# Institutionalism and the 'Common Man' through the Lens of Philip Klein: Business Cycles, the Public Sector, and the Economics of Keynes

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August 2016

**JEL Codes:** B25, B31, E32, H11

**Key Words:** Philip A. Klein, business cycles, public sector, John Maynard Keynes, post-Keynesian institutionalism

**Abstract:** This article reviews and assesses Philip Klein's work on business cycles and macroeconomics, the public sector, and the economics of Keynes. Among the findings: 1) Klein built on the pioneering efforts of Wesley Mitchell to advance the development of cycle indicators and outline an eclectic theory of cycles that remains useful for synthesizing a broad literature; 2) Klein's essays on macroeconomics contain enduring discussions of the malleability of the "natural" rate of unemployment and the value of a behavioral approach to expectations; 3) Klein deepened institutionalist attention to the public sector by introducing "higher efficiency" and other concepts to help explain how government policy plays a role in economic life; 4) Klein emphasized the role of fiscal policy in moderating business cycles; and 5) Klein's work points in the direction of today's post-Keynesian institutionalism, both by stressing that Keynes was "profoundly institutionalist" in his approach and by arguing that conjoining Keynes and institutionalism would provide a stronger foundation for macroeconomic theory and policy.

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## Institutionalism and the ‘Common Man’ through the Lens of Philip Klein: Business Cycles, the Public Sector, and the Economics of Keynes

John R. Commons, whose research career as an institutional economist was motivated by “whatever helped the common man,” saw the business cycle as the most important of all labor problems (Parsons 1985, 757; Whalen 1993). More recently, Philip A. Klein devoted much of his career to analyzing business cycles for the same general reason. That career, which spanned a half century, took shape when he was a university student in the 1940s: Observing the widespread poverty around him, Klein focused on business cycles and macroeconomic theory to discover and address the reasons “why U.S. economic performance was so flawed” (Klein 1944, 301).

In addition to business cycles and macroeconomics, Klein wrote about the role of the public sector in the economy and about the economics of John Maynard Keynes and its relationship to institutionalism. After providing a brief sketch of Klein’s professional life, this article reviews and assesses those writings on cycles, public action, and Keynes. Among the findings:

- Klein built on the pioneering efforts of Wesley Mitchell to advance the development of cycle indicators and outline an eclectic theory of cycles that remains useful for synthesizing a broad literature;
- Klein’s essays on macroeconomics contain enduring discussions of the malleability of the “natural” rate of unemployment and the value of a behavioral approach to expectations;
- Klein deepened institutionalist attention to the public sector by introducing “higher efficiency” and other concepts to help explain how government policy plays a role in economic life;

- Klein emphasized the role of fiscal policy in moderating business cycles, even as most of the economics profession dismissed that role from the 1970s until the onset of the global financial crisis in 2008; and
- Klein's work points in the direction of today's post-Keynesian institutionalism, both by stressing that Keynes was "profoundly institutionalist" in his approach and by arguing that conjoining Keynes and institutionalism would enhance both traditions and provide a stronger foundation for macroeconomic theory and policy.

**Philip Klein, Institutionalist in–and after–the Age of Keynes**

Klein (1927-2011) grew up in Austin, Texas with institutional economist Clarence Ayres as his neighbor. Klein was attracted to economics at The University of Texas partly because he found Ayres spellbinding in the classroom but also because he was troubled by the problems of poverty and inequality. He quickly came to see economics as a vital field of study aimed at advancing society by analyzing and tackling real-world problems (Klein 1994, 298-301).

Klein was influenced by institutionalists and by Keynes's *General Theory*. That Klein was an institutional economist is unmistakable. His institutionalist perspective was developed and reinforced by reading Ayres, Veblen, Berle and Means, and Myrdal; and it was recognized by the members of the Association for Evolutionary Economics (AFEE), who elected him to serve as AFEE's president in 1977 and selected him to receive the organization's Veblen-Commons Award in 1990. But Klein was also an admirer of Keynes, who "was looking at the obviously flawed system around him and asking why it was operating so poorly" (Klein 1994, 299-301).

Klein combined an institutionalist orientation and his admiration for Keynes by studying business cycles—a subject that received attention from Veblen, Mitchell, Commons, and Keynes—first as a doctoral student of Robert A. Gordon at the University of California, Berkeley, and later as a professor of economics at The Pennsylvania State University. He also served as a senior researcher at

both the National Bureau of Economic Research (NBER), founded by Wesley C. Mitchell, and the Center for International Business Cycle Research (CIBCR), created to keep alive Mitchell's research on cycles.[1] Much of what Klein wrote on the public sector, meanwhile, complemented his cycle research and was grounded in the recognition that macroeconomics gives the public sector a continuing and distinctive role in economic life.

Klein's career encompassed both the rise and decline of the "Age of Keynes" (an era that spanned from the end of World War II to the 1970s).[2] Through it all, however, he kept real-world economic problems at the center of his attention and judged new developments in economic theory according to their usefulness in tackling such problems. He also allowed his views to evolve: For example, Klein emphasized the differences between institutionalism and the economics of Keynes in an essay published in 1980, but over time he came to see the traditions' commonalities as more important than their differences (Klein 1980; Klein 1994, 105-114; Klein 1998; Klein 2003).

Klein resided in State College, Pennsylvania from 1955 until his death in 2011; but the school of institutional economics was always his intellectual home—and his final book was a plea for economics to reconnect with institutionalism (Klein 2006). As Klein stated at the conclusion of his AFEE presidential address, which was delivered in New York City, "Here we are—far from Texas… [But] I am back where I began" (Klein 1994, 43).

