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Patinkin on Keynes
and Meltzer

by

Allan H. Meltzer

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Patinkin on Keynes and Meltzer

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Don Patinkin's discussion of alternative interpretations of Keynes's General Theory gave considerable weight to an author's motivation, particularly mine. Patinkin also restates his view that the General Theory offers a short-run disequilibrium approach. I suggest that textual interpretation in economics should not consider motives because better methods are available and are now used. I propose three standards. Applying these standards, I find little support for Patinkin's interpretation of the General Theory. Although my interpretation better meets the three standards, I conclude that the General Theory does not have a single correct interpretation.

In a lengthy comparison of different interpretations of Keynes's General Theory, Don Patinkin (1990) gives considerable space to discussion of my recent book, Meltzer (1988). Parts of his paper are concerned with the question: Why are there so many different interpretations of the General Theory? I will comment on that below. The bulk of my reply, however, is concerned with his discussion of my book.

At several points, Patinkin charges that 'what stands out most in Meltzer's interpretation is his political motivation' (1990, p. 237). My alleged aim is 'to create the impression that Keynes shared the conservative view in favor of rules' (ibid., p. 225) and opposed 'deficit financing' (ibid., p. 238). And he closes his penultimate section with a reference to 'politically motivated interpretations' (ibid., p. 238) of which mine is alleged to be one.

I could readily accept the charge of 'political' if it meant 'concern for policy'. My book is clearly concerned with the relation of Keynes's theoretical and policy views. A main point of the book, to which I devote many pages and which Patinkin ignores, is that the General Theory provided the analytical foundation for policy views that Keynes had held at least since the 1920s.

1See also p. 225 where he places my book on the 'political spectrum'. Also, there is no reason that 'rules' must be 'conservative'.

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This point is not unimportant for the current discussion. If correct, it helps to place the book in a context somewhat broader than the depression of the 1930s and connects Keynes's (mainly) theoretical General Theory to his earlier work, including his many essays written in the 1920s. Of course, Keynes recognized and was concerned about the depression of the 1930s. No one familiar with Keynes's work could have any doubt on that score. It does not follow that 'the short-run context...is the major concern of the General Theory' (ibid., p. 213). One might try to solve a current problem while reforming the structure to reduce the probability of a future reoccurrence.

A very different meaning of 'political' is 'partisan or factious'. If this is Patinkin's intent, and I believe it is, the charge is insulting, personal, and gratuitous. It is also baseless and has no place in a scientific, scholarly discussion about issues that are open to different interpretations. Yet, I can find no other interpretation of his charges that I 'desire to claim the political mantle of Keynes' or 'deny that mantle to the 'Keynesians'...by denying that the latter are the legitimate heirs of the Master's (sic) views' (ibid., pp. 237–238).

Patinkin's claims about motivation are presented as a part of a search for the 'intention of the author when we interpret a text' (ibid., p. 207). To support these claims Patinkin blunders into the use of hermeneutics interpreted as a choice of understanding of motivation over the more usual kind of scientific explanation [Albert (1988)]. Whatever merit or demerit textual interpretation may have in fields like biblical study or literary criticism, there are less subjective techniques open to economists who work on the economic thought of dead economists. My book uses three, on which Patinkin comments very little or not at all. Any one of the three is, I submit, more useful

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1. These definitions, and the previous definition of 'political', are among those given in the Oxford Universal Dictionary.

2. See the quotations above about my political motivations. A brief discussion of hermeneutics will suggest my reasons for rejecting this use of hermeneutical method for the history of economic thought. The Oxford Universal Dictionary defines hermeneutics as 'the art or science of interpretation, esp. of Scripture'. In the past hermeneutics was applied mainly to such things as the interpretation of biblical texts. More recently, it has been used for the interpretation of other texts. As a philosophical school, hermeneutics owes much to the work of Martin Heidegger and his followers among German philosophers, particularly Hans Georg Gadamer. The distinguished philosopher Hans Albert is a long-time student of hermeneutics. He writes about the use of hermeneutics as a solution to the problem of meaning. A small sample will suggest why we should be reluctant to use hermeneutics as Patinkin proposes in the interpretation of economic texts: 'In hermeneutical...thought, the cult of understanding is associated not only with a rejection of theoretically based explanation, but beyond that, with an attitude that is designed to insulate certain facts of a meaningful character...by considering them as ultimate 'givens'...The possibility of a political hermeneutics also emerges here which supports all kinds of political theologies...[Such a philosophy of history with practical intention on a hermeneutic basis is nothing else but continuation of theology by other means]' [Albert (1985, p. 198)]. This is distinct from what Albert calls classical hermeneutics 'based on a general knowledge about the working of language in communication' [Albert (1988, p. 582)].
for economists than inferences about motivation since for each of the three we can confront interpretations with observables.

