeling, rapacious and plundering" (Briggs, 1959, p. 314).

But how can economics, if it is to be value free, address distributional questions? How can it weigh the gains of one individual or one group of individuals against the losses of another? The "Pareto principle" according to which economists can pronounce an improvement only if no one has been harmed and at least one person has benefited, is a recipe for policy impotence since most policy changes (for example the repeal of the Corn Laws), would surely entail winners and losers. In the 1930s a series of debates between the giants of that time—Robbins (1932, 1938), Kaldor (1939), Harrod (1938) and others—tried to resolve this through the "compensation principle", which states that a policy change can be pronounced an improvement if the gainers *could* compensate the losers and still have some surplus left over. But no actual payment was required by this principle, which therefore embodied a value judgement that gave distribution no weight whatsoever. It took the post-war work of Atkinson (1971), Sen (1973) and others to establish that distributional value judgements will always be involved in economic policy making, and it is best to be explicit about these.

3. Keynes, Laissez Faire, and the Treasury View

With the repeal of the Corn Laws, economic policy in Britain and perhaps in Europe settled into a long period of laissez faire liberalism where the core of economic analysis was governed by a framework of markets in which no agent held economic power, and economic policy matched this analytical construct. The dominant text of the latter part of this period was Alfred Marshall's *Principles of Economics*, first published in 1890. The Royal Economic Society was also founded in 1890, the American Economic Association in 1885, and Marshall succeeded, against considerable opposition, in founding a separate degree in economics at the University of Cambridge in 1903. Before this date, however, the young John Maynard Keynes, admitted to Cambridge to study mathematics, had been introduced by Marshall to economics through his text *Principles of Economics*.

It is perhaps ironic, then, that it was Marshall's student Keynes who issued in 1926, two years after the death of Alfred Marshall, a clarion call against laissez faire liberalism, the

dominant economic and economic policy anchor of its time. In his brilliant essay, *The End of Laissez Faire*, he excoriated the foundations of the doctrine:

“Let us clear from the ground the metaphysical or general principles upon which, from time to time, *laissez-faire* has been founded. It is *not* true that individuals possess a prescriptive ‘natural liberty’ in their economic activities. There is *no* ‘compact’ conferring perpetual rights on those who Have or on those who Acquire. The world is *not* so governed from above that private and social interest always coincide. It is *not* so managed here below that in practice they coincide. It is *not* a correct deduction from the principles of economics that enlightened self-interest always operates in the public interest. Nor is it true that self-interest generally *is* enlightened; more often individuals acting separately to promote their own ends are too ignorant or too weak to attain even these. Experience does *not* show that individuals, when they make up a social unit, are always less clear sighted than when they act separately.”*

The above was of course only one salvo in Keynes’s long battle against economic orthodoxy which he waged throughout the 1920s and the 1930s. This included his critique of monetary orthodoxy which took Britain back to the Gold Standard in 1925, a critique passionately argued in *The Economic Consequences of Mr. Churchill*, against then Chancellor of the Exchequer Winston Churchill. As the 1930s wore on and unemployment climbed dramatically, Keynes railed against the so called “Treasury View”, stated by the then Chancellor of the Exchequer Winston Churchill in his 1929 budget speech as follows:

“The orthodox Treasury view ... is that when the Government borrow[s] in the money market it becomes a new competitor with industry and engrosses to itself resources which would otherwise have been employed by private enterprise, and in the process raises the rent of money to all who have need of it.”

This proclamation of the impotence of fiscal policy in the face of massively underused labor and capital was the policy spur for Keynes (1936) to develop the arguments crystallized in his *General Theory of Employment, Interest and Money*, ushering in, analytically at least, the era of Keynesian economics.