## Klein on Business Cycles

Klein's work on business cycles can be grouped into two categories: development of cycle indicators and critical appraisal of mainstream macroeconomics. In this section, major contributions to each category are summarized and briefly assessed.

### *Economic Indicators*

Klein saw his work on business-cycle indicators as continuing the cycle research of Wesley Mitchell and contributing to a theory of business cycles. That work grew out of his Berkeley doctoral dissertation and

continued, often in collaboration with Geoffrey H. Moore, through his affiliation first with the NBER and later with the CIBCR.[3] To Klein (1994, 244, 267), developing cycle indicators was "thoroughly institutionalist" and resulted in a necessarily "eclectic" theory of cycles.

Mitchell's research on cycles, argued Klein (1994, 244-272), was exemplary institutionalism. It took the institutionalist emphases on acquiring facts and analyzing economic processes and applied them to a major economic problem. In addition to measuring cycles and establishing cycle chronologies, Mitchell and the NBER pioneered the development and publication of leading, coincident, and lagging cycle indicators.

Working at the NBER and the CIBCR, Klein helped to extend Mitchell's work on indicators. Klein's Ph.D. dissertation on changes in the quality of U.S. consumer credit (completed in 1958) led eventually to a similar NBER publication, which was co-written with Moore and gave special attention to variations in consumer installment loans over the business cycle (Moore and Klein 1967), and to a report on the cyclical timing of consumer credit between 1920 and 1967 (Klein 1971). Klein's work contributed to and complemented the addition of consumer installment loans to the Commerce Department's list of leading indicators in 1966.

Klein collaborated with Moore to extend research on economic indicators in other ways as well. For example, they conducted analyses demonstrating the role of corporate profits and purchasing management survey data as leading indicators (Klein and Moore 1982; Klein and Moore 1991). They also led the way in creating composite (leading and coincident) indicators for several countries and in analyzing growth cycles as distinct from macroeconomic expansions and contractions (Klein and Moore 1983; Klein and Moore 1985).[4]

Although some economists have called Mitchell's analyses of business cycles "measurement without theory," Klein disagreed. According to Mitchell, the challenge to theorizing about business cycles is that while cycles are recurrent, "each new cycle presents idiosyncrasies." As a result, Klein

believed that any realistic theory of cycles must be "eclectic"—that is, capable of shedding light on "a complex multivariate phenomenon." Klein argued that research on economic indicators leads to precisely the sort of theory that Mitchell thought business cycles required (Klein 1994, 247-272).

For Klein, the key to constructing an eclectic cycle theory is to incorporate other cycle theories into a broader context, and the way to do that is to bring indicators into the picture. In particular, Klein classified a short list of "most reliable indicators" according to a simple categorization of cycle theories (see Table 1).[5] The result was a framework for examining and testing most of the major efforts to explain instability—in other words, his classification produced a what Klein considered a broad theory (it is actually more of a meta-theory) compatible with the fact that "the proximate causes of successive upper turning points [in the business cycle] may not always be the same" (Klein 1994, 261-267).

*Indicators: Assessment*

To assess Klein's research, three questions are addressed: Did his work on indicators advance institutionalist cycle analysis? Is there a practical use for indicators today? Is there value to the eclectic theory he describes?

Klein did indeed advance cycle analysis in the tradition of Wesley Mitchell. Klein was recognized as a major contributor to the indicators literature (see, for example, Banerji and Dua, 2011) and was respected in the community of scholars devoted to cycle analysis.[6] He also found opportunities to highlight the institutionalist dimensions of his work (see, in particular, Klein 1994, 244-272).

Among the economic mainstream, business cycle research in the Mitchell tradition was never fashionable during Klein's career. In the early 1960s, the NBER worked with the U.S. Department of Commerce to monitor cyclical developments and publish data on indicators in a Commerce series called *Business Cycle Digest.* However, the name was changed to name *Business Conditions Digest* in late 1968, because many influential economists believed that cycles had been tamed, and the series was discontinued in early 1990.[7] But Klein persevered (and, of course, cycles remain).

Is there a practical use for indicators today? Yes, but that usefulness is rather limited. Klein (1994, 266) correctly observed, in an essay originally published in the 1980s, that "many modern econometric models employ the economic indicators pioneered by Mitchell and his co-workers either as variables within the models or as appropriate measures with which to test the forecasting properties of their models." However, a 1998 paper by Klein suggests that even he saw the indicator indexes that he had the largest hand in creating (indexes of growth cycles) as useful primarily for historical analysis, not for real-time monitoring and forecasting (Banerji and Dua 2011, 10).[8]

His eclectic theory is also of limited value for monitoring, forecasting, and—an essential part of institutionalism—real-world problem solving. To be sure, the theory—which, Klein (1994, 247) recognized that some would prefer to call a classification scheme or taxonomy—can accommodate an array of causes of cycle turning points and could be used to test a range of other theories of cycles, but Klein never pursued that line of research. Klein also overlooked a point stressed by Mitchell (1927, 55), which is that causal explanations often provide more insight into cycles than do statistical correlations such as those provided by indicators.

The shortcomings of Klein's taxonomic theory are particularly evident when compared with the cycle analyses offered by Howard Sherman (2003; 2001) and Hyman Minsky (1986a; 1986b), who were also influenced by Mitchell. The analyses of Sherman and Minsky focused on the role of profits and on the evolution of institutions, allowing—unlike the work of Klein—clear insight into economic dynamics within and across business cycles in the United States since World War II.[9] For example, Minsky offered a financial instability hypothesis, which includes an investment theory of business cycles and has proven useful in focusing attention on key issues and problem areas of the economy, including the dangers associated with securitization of financial assets.[10]

*Essays on Mainstream Macroeconomics*

Klein (1994; 2006) wrote essays critical of mainstream macroeconomics on at least a half-dozen occasions, mostly between 1984 and 1990. Much of his attention focused on monetarism, supply-side economics, and new classical economics, traditions that gained substantial ground in the 1970s and signaled the end of the Age of Keynes. Although the essays broke little new ground, his discussions of the natural rate of unemployment and rational expectations made important, timely points and stand out as the most enduring portions of those works.