First is consistency, shown by repetition of ideas and thoughts. Keynes often used the same (or very similar) words to make a point. I warned readers of my book that the book was made longer by my extensive use of quotations to show that on many subjects Keynes's ideas changed very little from the 1920s (or earlier) to the 1930s (or later). Among the many examples is the treatment of uncertainty in the *Treatise on Probability* and its treatment in the *General Theory* and in his much quoted 1937 paper in the QJE. More relevant to this discussion is Keynes's broad policy views, particularly the state's role as manager or director of state investment, his support for managed capitalism as opposed to laissez faire, his insistence on the importance of avoiding variability and instability, and others that a reader can find in Meltzer (1988, ch. 2). These views are traced, in part, to Keynes's philosophy of government and his beliefs about the role of intellectuals like himself in leading society. A finding that a position is consistent with his basic philosophy and restates an earlier position is, I believe, evidence about an author's commitment to that position. On this basis, I concluded that Chapter 24 is the policy conclusion of the book of which it is a part, and therefore important for interpretation, whereas Patinkin believes that the chapter 'could have been omitted without affecting its [the book's] central message' (ibid., p. 226).

I am puzzled that Patinkin, like many other interpreters of Keynes, simply dismisses those parts of the book that do not fit with his interpretation without reference to anything that Keynes said. Second, unlike the Bible or authors of literary works, economists see theory as a basis for policy conclusions. This is certainly true of Keynes. Keynes wrote extensively on policy issues after the *General Theory* was published. There are scholarly papers, government reports, and newspaper articles. Yet, Keynes made few appeals for discretionary policy. He wrote most directly and clearly about public works spending as counter-cyclical policy action before the *General Theory* was conceived – in 1928 ('Can Lloyd

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4 Surprisingly Patinkin credits Knight (1921) with these ideas about uncertainty. Knight's book contains an independent development of very similar ideas about probability, risk, and uncertainty to those that Keynes had developed as a student and which he published, after a long delay, in Keynes (1921).

5 Since I do not share these views and criticize them as 'naive' for their neglect of public choice and voting, I do not know in what sense I claim his 'mantle'. A more accurate statement would be that my reading led to a greater appreciation on some points, rejection of others, puzzlement at still others.

6 Patinkin seeks to strengthen his case by claiming that Keynes did not submit the chapter to the criticism of his Cambridge friends. He is wrong. See the quotation from Joan Robinson reproduced in Meltzer (1988, p. 317) where Robinson leaves no doubt that this material was sent to her by Keynes. It is unlikely that Robinson was the only reader. Keynes paid to have multiple copies of his galley pages printed expressly for the purpose of getting criticism.
George Do It?') and in 1933 ('The Means to Prosperity'). In 1937, he wrote 'How to Avoid a Slump' for the *Times*.

The main recommendation calls for a board of public investment to plan future investment projects, in line with the proposals in Chapter 24 and in his 1920s essays. With British unemployment at 11 percent, Keynes's emphasis in 1937 is on developing long-term plans to avoid a future slump. He does not reject counter-cyclical policy; he favors it. But, his proposals are cautious and directed at action to be taken in a possible future slump. As for interest rates, he advocates stability at the long-term optimum. The interest rate 'is not suitable to be used as a short period weapon' [Keynes (1982, p. 389)]. Patinkin neither comments on this statement nor refutes the interpretation I gave in my book [Meltzer (1988, pp. 195–196)].