And yet, for Keynes the object was not to destroy markets and capitalism, but to save them from themselves. The easy association of Keynes with policy interventionism belies his conservatism once what he saw as the major market failures were addressed by government policy:

“We cannot therefore settle on abstract grounds, but must handle on its merits in detail what Burke termed ‘one of the finest problems in legislation, namely, 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.’.....Perhaps the chief task of economists at this hour is to distinguish afresh the *Agenda* of government from the *Non Agenda*....“The important thing for government is not to do things which individuals are doing already, and to do them a little better or a little worse; but to do those things which at present are not done at all.”†

* Keynes (1926, pp 287-288).

† Keynes (1926, pp. 287-291)

This tension between fixing market failures one by one, or questioning the market system wholesale, is one which runs through economics as it interacts with economic policy.

4. The Post-War Consensus in Macroeconomics and Its Breakdown

The “Keynesian Revolution” is perhaps an apt description for the change in economics and in economic policy, especially in the domain of macroeconomics, from the mid-1930s onwards. Young economists of the time took up Keynesianism with great fervor, including Paul Samuelson in the USA, whose best-selling text book *Economics* spread the vision to a generation of students the world over. The basic economic models taught in Universities were those of Keynes and his followers, and the basic economic policies pursued by post-war governments were also Keynesian, using fiscal policy to regulate the economy, and especially to keep unemployment low. Right through the 1960s and into the 1970s, these models and these policies ruled the roost.

An iconic analytical construct of this time with enormous policy impact was the “Phillips curve”, named after A. W. Phillips, an academic economist who posited and estimated an empirical relationship between the rate of unemployment and the rate of inflation. The lower the rate of unemployment, the higher the rate of inflation (Phillips, 1958). Economic analysis thus seemed to have quantified a key tradeoff for economic policy makers. Given their preferences between unemployment and inflation, they could locate themselves as they wished along the “Phillips curve.”

However, as the long post war boom came to an end with the OPEC driven oil price increases of the mid 1970s, the empirical foundations of the Phillips curve were beginning to be questioned. It came to be argued, a quarter century after the end of the war and the triumph of Keynesian doctrine, that in the macroeconomic arena there was in fact no stable Phillips curve, and a little less unemployment could not be purchased at the cost of a little more inflation—the cornerstone of post war Keynesian economic policy making. In fact, it was argued, each economy had a “natural rate of unemployment” given to it by the workings of the market system, and attempts to lower unemployment below this could only lead to ever accelerating higher rates of inflation. As famously stated by Milton Friedman in his Presidential Address to the American Economic Association:

“At any moment of time, there is some level of unemployment which has the property that it is consistent with equilibrium in the structure of real wages ... The ‘natural rate of unemployment’ ... is the level that would be ground out by the.....system of general equilibrium equations.....” (Friedman, 1968, p.8).

Friedman of course went on to win the Nobel Prize in economics, in 1976. This shift in economic theorizing coincided with a corresponding move away from an interventionist stance in economic policy making, in macroeconomics and as well as at the micro and structural level in terms of the operation of markets. In the “Reagan-Thatcher-Kohl” years of the 1980s there was a decided shift towards free market orthodoxy of the laissez faire era, which Keynes had railed against in the 1920s and 1930s. But in the post war years this long running battle between

laissez faire and interventionism also played out in developing countries. We now turn to this story, told through the eyes of a giant of development economics, W. Arthur Lewis.

5. W. Arthur Lewis, Economics and Economic Development Policy

W. Arthur Lewis, who won the Nobel Prize in economics in 1979, was born on the British West Indies island of St. Lucia in 1915, and studied economics at the London School of Economics. Lewis imbibed the economics of Keynes in the 1930s, despite being a student and then teacher at the London School of Economics, where laissez faire liberalism had a stronghold with the presence of the likes of Lionel Robbins and Friedrich Hayek. He also participated in the decolonization debates of the 1930s as a student, and then joined the Colonial Economic Advisory Committee of the British Colonial Office as the 1930s and 1940s turned to the decolonizing 1950s and 1960s. In the 1950s Lewis became deeply involved in economic policy making in Ghana, the first independent nation in black Africa, as economic adviser to Ghana's charismatic leader Kwame Nkrumah. How did this coming together of economic analysis and economic policy work out?