Klein's primary discussion of the natural rate of unemployment appeared in "What's Natural About Unemployment?" an essay prepared for a volume celebrating the 75th birthday of Geoffrey Moore (published in 1990; reprinted in Klein 1994). He maintained that economists' labeling of persistent seasonal, frictional and—most important of all—structural unemployment as "natural" was intended to suggest we must live with such unemployment to avoid accelerating inflation. Klein's core argument was that there is nothing *natural* about unemployment, inflation, or the tradeoff between them. Thus, he insisted that persistent unemployment was not beyond the reach of judicious policy action: "There is, therefore, everything to be said for searching for ways to raise real growth rates, including investing in ways to improve the productivity of the labor force, especially by reducing structural obstacles to more efficient use of labor" (Klein 1994, 277). Instead of seeing a "natural" rate of unemployment, Klein saw a policy challenge that called for institutional innovations to tackle unemployment and contribute to lower trend rates of inflation.[11]

Klein also took issue with the assumption of rational expectations, which he saw as helping to explain the "equilibrium cycles" perspective of new classical economics (Klein 1994, 286). Quoting from a well-known macroeconomics text, Klein (1994, 91) summarized the rational expectations position as assuming that individuals use information efficiently and do not make systematic mistakes in their

expectations. With that assumption, Klein argued, it became easy for the new classical economists to maintain that markets always clear, thereby managing to "defang" the study of business cycles.

Klein's alternative to rational expectations was a perspective informed by institutional and behavioral economics. Klein argued (drawing primarily on the work of George Katona, but also on Veblen, Mitchell, and others) that people form attitudes, objectives, and expectations through a complex process, influenced by many factors—including not only past views and events but also cultural conditioning and human interaction. He also stressed that expectations are subject to volatility, and that changing expectations often have significant effects on economic activity (Klein 1994, 81-114).

Klein underscored two implications of his alternative view of expectations. One is that it reinforced his admiration for the macroeconomics of Keynes, which not only "includes the expectations of economic agents, particularly entrepreneurs, explicitly," but also has "the singular virtue of permitting the inclusion of changing human behavior over time and in differing circumstances" (Klein 1994, 96-101). The other implication is that Klein argued his view pointed to the value of surveys of entrepreneurs as qualitative indicators of the nature of expectations at any given time (Klein 1994, 95-99).[12]

**Klein on the Public Sector**

Klein saw the public sector as an essential complement to the private sector, helping the economy to function on a daily basis and providing society with ways to address business cycles and other economic problems. In the course of discussing the role of government in the economy, Klein introduced four concepts: higher efficiency, collective ought, the value floor, and emergent values. He also gave special attention to fiscal policy, which he described in 2003 as "the most explicit embodiment of the institutionalist conviction that there is a constructive role for government intervention in the quest for stable satisfactory growth rates in the modern market economy" (Klein 2003, 47). In the end, however, Klein offered valuable insight, but little guidance to those interested in making and assessing economic policy.

*Higher Efficiency*

Klein (1994, 194-196) argued that an economy operates simultaneously along many dimensions, including: efficiency, equity, freedom, security, and compassion (or humaneness). Mainstream economics trains its sights on what it takes to maximize the first of these, he added. In contrast, Klein argued that considering all five of those dimensions, which together he called higher efficiency, is the proper scope of economics—and that monitoring the economy's operation according to them is an essential function of the public sector.[13]

It could be said that mainstream economists have room for efficiency and equity (see, for example, Blinder 1987), and that freedom is incorporated into their notion of efficiency while aspects of security and compassion are incorporated into equity. But even the mainstream's public-sector economics is primarily about efficiency, and bringing equity into the picture is often a challenge (see, for example, Stiglitz 1988, 250; Musgrave and Musgrave 1984, 11).

Klein wanted economists to make room in their analyses for each of the elements of higher efficiency. In that way, he argued, their profession could better contribute to policy analysis. In particular, he maintained that economics—by drawing attention to higher efficiency—should help policymakers not only to determine the extent to which the operation of the economy conforms to the values of society but also to fashion policies that bring that operation into closer agreement with those values.

*Collective Ought, the Value Floor, and Emergent Values*

The values of society at any moment in time are what Klein called the collective ought; the public sector expresses those values and uses them to affect how the economy functions (Klein 1994, 188-191). Because society is composed of people with values that often vary widely, the collective ought cannot be found by merely summing individual preferences. Building on Milton Friedman's observation that "I cannot get the amount of national defense I want and you, a different amount," Klein argued that

government makes crucial judgments on all the dimensions of higher efficiency: The policymaking process (broadly defined to include all branches of government) determines the collective ought (Klein 1994, 191).

Embedded in the collective ought is the value floor, an implicit set of norms "conforming to currently accepted standards for efficiency, equity, freedom, security, and humaneness" (Klein 2003, 56). In other words, the value floor represents prevailing societal values concerning minimum standards. According to Klein, each economy has its own value floor, and that floor must be comprehended in the context of the culture in which it is found (Klein 2003, 56-57; 1994, 192-194).