There is little reason to speculate about Keynes's views on the role of counter-cyclical policy and planning of investment. He left a relatively clear record of his beliefs that removes the need for subjective interpretation or inferences about motivation. One such statement is:

'If for one reason or another, the volume of planned investment fails to produce equilibrium, the lack of balance would be met by unbalancing one way or the other the current budget. Admittedly, this would be a last resort'. [Keynes (1980, p. 352)]

Another statement, also consistent with my interpretation, is his comment to James Meade that 'if the bulk of investment is under public or semi-public control and we go in for a stable long-term programme, serious fluctuations are enormously less likely to occur' [Keynes (1980, p. 326)]. This is followed by a proposal (which I have called a fiscal rule) in which employers' tax changes are conditional on specific values of the unemployment rate and employee tax rates are constant.

There are many similar passages quoted in my book. There are also other proposals to aid our understanding of the role Keynes gave to counter-cyclical fiscal policy when used as a 'last resort'. One is highly relevant – Keynes's proposal in 1933. Despite the severe slump, he advocated a modest increase in steady state government spending as a share of GNP, from 17.5 to 18.5 percent. See Meltzer (1988, pp. 296–297). The increase was to be persistent, i.e., maintained, not temporary in line with Keynes's preference for stability and his preference for investment spending.

Nor am I alone in drawing the inference from Keynes's writings that the main message is not about reliance on counter-cyclical fiscal policy. Kahn (1984, pp. 158–159) points out that the *General Theory* advocates counter-

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7This is reprinted in Keynes (1982, pp. 384–395).
cyclical policy only at one point and only if other means fail. Kahn's comment is consistent with my interpretation of Keynes's policy views (1) as implications of his theory and (2) that his main concern in the *General Theory* as elsewhere was stability and avoiding variability, not counter-cyclical policy.

A third source of evidence available to economists comes from the inferences that the author claims to have drawn from his model. For mathematical models, these inferences are readily checked. Since Keynes did not set out an explicit set of equations, later readers have to do this work for themselves. They can check their formulation against the implications claimed by the author. I used this test for my models of both the *Treatise* and the *General Theory*.

In the latter case, we are aided by Keynes's explicit statement accepting the IS-LM model with expected investment in place of actual investment. There are, however, statements about prices, wages, and the normal or long-term rate of interest that are not part of the IS-LM framework. I believe I have shown that my modest extensions of the IS-LM model generate implications consistent with Keynes's statements about the relation of these variables to the IS-LM model. I take this as additional evidence that my interpretation is consistent with the text.

**A theory of employment**

Patinkin (1990, p. 209) says that Keynes's intention in the *General Theory* was to develop a theory of employment. There is no controversy about that. Nor is there any dispute about Keynes's use of output as a factor equilibrating saving and investment 'at a level that need not be full employment' (*idem*). And, we agree that Keynes concluded that the economic system *unaided* cannot achieve continuous full employment either by changes in money wages or changes in money.

These statements are open to more than one interpretation. I find nothing in Keynes's statements, and little in the rest of the book or the related materials in Keynes's papers, that supports Patinkin's conclusion that Keynes developed a short-run disequilibrium explanation of unemployment that was to be removed by fiscal action. First, the *General Theory* does not claim that the level of employment reached is a short-run disequilibrium position that should be removed by fiscal action. There is much to suggest the opposite — that saving and investment determine an *equilibrium* position, a

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8The discussion appears in a section titled 'Misconceptions about the *General Theory*'. I doubt that Patinkin would charge Kahn with political motivation similar to mine.

9On this point, Patinkin and I agree.

10For the moment, I put aside the issue of whether the *General Theory* recommended discretionary fiscal policy action. I have discussed the issue above and discuss the more general issue of activist policy below.
chronic state (as Keynes described it), an underemployment equilibrium. Second, Patinkin interprets income determination to apply 'in the short-run context which is the major concern of the General Theory' (ibid., p. 213).

While there should be no doubt that one purpose of the General Theory is to develop a theory of employment, we should remember that employment is a measure of real income or output [Keynes (1936, pp. 40-41)]. Keynes's statements, both at the beginning of the General Theory and after it was written, suggest that his major concern is not the short-run. In the preface to the General Theory Keynes (1936, p. vii) says that the book 'is primarily a study of the forces which determine changes in the scale of output and employment'. To a classical or neo-classical economist, scale is a long-run, not a short-run, matter. After the book was written, Keynes wrote a very clear statement intended to explain to critics what he had done (or intended). He explicitly rejects a short-run approach oriented toward counter-cyclical policy.