Arthur Lewis received an invitation to advise the soon to be independent nation of Ghana in 1952, when it was still the colony of the Gold Coast, and he was asked to write a report on industrialization. At that time Lewis was developing his famous theory of "economic development with unlimited supplies of labor" (Lewis, 1954), for which he would win the Nobel Prize in economics in 1979. His framing was with reference to the development of countries like India and Egypt. He characterized these countries as having surplus labor in agriculture and traditional activities, so that the path to growth was through industrialization, which would draw on the pool of labor. To the extent that this industrialization was being held back by failures of the market, Lewis advocated intervention and government support to build up manufacturing, true to his skeptical position on laissez faire.

With this background, the radical policy interventionists in Ghana were expecting support from the eminent economist Lewis for their plans for government subsidized manufacturing. However, Lewis disappointed them (much as he "pleasantly surprised" administrators at the Colonial Office). His analysis of the situation was that in Africa, unlike in Asia, there was labor shortage not labor surplus. The constraint to growth and development was not manufacturing growth but low agricultural productivity. The focus on market failures should thus be in agriculture and not in manufacturing: "Number one priority is therefore a concentrated attack on the system of growing food in the Gold Coast, so as to set in motion an ever increasing productivity..." (Lewis, 1953, paragraph number 253). This line of reasoning continued into Lewis's period as resident economic adviser in Ghana during 1957-1958, and eventually led to a break with Kwame Nkrumah.

The break itself came over the Five Year Plan, in which Lewis felt that many "white elephant projects" were being promoted for political reasons: "Alas, the main reason for this lack of balance is that the plan contains too many schemes on which the Prime Minister is insisting for "political reasons." (Lewis, quoted in Tignor, 2006, p. 167). Nkrumah, who is famously reported to have said "seek ye the political kingdom first", responded as might be expected. He emphasized "political decisions which I consider I must take. The advice you have given me,

sound though it may be, is essentially from the economic point of view, and I have told you, on many occasions, that I cannot always follow this advice as I am a politician and must gamble on the future." (Quoted in Tignor, 2006, p. 173). This gulf between "sound" economic advice and the political reality of economic policy making continued to be a theme in Lewis's later writings even after he had left Ghana and returned to the safety of academic economics at Princeton University (Lewis, 1965). But Lewis's careful, market by market analysis of market failure highlights a strand in policy analysis carried out by economists which does not always sit well with policy makers or social theorists looking for "big" answers to "big" policy problems (Kanbur, 2016b).

6. The Washington Consensus and The End of History

The balance between state intervention and market orientation, which Edmund Burke referred to as "one of the finest problems in legislation" and which Arthur Lewis attempted to walk the tight rope on in his economic advisory work, reflects in many ways the pendulum swings that have taken place in development economics policy and in economic policy more generally. The laissez faire liberalism of the late 19th and early twentieth century gave way to Keynesian interventionism in the 1940s and 1950s, and this transition was reflected in policy making in developing countries as well, as shown in Kwame Nkrumah's predilection for government subsidized efforts at industrialization.

This tendency was equally clear in the trajectory of the Indian Five Year Plans (Kanbur, 2008). In the 1950s these plans bore resemblance to central planning models of the type used to manage the economy of the Soviet Union, a system which enjoyed great prestige as a counter to the high unemployment of the 1930s under capitalism, and the (seemingly) high growth enjoyed by the Soviet Union in the immediate post-war period. The Indian Third Five Year Plan also introduced distributional goals. The plans into the 1960s and 1970s were all supportive of industrialization through import substitution, in keeping with the orthodoxy of the time that the development of manufacturing needed government intervention and subsidy, and protection from international competition.