Klein (1994, 192-194) stressed that public policy reflects the value floor. That floor manifests itself, for example, in actual public spending, whether for housing, healthcare, nutrition, income support, or some other purpose.[14] As Klein observed in the mid-1980s, the rhetoric of President Ronald Reagan indicated a devotion to reducing social spending and income supports, but the reality is that such spending increased, driven primarily by increased outlays for Social Security. Thus, Klein (1994, 221) suggested that the counterweight to the Reagan agenda was a social consensus (that exerted itself through the federal legislative process) about the value floor.

Klein also stressed that because the economy is inherently dynamic, values are always evolving. In particular, he often wrote that values, including those shaping public policy, are "emergent" (see, for example, Klein 1994, 190-192; and Klein 2000). A multitude of prevailing social standards—not just on matters such as public health, safety, education, and environmental protection, but also on economic matters including poverty and inequality—evolve as the economy changes.

In fact, Klein (1994, 190-198) went further, observing that the public sector does more than just transmit existing values into public action: in some instances, it also contributes to the constant reshaping of social attitudes and values. Much of that reshaping is indirect and often inadvertent, a consequence of government action that supports and channels economic activity or that resolves

disputes between conflicting parties (such as the farmers, loggers, boaters, manufacturers, and others who might wish to use a waterway; see Schmid 1962). However, the reshaping of values can also be a more direct aim of public policy, as in the case of public support for anti-littering or highway-safety initiatives. To be sure, some might look at such direct action as unwarranted, "social engineering," but Klein (1994, 194) noted that there is a built-in constraint on the public sector's ability to influence emergent values: such initiatives only occur when the public sector (acting through the democratic political and policymaking processes) "has a clearly recognized responsibility" to take such action.

*Fiscal Policy*

According to Klein, fiscal policy is a key manifestation of the collective ought. Government spending and tax polices not only influence how the private sector allocates resources, they also directly allocate and help to develop resources (by means of education policies, for example). Such policies are also a potentially potent weapon with which to address business cycles—that is, fiscal policy can be useful in the pursuit of economic growth and stability (Klein 1994; 181-188; 2003, 48-84).

In an essay published in 2003—when the economics profession was mostly dismissive of countercyclical fiscal policy (the onset of the global financial crisis was still a few years later)—Klein stressed that much attention in fiscal policy discussions is misplaced. Although the size of actual budget deficits often receives considerable notice from economists and the public, Klein (2003) argued it was worth keeping in mind that some deficits are the result of the economy's automatic stabilizers (which increase outlays and reduce taxes in downturns, and have the opposite economic impact in expansions) and suggested that cyclically-adjusted deficits might warrant greater attention than actual deficits. In other words, Klein suggested that perhaps less attention should be given to actual deficits and more should be given to what deficits would be in the event that economic output was at its potential. Similarly, Klein emphasized that Keynes advocated balancing a nation's government budget over the course of the business cycle, rather than having annually balanced budgets or unrestrained spending.

For Klein (2003), the notions of cyclically-adjusted and cyclically-balanced deficits were useful concepts, but the overriding aim of fiscal policy was to achieve and sustain full employment. Rather than express concern about unbalanced budgets, he stressed the need for government action (via tax and spending policies) to stimulate aggregate demand when the economy was below full employment and to restrain demand—producing budgetary surpluses as a consequence—during a boom economy (characterized by inflation owing to excessively tight labor and product markets). Moreover, to that end, he favored reliance on automatic stabilizers as much as possible, including "a 'public works shelf'—a set of proposed public projects planned and budgeted in advance, so as to be activated in a timely fashion" during economic downturns (Klein 2003, 67-68).

*Making and Assessing Economic Policy*

Klein's concepts of higher efficiency, the collective ought, the value floor, and emergent values offer useful insight into how the real-word economy operates. For example, whether or not economists think about the "higher efficiency" dimensions of equity, freedom, security, and compassion, those dimensions of economic life exist alongside the mainstream notion of efficiency and each of them is at least implicit in (and affected by) policymaking. Similarly, the collective ought, the value floor, and emergent values all shape (and are shaped by) public policy, even when those terms go unspoken. Still, his concepts offer little guidance to those interested in making and assessing economic policy.

From Klein's attention to fiscal policy, one can, to be sure, gain an appreciation for countercyclical tax and spending policies, for budgets that are at least roughly balanced over the business cycle, and for shovel-ready public projects. In addition (as mentioned above), a call for institutional innovations to tackle unemployment and inflation can be found in his critique of the natural rate of unemployment. But what about public action beyond that aimed at addressing those macroeconomic problems? Klein (2003, 49) maintained that institutionalists have always focused on "illuminating market failures" so public policy could be brought to bear in overcoming them. However,

rather than offer a substantial list and extended discussion of such failures, Klein's main essay on the role of government merely mentions "clogged or distorted information channels" and concentrated economic power and wealth as sources of market failure (Klein 1994, 191): not a lot upon which to build an alternative to conventional economics.[15]

As indicated above, Klein suggested that economics should help policymakers determine the extent to which the operation of the economy conforms to the values of society. But just identifying the values to be used as a benchmark seems a huge challenge—since, according to Klein (1994, 187-196), price signals are imperfect (because market failures are widespread), values are always in flux (constantly emerging), and the public sector itself facilitates the development and spread of social values. Moreover, there are further policy-analysis complications in Klein's recognition that while there is no absolute or fixed content to the "great society," whatever content there is at any moment in time will likely necessitate tradeoffs (owing not only to conflicts in the goals of various individuals and groups, but also to resource constraints) (Klein 1994, 190).