'This that I offer is, therefore, a theory of why output and employment are so liable to fluctuation. It does not offer a ready-made remedy as to how to avoid these fluctuations and to maintain output at a steady optimum level. But it is properly speaking a theory of employment because it explains why, in any given circumstances, employment is what it is'. [Keynes (1973, v. 14, pp. 121-122) – italics added]

Keynes describes an equilibrium theory and the reasons why output fluctuates around the long-run optimum. The emphasis on 'optimum level' is consistent with his discussion of scale. I find no basis here for Patinkin's interpretation that Keynes's main concern was short-run disequilibrium. And, with respect to his policy conclusions, Keynes adds that such suggestions 'are not meant to be definitive' (ibid., p. 122). This is hardly the view of a man who had written a book to make the case for short-run fiscal stabilization.

**Rules and discretion**

Patinkin claims that for political reasons I have wrongly portrayed Keynes as an advocate of rules and an opponent of discretion. Also his reference to Milton Friedman's rule for monetary policy suggests that he equates 'rule' with permanently fixed rate of money growth. He is wrong on both counts.

The modern discussion of rules characterizes any systematic, predictable path for a policy variable as a rule. Most rules are conditional on realizations of relevant variables. Keynes's recommendation that business taxes be reduced when unemployment rises above a given value is a rule in this sense; the amount of tax payments is conditional on the realization of unemploy-
ment. If the rule is announced, anyone can compute tax rates given the unemployment rate. The classical gold standard is a rule in the same sense.

Classical and neo-classical economists discussed alternatives to the gold standard – alternative rules. Jevons, Marshall, Keynes, and many others sought to avoid the procyclicality of money by modifying the gold standard rule. Keynes in the 1920s proposed a type of commodity money standard; the money stock varied with gold, but the price of gold was tied to the price of a basket of commodities. Frank Graham and others proposed different commodity money rules.

Patinkin’s comments on discretion are fanciful and wrong. No reader of my book could conclude that I portray Keynes as opposed to discretion. Wrong also is Patinkin’s claim that I portray Keynes as an advocate of a balanced budget. Patinkin makes no use of citations to establish his claims. And he relies on a quotation from the Treatise to present Keynes’s views on discretionary policy. He does not establish the relevance of this quotation for Keynes’s views in the General Theory or after.

If a reader looks only at the introduction and conclusion of my book, he will find that I do not present Keynes as opposed to discretion. There are passages describing Keynes as favoring rules to restrict discretion, passages describing Keynes’s advocacy of public works spending in the 1928 election campaign, and this summary:

‘The problem, as I see it, is not to establish whether Keynes may have favored short-term demand management on occasion. What is surprising is how much has been built on the statements that can be found and how much of his argument and his conclusion about long-term policy has been neglected’. [Meltzer (1988, p. 309)]

In this section called ‘The Activist Keynes’, I discuss Keynes’s different policy positions. I summarized as follows:

‘There are two sides to Keynes. One, most often found in his books and scholarly papers, proposes reforms. These call for new rules to achieve an optimum, or what Keynes often called an ideal. The other, most often found in his letters to editors, pamphlets, and newspaper columns, proposed solutions to problems he regarded as pressing’. [Meltzer (1988, p. 194)]

This also falsifies Patinkin’s claim that I contend that Keynes was an advocate of rules as against discretion. And, after the paragraph just quoted,
I go on to say that:

'When problems arose, Keynes proposed remedies based on his judgment, intuition, computations, or hunch if no theory was available'.

I then give several examples to illustrate Keynes's advocacy of activist policies.

Whatever merit or demerit there is in Keynes's position, there is no doubt that he proposed rules and discretionary action at different times. My reading leads me to the conclusion that the relevant distinction is the one I made between his proposals included in or based on his main scholarly works, such as the *Tract*, the *Treatise*, and *General Theory*, and his efforts to alleviate a problem where there was not much theory to guide the proposal or little chance of getting a relevant (optimal?) reform adopted. This explains why Keynes advocated a fiscal rule after the *General Theory* but proposed discretionary action before. And it explains why Keynes's proposal for post-war monetary reform was a system of rules based on his earlier proposals in the *Tract* and the *Treatise*.