However, by the 1970s and 1980s doubts had set in about this "inward oriented" strategy. The seeds of questioning are to be found, for example, in the Oxford economics doctoral thesis of Manmohan Singh, later Finance Minister and Prime Minister of India (Singh, 1964), and in Bhagwati (1970). In terms of economic outcomes, the anemic growth of India, and disappointing performance in poverty reduction, contrasted with the spectacular growth and poverty reduction in the "East Asian tigers" which had followed a more outward oriented strategy. Despite debate at the time, and ongoing debate, on exactly how "free market" these policies were, there is no question that this comparison had an effect (Kanbur, 2008). In 1991, following a financial crisis, India moved to more liberal internal and external economic policy orientation under the leadership of then Finance Minister Manmohan Singh.

Of course this move in India came at a momentous time in global politics and at the time of crystallization of certain tendencies in thinking. The "Reagan-Thatcher-Kohl" decade ended with the fall of the Berlin Wall in 1989. In the same year, John Williamson (1989) coined the term "The Washington Consensus" which came to capture a neo-liberal economic stance in

policy making, and Francis Fukuyama (1989) proclaimed "The End of History." The latter, in particular, argued that: "What we may be witnessing is not just the end of the Cold War, or the passing of a particular period of post-war history, but the end of history as such: that is, the end point of mankind's ideological evolution and the universalization of Western liberal democracy as the final form of human government."

As we now know, "The end of history lasted for such a short time" (Kanbur, 2001). Fukuyama (2014) has himself reconsidered the finality of his proclamation in the political realm. On the Washington Consensus, Williamson (2002) commented on how his term had been (mis) used: "I of course never intended my term to imply policies like capital account liberalization (...I quite consciously excluded that), monetarism, supply-side economics, or a minimal state (getting the state out of welfare provision and income redistribution), which I think of as the quintessentially neoliberal ideas." In any event, the economic liberalizations of the 1980s and 1990s either had mixed results (for example the "lost decade" of low economic growth in Latin America and Africa) or, when there was success (for example in China), there is debate about how true economic policies were in these countries to laissez faire liberalism. Further, the sharp rise in inequality in many countries (Kanbur, 2014) raised the question of the connection between liberalization and the inclusivity of economic growth.

Thus, even before the financial crisis of 2008, the swing towards laissez faire liberalism in development economics and development economic policy had abated. The Growth Commission, which reported just before the crisis, captured this movement. The Commission, chaired by Nobel Prize winner Michael Spence, had leading economists and leading economic policy makers as members. The Report of the Commission (Commission on Growth and Development, 2008, p.4) reflected well a balanced view on the debates of the previous two decades:

"In recent decades governments were advised to "stabilize, privatize and liberalize." There is merit in what lies behind this injunction-governments should not try to do too much, replacing markets or closing the economy off from the rest of the world. But we believe this prescription defines the role of government too narrowly. Just because governments are sometimes clumsy and sometimes errant, does not mean they should be written out of the script. On the contrary, as the economy grows and develops, active, pragmatic governments have crucial roles to play."

But then the financial crisis struck and the economics of laissez faire liberalism was questioned even further.

7. Economics and the Financial Crisis of 2008

A decade before the great financial crisis of 2008 there was the Asian financial crisis of 1997, which was argued by many to be the culmination of the previous decade of liberalization of capital controls. Those debates have now receded into history, but they pitted proponents of setting markets free in cross-border capital flows against those who warned that such liberalization would lead to instability and crisis. A leading example of the critics is Joseph Stiglitz, who sees a direct link between his Nobel prize winning research in the operation of

markets with imperfect information (Stiglitz, 2002a), and a range of policy issues including capital controls (Stiglitz, 2002b).

But it seemed that the lessons of the crisis of 1997 were never learnt, or slowly forgotten, as the financial boom of the early 2000s took hold, driven by the development of financial derivative instruments which had themselves been incentivized by the long march of deregulation of financial markets in the 1980s, 1990s and 2000s. The development of the infamous “sub-prime” mortgage instruments, and their bundling and hiding into ever more complex financial products, eventually came unstuck and precipitated the deepest financial crisis since the Great Depression of the 1930s. Economic analysis was implicated in the development of the crisis and the policy responses to it.