When writing about his reason for being an economist, Klein (1994, 301) made it clear he was interested in solving economic problems that affected ordinary men and women—the "common man," to use the terminology of Commons and Veblen. Consistent with that inclination, Klein occasionally mentioned the "vested interests" (owners of large holdings of wealth) who hold economic power and can control the conditions of life for the women and men who make up the rest of society (see, for example, Klein 1994, 162, 208-209). However, Klein (1994, 187) refused to presume that he had a notion of what constitutes the best interests of the working class and could then assess economic policy according to that notion. He saw that as characteristic of "radical" (or Marxist) economics, not institutional economics.

The best statement that Klein managed to offer on his institutionalist approach to public policy was the following: Institutionalists are concerned with assessing the economy according to how

effectively it advances “the life process.” He added: “Allocative efficiency in the institutionalist context must, therefore, be related to economic allocation by the same process that ‘free elections’ or majority voting follow in the pursuit of representative democracy” (Klein 1994, 187; see also Klein and Miller 1996). Again, there is not a lot to build upon.

There has to be more that institutionalist can say. A few years ago, Charles Whalen (2013a) outlined the contours of an institutionalist approach to public finance. He concluded that there are four steps to such an approach:

- Focusing on economic problem solving;
- Using institutional analysis, which aims to “get to the root” of the problem at hand and employs the comparative case method of investigation to identify policy options;[16]
- Assessing those options by means of either presenting alternative scenarios (and describing the likely consequences of each option) *or* making explicit a strategic choice (that is, explicit identification of goals and/or value premises);[17] and
- Including—indeed, meaningfully engaging—all stakeholders in the policymaking process (Whalen 2013a).

That essay was not intended to be the last word on the matter, but it is a start—and, perhaps, offers one way to shape the meaning of higher efficiency (as well as Klein’s other concepts) for a particular time and place.

**Klein on Institutionalism and Keynes**

In addition to writing about business cycles and public policy, Klein wrote about the economics of Keynes and its relationship to institutionalism. A look at those writings show an evolution in his thinking. In an essay published in 1980, Klein emphasized the differences between institutionalism and Keynes (Klein 1980). By 2003, however, Klein had come to view Keynes as “profoundly institutionalist” in his

approach (Klein 2003, 49). Taken as a whole, Klein's essays on institutionalism and Keynesianism and his scholarship on cycles and policy point in the direction of today's post-Keynesian institutionalism.

*Klein's View in 1980*

Klein addressed the relationship between institutionalism and Keynes in an essay published in 1980 as part of a festschrift for institutionalist Allan G. Gruchy. That essay argued that Gruchy's concept of "holistic economics" highlighted the most distinctive feature of institutionalism. In the course of developing his thesis, Klein explained that holistic economics was different from macroeconomics, for which it was sometimes mistaken.[18] Tracing the introduction of macroeconomics to publication of Keynes's *General Theory*, Klein maintained that although Keynes represented a break from the conventional economics of his time, Keynes's concerns were not the same as those of the institutionalists and Keynes's notion of the economy as a whole was not the same as that of holistic economics (Klein 1980).

According to Klein (1980), Keynes's macroeconomics was concerned primarily with the quantity of aggregate economic activity, while institutionalism is concerned with the overall direction of economic activity. Keynesian economics tells us where the economy is relative to full employment, but holistic economics wants to know more, including: what the employed are producing; how output-mix decisions were determined (including, for example, whether concentrated economic power played a role); and the implications of the resulting economic activity on resources, technology, and the quality of life. In short, Klein (1980, 48-49) argued, "The output of Keynes's macroeconomy is *measured* but not evaluated," whereas institutionalism is concerned with "*where* the economy is going…and how its emergent operation impinges on its participants."[19]

*Klein's View after 1980*

Klein returned to the relationship between institutionalism and Keynes in an essay published in 1986 (republished in Klein 1994, 105-114). That essay discussed both traditions in the context of offering a

critical assessment of new classical economics. In a section of the essay titled "The Institutional Character of the Keynesian Message," Klein argued that "the Keynes of the *General Theory* had one characteristic in common with institutionalists: a penchant for facing the economy as in fact it was, and working at explaining how it functioned" (Klein 1994, 106). According to Klein, the genius of Keynes was to drop the unrealistic assumptions of neoclassical economists—Say's Law (the notion that supply creates its own demand), full employment of all resources, and self-correcting markets—in favor of developing a theory on which useful macroeconomic policy might be based. Keynes's alternative starting point was the realistic premise of persistent, large-scale unemployment (a problem that he viewed as requiring analysis and concerted public action, unlike new classical economists, who view the same unemployment as a market-clearing state of affairs produced by economic agents with rational expectations). In this approach, wrote Klein (1994, 106), Keynes resembled Wesley Mitchell, "who insisted that economic theory could be usefully developed only if we first get 'the main facts of history.'"

It is possible that the difference between the essay that Klein published in 1980 and the one he published in 1986 could be attributed to a different emphasis. That explanation is consistent with the fact that the 1980 essay was prepared to honor Gruchy, who was known for contrasting the economics of Keynes and the institutionalists, whereas the 1986 article sought to highlight the extent to which new classical economics represented a radical departure from the Keynesian thinking its adherents aimed to replace.[20] In 1998, however, Klein wrote an essay titled "Normative Macroeconomics: Conjoining Keynes and Institutionalism," in which he argued that there is "great overlap between institutionalism and Keynesian macroeconomics" and that integrating the two schools would enhance both traditions and provide a stronger foundation for macroeconomic theory and policy (Klein 1998). Moreover, that essay was followed a few years later by one in which Klein (2003) argued (as mentioned above) that Keynes's approach was "profoundly institutionalist."[21] This suggests more of an evolution in Klein's thinking than a mere shift in focus from one article to the next.