A section of my book called 'Short-term Policy' starts by describing Keynes 'as a proponent of discretionary action constrained by well-defined rules' [Meltzer (1988, p. 293)]. I give examples of his advocacy of discretionary policy (as in the National Debt Inquiry, which Patinkin also cites). But, I also discuss his explicit comments on Abba Lerner's proposals for discretionary functional finance. Keynes gave credit to Lerner for developing these proposals but said that he did not believe they should or could be applied. His statement is hardly an endorsement of discretionary fiscal policy.

After repeating and summarizing part of the evidence I cite, and noting that Keynes's proposals in the 1943 discussion repeat his call for government control of investment in Chapter 24, Patinkin (1990, p. 228) concludes that Keynes 'was not thinking in terms of a fixed rule'. I am not sure what he means by fixed. Keynes's rules for fiscal policy and his various rules for international monetary standards are contingent rules. The rule is fixed; the application is contingent on the state of the economy as in his proposal for business tax reduction in recession. An exception is his proposal to bring the long-term interest rate to its optimal level, usually zero, and keep it there.

Patinkin then cites the 1944 White Paper on Employment Policy which, he says, 'largely reflected Keynes's views on how to carry out the full-employment policy that he advocated' (ibid., p. 229). On this point, he disagrees not only with me but with Joan Robinson who wrote:

'It was his British disciples, rather than he, who drafted the white paper in 1944 which proclaimed that it is the responsibility of government to maintain a high and stable level of employment. Keynes said: you can
promise to be good but you cannot promise to be clever' [Robinson (1979, p. 27)]

Many interpretations

Patinkin asks why there are so many interpretations of the General Theory. I suggest that there are several answers, not a single one. I do not intend my suggestions to be exhaustive; I offer them to show that there are better alternatives than claims about 'political motivation'.

First, the interpreters have different purposes. Some offer a particular interpretation, then show what Keynes would have had to say if he shared their interpretation. I cite Paul Davidson, Clower, and Leijonhufvud as three of many examples of writers in this tradition. Others develop a model or models of Keynes's theory, draw its implications, and compare the model's implications to the implications Keynes draws based on his verbal arguments. I am one of the latter. Still others have tried to use the General Theory to support particular policy actions such as price and wage guidelines. This list, also, is not exhaustive.

Second, the book is a major work, by a major economist, on a central topic, so it attracted much attention. The book is written in a style very different from Hicks's Value and Capital or Samuelson's Foundations. It is open to different interpretations; it is ambiguous at times, so readers draw different conclusions. A particular problem that I comment on in my book is the dismissal of certain chapters and concentration on one or more chapters as the key. Authors choose different chapters as critical, so they come to different conclusions. I believe that a more correct interpretation is obtained by trying to see how the chapters are related to each other and to the values and beliefs to which Keynes was committed in his earlier and later work. Hence, I discuss the General Theory as part of Keynes's life work.

Third, Keynes wrote prolifically. In the most active 25 years of his professional life - from the early 1920's to his death in 1946 - he filled most of the thirty volumes of his collected works. Reading this material, one finds some changes of emphasis and opinion. Some of the latter are genuine changes of opinion; others are contextual. Keynes would propose a rule, say, for international monetary management as in the Tract or the Treatise. If the rule was not in place, he proposed measures to deal with particular circumstances, as in his well-known advocacy of a tariff to create domestic employment. Separating these two types of changes requires judgment. There is no unique answer applicable to all cases.

In the same paragraph, Robinson (1979, p. 27) writes: 'When he dined in Washington with his converts, he told Austin Robinson the next day: I was the only non-Keynesian there'. The reference may be to an informal seminar at the Federal Reserve at which Keynes opposed proposals for deficit finance. See Meltzer (1988, p. 295).
Fourth, I agree with Patinkin that Keynes accepted the IS-LM interpretation (with investment changed to expected investment). This is not the whole of the book; there are no prices, wages, and long-run or expected interest rate in that model. These variables are clearly present in Keynes's discussion. They have to be joined to the IS-LM model, and anticipations have to be introduced. I offer an interpretation of how these variables can be brought into the model. I do not claim that mine is the only interpretation. Such a claim would not be credible. Nor is it credible to claim, as Patinkin appears to do, that his is the only correct interpretation of a book that has been the subject of many different interpretations.