Famously, the Queen of Great Britain asked economists why nobody had seen the crisis coming, and the British Academy (2009) responded with a letter drafted by Timothy Besley and Peter Hennessy, which concluded as follows:

“So where was the problem? Everyone seemed to be doing their own job properly on its own merit. And according to standard measures of success, they were often doing it well. The failure was to see how collectively this added up to a series of interconnected imbalances over which no single authority had jurisdiction. This, combined with the psychology of herding and the mantra of financial and policy gurus, lead to a dangerous recipe. Individual risks may rightly have been viewed as small, but the risk to the system as a whole was vast.....So in summary, Your Majesty, the failure to foresee the timing, extent and severity of the crisis and to head it off, while it had many causes, was principally a failure of the collective imagination of many bright people, both in this country and internationally, to understand the risks to the system as a whole.” It is interesting to note the ancestry of this assessment, in Keynes’s indictment of laissez faire quoted earlier: “It is *not* a correct deduction from the principles of economics that enlightened self-interest always operates in the public interest.....Experience does *not* show that individuals, when they make up a social unit, are always less clear sighted than when they act separately.”[‡]

The response to the crisis reignited many of the debates of the 1930s on the use of monetary policy and fiscal policy. The Chairman of the United States Federal Reserve Board, Benjamin Bernanke, is a renowned scholar of the Great Depression, and used the monetary policy instruments at his disposal to shore up the economy, as did central banks around the world (Bernanke, 2015). But the failures came on the side of fiscal policy, where a modern version of the “Treasury View” that Keynes railed against seemed to prevail. Fears of the consequences of a high level of public debt (for example, Reinhart and Rogoff, 2011) were set against the Keynesian instinct to expand public expenditure at times of severe unemployment of labor and capital (for example, Krugman, 2013).

It is fair to say that the “Treasury View” won in the fiscal battle, leaving a more depressed global economy for longer than necessary. The long recession has led to theses of secular stagnation (Teulings and Baldwin, 2014), with proposals for addressing, among other imbalances, the market failures which are leading to mismatches between large savings, especially in Asia, and great infrastructure needs the world over (Spence, Leipziger, Manyika

[‡] Keynes (1926, pp 287-288).

and Kanbur, 2015). The debate continues, and the interactions between economic analysis and economic policy remain as involved and as intricate as ever.

8. Rising Inequality: Economic Analysis and Policy Concerns

As argued at the start of this essay, distributional concerns have always been present in economics as a discipline, although the strength of those concerns have of course waxed and waned over the quarter millennium of its relative independence from moral philosophy. Policy concerns about distribution have brought forth theorizing and analysis in the discipline, as was the case, for example, at the time of the great Corn Laws debates of the nineteenth century. The first decades of the twenty first century have equally seen a remarkable resurgence of analysis and policy concern about rising inequality.

The best example of the coming together of academic analysis and popular and public concern is the phenomenal success of the book by Thomas Piketty (2014), *Capital in the Twenty First Century*. First published in French in 2013, it was translated into English in 2014 and reached number one on the New York Times best seller list for hard cover non-fiction. That an 800-page economics book with charts and graphs, and even an equation or two, should sell so well to the general public shows how it captured the Zeitgeist marked also by the “Occupy Wall Street” movement and the immediate popular recognition of the “1% versus 99%” distinction, particularly in the United States and also in Europe.

In fact, Piketty (2014) was the culmination of two decades of detailed empirical work by economists documenting the rise of inequality and its causes (see discussions in Piketty and Saez, 2003; Kanbur, 2014; Atkinson, 2015). Some of this work, for example Piketty and Saez’s (2003) documentation of the rising income shares of the top 1% of income earners, contributed to the popular debate. But the long period of stagnation of median wages, from the mid-1980s onwards at least, and the rise of the superrich and their conspicuous consumption, also ignited the policy concerns. Piketty’s (2014) powerful thesis is that rising inequality is the natural tendency of capitalism and needs to be mitigated through active economic policy. Indeed, inequality has actually fallen in Latin America in the 1990s, 2000s and 2010s. This has been put down to proactive policy on the part of Latin American governments to counteract the global forces of technical change, which are tending to displace basic labor and increase demand for skilled labor and capital. These policies included expansion of education and skills as well as direct redistributive measures (Kanbur, 2014).