In the essay that Klein produced in 1998, he argued that institutionalism “has much in common” with the macroeconomics of Keynes. In particular, Klein (1998, 44) stressed that the economics of Keynes and institutionalists “converge in their normative insistence on judging the imperfect performance of flawed economies.” In fact, one section of Klein’s essay bears the title “Keynesian Economics: Institutionalist Macroeconomics.” In that section, Klein (1998, 46) writes that a major thesis of his essay is that “Keynes gave impetus to the institutionalists’ longstanding concern with economics as a science of valuation rather than mere allocation.” According to Klein, Keynes tossed out the notion that the economy’s actual equilibrium has normative value (that is, it was no longer true that “what *is* must be ‘good’”) and provided room for economists and policymakers to identify and pursue a different equilibrium (full employment). Thus, Klein reached the conclusion that Keynes was “a major contributor to that profoundly institutionalist concern with valuation” (Klein 1998, 46).

Klein’s essay also argued that although many institutionalists failed to appreciate the commonalities between Keynes and institutionalism, there were exceptions. Ayres was one: “At the end of his life, Ayres did a virtual about face and, to his credit, gave evidence that he not only had come to appreciate the significance of what Keynes had done, but saw that Veblen’s concerns and those of Keynes had large overlap” (Klein 1998, 49). J. Fagg Foster and Gladys Parker Foster were the other exceptions identified and discussed by Klein.[22] For example, according to Klein, Fagg Foster called Keynes’s *General Theory* “the most notable application of the institutional approach to a fundamental economic problem” and, as early as the 1960s, Foster suggested that Keynesian theory “was a theory of economic process, or at least pointed in that direction” because Keynes treated institutional structures, and in turn, the whole economic system, as adjustable.

*Klein and Post-Keynesian Institutionalism*

Klein’s essays on institutionalism and Keynesianism *and* his scholarship on cycles and policy both point toward today’s post-Keynesian institutionalism (PKI). But Klein never pursued the integration of

institutional and Keynesian economics that he identified as capable of enhancing both traditions.[23] In fact, he gave little attention to the research of economists who were engaged in precisely that sort of undertaking.

Today, a number of economists are working to conjoin institutionalism and the economics of Keynes for the purpose of advancing theory and policy; Klein's work foreshadowed some of that ongoing research. To be sure, not everyone agrees on the contours of that PKI (as is also the case with institutionalism, post-Keynesianism, and most other schools of economic thought), but one recent examination of those contours can be found in the lead article of a special issue (on post-Keynesian and institutional political economy) of *European Journal of Economics and Economic Policies: Intervention*. Klein anticipated many aspects of the PKI described in that article—by Whalen (2013b)—including: the aim of addressing unemployment and other real-world economic problems by constructing models that reflect the reality of how humans behave and how institutions are adjusted; the emphasis on an ever-evolving economy; and the perspective that actual economic outcomes are not natural, inevitable, or inherently optimal.

However, in addition to not pursuing his own integration of institutionalism and Keynes, Klein rarely discussed the work of others who were doing so. For example, Klein (2006) cited Dudley Dillard's *The Economics of John Maynard Keynes* in a footnote to his final book, but ignored Dillard's decades-long effort to bridge institutionalism and Keynesianism by highlighting their shared interest in a monetary theory of production (see, for example, Dillard 1980).[24] Klein also gave little or no attention to Wallace Peterson, Alfred Eichner, and Minsky, who each contributed to integrating institutionalism and Keynes.[25] Thus, Klein's essays on institutionalism and Keynes point to PKI, but they don't really offer much help to get us there.

Klein's writings on business cycles—and fiscal policy (to be discussed shortly)—also suggest the possibility of a PKI. If Klein had focused his scholarship on industrial organization, the economics of

developing countries, health economics, or any of a number of other fields, his work would have not fueled interest in the integration of institutionalism and Keynes. Instead, he was an institutionalist who studied booms and downturns and the associated problem of unemployment—the common ground of Veblen, Commons, Mitchell, and Keynes.

Moreover, in at least one essay, Klein (1994, 244-272) offers tantalizing hints of room for institutionalist and Keynesian integration. In that essay, "The Neglected Institutionalism of Wesley Clair Mitchell: The Theoretical Basis for Business Cycle Indicators," Klein mentions Veblen's influence on Mitchell, which yielded an appreciation of the distinction between business and industry (and between making money and making goods) and a recognition of the central role of expected and realized profits in business cycles. What is tantalizing here is that—as Dillard (1948, 266-333) indicated long ago—both elements were also key components of Keynes's thinking.[26] Also intriguing is that many of the indicators contained in Klein's eclectic theory of cycles (see Table 1) can be matched with the various factors discussed in the cycle chapter (chapter 22) of Keynes's *General Theory* (Keynes 1936).[27]

Looking beyond Klein's writings on cycles, one finds that his fiscal-policy writings point to today's PKI in at least two ways. First, by focusing on public budgets from a business-cycle perspective and emphasizing the use of fiscal policy as a tool for achieving full employment, Klein offered an approach to fiscal policy that aligns with the thinking of many of today's post-Keynesian institutionalists.[28] Second, by suggesting that automatic stabilizers might include an on-the-shelf set of public-works projects, Klein was anticipating a recommendation often proposed by contemporary institutionalists and post-Keynesians.[29]

**Summary and Conclusion**

This article has reviewed and assessed Philip Klein's career-long focus on business cycles and the public sector. Motivated to study economics to address poverty, inequality and the other economic problems faced by ordinary women and men, Klein followed in the footsteps of Wesley Mitchell by working on

business cycles and helping to keep alive the tradition of institutional economics, especially by writing on the role of government in a market-oriented economy. He grew up in Austin with Clarence Ayres as his neighbor, served as president of AFEE in the middle of his professional life, and finished his career with an impassioned plea for an economics that truly confronts the economy (Klein 2006). Observing that his AFEE address brought him back where he began, Klein (1994, 43) mused: "*Plus ca change, plus c'est la meme chose.* What would Clarence Ayres have to say about that?"