Of course, all interpretations are not equally valid. Above, I offered three different tests that I applied when writing my book to several of the more familiar interpretations and to my own. A reader must judge by evaluating the evidence. If he uses the tests I proposed, I am confident he will reject the short-run interpretation as incomplete and the disequilibrium interpretation as unfounded. He will accept an interpretation that sees the *General Theory* as part of Keynes's long-standing concern for the problems of variability and uncertainty and for policies to reduce risk and uncertainty toward the minimum inherent in nature and arrangements for production and trade.

**Conclusion**

Many of the reviewers of my book on Keynes's theories are Keynesians. Generally they were complimentary about the book and accepted my interpretation as valid and useful for rescuing Keynes's ideas from various entrenched orthodoxies and bringing them to bear on current policy issues and problems of institutional design (rules).

Throughout his life, Keynes was concerned with variability and instability. Those who interpret the *General Theory* as a short-run theory do Keynes a disservice. Short-term adjustments of fiscal and monetary policy based on forecasts have not produced stability.

At times, short-term policy actions have increased instability. One reason is the difficulty economists have encountered in making forecasts with sufficient accuracy to lower the variability of output and prices. We know from Keynes's comments on Tinbergen's econometric model that Keynes believed econometric models would not be useful for forecasting. He criticized the use of such models on grounds that many economists now accept. Public officials have learned this lesson from their experience. Governments in many countries have now moved to medium-term strategies and, in Europe, toward a fixed exchange rate system without exchange controls. This system has many features of the international monetary system Keynes helped to design. In its current form, there is limited room for short-term discretionary policy actions by national governments.
My interpretation credits Keynes with making a valid economic argument – that government policy rules can remove an externality. The externality arises because there is a difference between the social and private cost (or net benefit) from investment. This difference is the result of variability and uncertainty. Part, or all, of the premium for uncertainty, Keynes believed, was avoidable. And, if it was avoided, increased investment would raise the capital stock and the standard of living. The process would continue until the capital stock reached satiety. This was the optimum, or ideal, that Keynes had searched for most of his professional life. I wrote:

'Keynes treats society as analogous to an individual with infinite life. In contrast to risk-averse individuals, society can avoid the borrowers’ and lenders’ risk of default and therefore make investments that individuals do not make. The risk, which Keynes called moral risk and we now call moral hazard is, on his argument, an avoidable risk. Freed of this risk, society would achieve a higher capital stock and a higher standard of living.' [Meltzer (1988, p. 304)]

This is an argument about the long-run that gave an analytic foundation to Keynes's 1920's proposal that government should manage or direct investment to reduce variability and instability. Hence I treat Chapter 24 repeating this policy recommendation and Chapter 12 on long-term expectations as central ideas, not peripheral thoughts unrelated to the main message.

Keynes's policy recommendation was badly flawed. State management of investment has generally produced much waste of resources through investment in politically determined or 'prestige' projects with low or negative returns. Public choice theory gives reason to expect this result, as I discuss in my book. But Keynes's concern for removing the excess burden of avoidable uncertainty was correct. He recognized that government policy rules should aim to reduce uncertainty and variability.

A puzzling aspect of Patinkin's criticism is that he does not question the evidence I present about Keynes's lifetime interest in international monetary rules and his work on the Bretton Woods system. Nor does he discuss Keynes's comments on functional finance. And he neglects the relation of the General Theory to Keynes's lifetime interests and scholarly writing. Along with the implications Keynes drew from his work, these tell us much more

12 Keynes undoubtedly learned about externalities from his teacher, Pigou. He understood that externalities could invalidate the case for laissez faire. He refers frequently to the problem of achieving an optimum, writes about moral risk (hazard), etc.

13 Several reviewers of my book explicitly endorse my view that Keynes's proposals for post-war international monetary reform provide evidence of his interest in (contingent) policy rules. See especially de Cecco (1990).
about what he meant than speculations about hermeneutics interpreted as an appeal to motivation.

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