It is often argued by social scientist that economists ignore distributional considerations and are only concerned about “efficiency.” I have argued (Kanbur, 2002) that this is inaccurate and in fact precludes a more interesting and important characterization. The instincts of economics as a discipline are marked not so much by a neglect of distribution and a focus on efficiency, but a deep seated drive to *separate out* efficiency from equity, especially in the policy arena. Thus James Meade, who won the 1977 Nobel Prize in economics and was known as a prominent egalitarian, nevertheless wrote the following in his *The Intelligent Radical’s Guide to Economics* (Meade, 1975):

“In a competitive system those citizens who are well endowed from birth with inborn capacity or inherited wealth and social contacts and who are favored by the luck of the market may earn much higher incomes and accumulate much higher properties than the less fortunate members of society. The intelligent radical does not draw the conclusion that the competitive market should be abandoned, but rather that far reaching direct fiscal measures should be taken by budgetary taxes and expenditures to moderate high, and to supplement the low, income and properties....In general...the intelligent radical will advocate more direct general measures for the redistribution of income and properties in preference to particular interventions in particular markets for this purpose.”

It is this separation of efficiency from equity which has been questioned by other Nobel Prize winning economists such as Sen (1999) and Stiglitz (2012). They have pointed out in their academic work that the conditions for this separation to hold are indeed the unrealistic conditions of The Fundamental Theorems of Welfare Economics, which also provide the analytical underpinnings for Adam Smith’s invisible hand proposition on the efficacy of the market system.

Economics as a discipline, and as an engine for policy analysis, is a battle ground between these pulls, to separate out efficiency from equity on the one hand, and to view them as an integrated whole on the other. The strong empirical trends identified in the work of Piketty (2014) and others have also spurred new theorizing on how the working of markets needs to conceptualized differently from the standard laissez faire framework if we are to explain the stylized distributional facts of the past two decades, including the sharply rising inequality in advanced industrialized economies (Kanbur and Stiglitz, 2015).

9. Conclusion: The Two Axes Again

This quick run through the history of economics and economic policy making highlights the two fundamental questions which face economics as a discipline. First, what is the appropriate way to capture the workings of the economy, at the micro and at the macro level? Second, what is the appropriate way to evaluate economic outcomes? I have argued that economics is characterized by disputes and debates along these two axes. Laissez faire liberalism embodies a view of markets as functioning well, without impediments of imperfect information or concentrations of economic power. The analytical foundations of this perspective, or rather the conditions under which it has credence, also rationalize a tendency to be found in many strands of economic policy making, namely the separation of efficiency considerations from distributional ones. Thus those who find themselves at opposite ends of these two axes will generally differ in their policy recommendations, and have done so throughout history.

The two axes also explain the phases of cycles and swings of seeming consensus on economic policy—from market orientation to state interventionism and back again. I have argued elsewhere (Kanbur, 2016a) that the interaction between economics and economic policy making is centered on what Edmund Burke called ‘one of the finest problems in legislation, namely, 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.’[§] Keynes, despite his searing critique of laissez faire liberalism, agreed that “the chief task of economists at

[§] Keynes (1926, pp. 287-291)

this hour is to distinguish afresh the *Agenda* of government from the *Non Agenda*.” ** This is indeed the question of every hour; it is the eternal question of political economy, posed and formulated by each generation in its own terms and in its own context. Since the policy question is constant, and the analytical axes are well set, it is perhaps not surprising then that the answers themselves have cycled, and will cycle, with some regularity (Kanbur, 2016a).

** Keynes (1926, pp. 287-291)

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