Klein's work on business cycles focused on the development of cycle indicators, explicitly building on the pioneering efforts of Mitchell and the nascent NBER, and was supplemented by essays critical of mainstream macroeconomics. His research on indicators led to an eclectic (meta-)theory of business cycles that remains useful as a way to synthesize a broad literature, even though the less comprehensive institutionalist analyses of Sherman and Minsky have often proven more useful in shedding light on recent cyclical developments. His essays on mainstream theory were timely when published, and contain enduring discussions of the malleability of the "natural" rate of unemployment and the value of a behavioral approach to expectations.

Klein's attention to the public sector centered on introducing four concepts to explain how policy is made and plays a role in economic life—higher efficiency, collective ought, the value floor, and emergent values; he also addressed fiscal policy, emphasizing its role in moderating business cycles. In the end, his fiscal-policy insights are enduring but his overall discussions of the public sector provide an unsteady foundation for making and assessing economic policy from an institutionalist perspective. In all of his work on policy and the public sector, however, Klein challenge us to think about the most fundamental issues in economics.

Klein also wrote about the economics of Keynes and its relationship to institutionalism. Over time, he came to view Keynes as "profoundly institutionalist" in his approach. Klein also argued that conjoining Keynes and institutionalism would be advantageous not merely to both traditions but also

(indeed, more importantly) to economic theory and policy. Taken together, Klein's essays on institutionalism and Keynesianism and his scholarship on cycles and policy point in the direction of today's PKI.

Today, as post-Keynesian institutionalists confront the difficulties faced by the poor, the unemployed, and working families (the "common man"), they can and should build on the work of Klein and the bridge he provides between contemporary PKI and institutionalism's founders (Veblen, Commons, and Mitchell). And if a guiding principle is needed, let it be the one that Klein (1994, 310) offered a quarter-century ago, when he asked: "Is it not time, finally, for economic theorists to look at the world around them and ask themselves, in all humility, 'How can we help?' "

**Table 1. Philip Klein's Eclectic Cycle Theory: Business Cycle Indicators, Classified by Cycle Theories**

| Classification of Theories | Classification of Indicators | | |
|---|---|---|---|
| | Leading | Roughly Coincident | Lagging |
| I. Purely Monetary | Money Supply | | |
| II. Savings-Investment Theories | | | |
| A. Over-Investment | | | |
| 1. Monetary | Changes in consumer installment debt | | Commercial and industrial loans outstanding; bank interest rates; business loans (short-run); average prime rate charged by banks |
| 2. Non-Monetary | Average work week; manufacturers' new orders, durable goods | Manufacturing and trade sales; GNP, constant dollars; index of industrial production | Business expenditures for new plant and equipment |
| B. Partial Over-Investment | Index of net business formation; index of building permits, private housing; contracts and orders; plant and equipment | | Business expenditures for new plant and equipment |
| C. Under-Consumption | Initial claims, unemployment insurance | Personal income; non-agricultural employment; unemployment; retail sales | Ratio of consumer installment credit to personal income; average duration of unemployment |
| D. Dynamic Multiplier-Accelerator | Index of net business formation; new orders; durable goods; contracts and orders; plant and equipment | | Business expenditures; plant and equipment |
| III. Business Economy | | | |
| A. Price/Cost Relations; Profit Margins; Horizontal Maladjustments | Index of industrial materials prices; corporate profits after taxes; index of price per unit labor cost; change in sensitive prices (smoothed) | Manufacturing and trade sales; retail sales | |
| B. Psychological (Expectations) | Index of stock prices | | |
| C. Inventory | Change in book value of manufacturer and trade inventories | | Index of labor cost per unit of output |
| D. "Political" Business Cycle | Money supply | | Manufacturing and trade inventories; total book value |

Source: Klein (1994, 264-265).

**Notes**

1. For Gordon's own appreciation of key aspects of institutionalism, see Gordon (1963; 1976).
2. For a discussion of the Age of Keynes and its aftermath, see Peterson (1987).
3. Mitchell was not the only major institutionalist affiliated with the early years of the NBER. Between 1920 (when NBER was founded) and 1928, John R. Commons served on the NBER board of directors. In contrast to the NBER, the CIBCR was established much later, in 1979 at Rutgers University. Four years later, it moved to Columbia University. In 1996, CIBCR evolved into an independent research group called Economic Cycle Research Institute (ECRI).
4. According to Anirvan Banerji, co-founder and research director of ECRI, Klein and Moore began their project on international economic indicators in the early 1970s (Banerji and Dua, 2011, 9). Klein also published other studies related to business cycles in the 1960s and 1970s; see, for example, Klein (1965; 1976) and Klein and Gordon (1971).
5. In addition to the theories listed in Table 1, Klein also mentions other theories that focus on agriculture and the weather, but he does not link those theories to his reliable indicators.
6. In addition to serving as associate editor of the *International Journal of Forecasting* and co-author of a textbook on cycles and forecasting (Niemira and Klein 1994), Klein participated regularly in the conferences of the Centre for International Research on Economic Tendency Surveys, a community of scholars who analyze business cycles and their effects on economic and social issues.
7. Today, summary reports on indicator indexes are published as news releases by ECRI and by the Conference Board.
8. Some ECRI research suggests that economic indicators can be used by individuals and organizations to reduce risk in stock market investments (see, for example, Moore, Boehm, and Banerji 1994).

However, Klein never focused on such applications. For a further critical (but sympathetic) assessment of work by Klein and Moore on indicators, see Cornford (1989).

9. Sherman (2001) offers a masterful presentation of Mitchell's cycle theory.
10. It is clear that Klein was aware of the focus on profits at the heart of Mitchell's theory of cycles (see, for example, Klein 1994, 248-249); Klein just did not pursue that line of analysis beyond his work on indicators.
11. Klein's essay did not elaborate on the policies needed to tackle unemployment and inflation, but other institutionalists have called for a variety of initiatives, including public-service employment, training and apprenticeship programs, and an incomes policy. See, for example, Briggs (1987) and Peterson (1987), which were published shortly before Klein delivered an early version of his essay on the natural rate of unemployment. Also, see Klein (2003, 75), which mentions Peterson's perspective on incomes policies.
12. Studying surveys of entrepreneurs within the European Economic Commission, Klein found that turns in expected price changes followed actual price changes. He concluded: "What this suggests, of course, is in line with what we have found to be true of many types of survey questions. The respondents extrapolate the past—in this case, they think prices will change in whatever way corresponds to their movement in the recent past….While expectations are critical variables, in the case of selling prices the influence appears to run from actual price changes to expected price changes, not the other way around" (Klein 1994, 98). Klein does not discuss indicators of entrepreneurs' expectations regarding profits and investment.
13. Klein (1994, 195) distinguishes "efficiency" from "higher efficiency" by describing the former as "narrow efficiency," which refers to "quantitative outputs per unit of inputs;" see also Klein (1994, 189-190).

14. National socioeconomic statistics (sometimes called development indicators) also provide a portrait of the value floor; see Klein (2000).
15. Klein (1994, 125-178) does devote two essays to economic power, but on the subject of public policy a main point in those essays is just that “economic power distorts the allocative process from what it would be otherwise” (Klein 1994, 169).
16. For more on institutional analysis and the comparative case method, see Atkinson and Oleson (1996) in addition to Whalen (2013a).
17. As Myrdal (1969, 55-56) wrote, there is no such thing as “objective” social research; the closest that researchers can come to objectivity is to “expose their valuations to full light” and to make their premises “conscious, specific, and explicit.”
18. Relying on the words of Gruchy, Klein (1980, 47) describes holistic economics as the study of the economic system “as an evolving, unified whole or synthesis, in light of which the system’s parts take on their full meaning.”
19. Readers familiar with Joan Robinson’s Richard T. Ely Lecture will immediately recognize the parallels in Klein’s distinction between Keynesian and institutional economics and Robinson’s distinction between what she called the first and second crises of economic theory (Robinson 1972).
20. In a footnote to his essay for the Gruchy festschrift, Klein (1980, 57, n. 16) wrote, “Gruchy has viewed Keynes in essentially the same way.”
21. In his 2003 essay, Klein’s discussion of Keynes’s institutionalist approach is similar to the one found in his 1986 article. In particular, the 2003 essay emphasizes that Keynes, like the institutionalists, focused “on the economy as it actually is, with the express purpose of illuminating market failures so that public policy could be brought to bear on overcoming them” (Klein 2003, 49).
22. Klein’s 1998 essay mentions in passing that Philip Arestis and Alfred Eichner also recognized the compatibility of Keynes and institutionalism, but apparently much more recently than J. Fagg Foster

(Klein 1998, 51). Other essays by Klein also note (but give little attention to the fact) that Wallace Peterson saw important connections between these two strands of economics (Klein 1994, 35; Klein 1980, 48).

23. Klein (2006, 362-368) did, however, outline a baker's dozen of postulates of "heterodox economics" in his final book. Those postulates derived from the book's critique of mainstream economics and were solidly grounded in his institutionalist perspective.
24. See also Wray (2007), which examines the common ground of a "monetary economy" in Veblen's *Theory of Business Enterprise* and Keynes's *General Theory*.
25. Minsky's contributions appear prominently in four of the seven articles making up the special issue on post-Keynesian and institutional political economy that was published in 2013 by the *European Journal of Economics and Economic Policies: Intervention*. The institutionalist and Keynesian dimensions of Minsky's work are also featured prominently in essays by Dillard (1987) and Peterson (1987), but I find no references to Minsky's work in Klein's publications. For two contributions to PKI that are mentioned by Klein, see Peterson (1977) and Arestis and Eichner (1988).
26. In Keynes's case, the underlying dualism centered on a distinction between finance, or speculation, and industry (Dillard 1948).
27. Also pointing toward today's PKI are Klein's essays on macroeconomics, which, as discussed above, stress a behavioral approach to expectations and human behavior. His essays hint at the need to incorporate into economics an awareness of conventions, heuristics, herding, contagion, loss aversion, and the like. Indeed, those elements are increasingly finding their way into macroeconomics (see, for example, Baddeley 2014) and are contributing to the construction of PKI (see, for example, Whalen 2011).
28. A pair of notes are warranted here. One is that I find Klein's position on fiscal policy broadly consistent with the views of those contemporary institutionalist and post-Keynesians who find

inspiration in the functional finance literature (for more on that literature and its relationship to institutionalism and post-Keynesianism, see Nesiba 2013). The other is that although I have been unable to find any discussions by Klein on the fact that the budget of the U.S. government does not distinguish between operating and capital (or public investment) expenditures, I see no reason why giving greater attention to capital budgeting—an idea that sometimes appears in the PKI literature—would be incompatible with Klein's approach to fiscal policy (for more on federal budgeting and the absence of a capital budget, see Whalen 1995).

29. Klein's public-works suggestion has been part of institutional economics for a long time (see, for example, Copeland 1967); it is also compatible with the contemporary institutionalist and post-Keynesian notion of government as employer of last resort (see, for example, Whalen 2011).

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