

## KEYNESIAN POLITICS: THE POLITICAL SOURCES OF ECONOMIC POLICY CHOICES

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THE ECONOMIC downturn of the 1930s was worldwide. The magnitude of the contraction subjected all countries to a universal shock. For the very imperfect laboratory of the social sciences, this provides an unusual opportunity—a chance to measure national particularities through different responses to a common stimulus. While countries responded to the shock of the 1930s by changing their economic policies, the actual content of those changes differed. In some cases we find early forerunners of demand stimulus, in other cases more habitual deviations from classical orthodoxy, such as devaluation and tariffs. The differences have to do with politics, with the political context of the debate over demand stimulus.

Looking at the economic content of Keynesian policies defines the topic as one in the history of ideas. The innovation to be explained in this way is an intellectual one: who actually conformed to the policy prescription and through what intellectual mechanisms did its influence spread? But the 1930s was marked not only by intellectual innovation, but by political innovation as well. Sharp departures in tradition occurred, established constitutions were overthrown, political alliances disintegrated, new party alignments emerged, and new mechanisms of decision making were formed. The period from which the seeds of Keynesianism came was also fertile ground for new political growth. The two are related. Experimentation in economic policy was, as usual, intimately linked to innovation in politics.

The adoption of Keynesian policies is thus a problem not only in the history of ideas, but in political sociology. Good ideas do not always win. Many interesting and powerful theoretical constructs have been developed, be it in economics or other domains, which have had little or no impact on policy. To become policy, ideas must link up with politics—the mobilization of consent for policy. Politics involves power. Even a good idea cannot become policy if it meets certain kinds of opposition, and a bad idea can become policy if it is able to obtain

support. An explanation of the pursuit of Keynesian policies (as opposed to a description of measures taken, or an account of the intellectual trajectory of ideas) must therefore explore the politics which surrounded the conflict over policy responses in the period when such policies emerged—the 1930s and the years after World War II.

One step in a political analysis would be to identify the decision makers who took up these policies. In the 1930s several important figures supported such policies. These included Ernst Wigforss in Sweden, Adolf Hitler in Germany, and Franklin D. Roosevelt in the United States. These individuals had power and their countries experimented with such policies. Others expressed support for these ideas, but lacked the power to make them national policy, at least in a constitutional political framework—Vladimir Woytinsky in Germany, David Lloyd George in Great Britain, and Keynes himself. Individuals surely matter; individual proclivities provide some leverage for understanding—the flexibility of Wigforss and Woytinsky, the rigidity of Philip Snowden and Rudolf Hilferding.

Nonetheless, identifying the individuals involved is not a sufficient political explanation. We must explore the broader political context that allowed the predilections of specific individuals to become policy. The emphasis must be on politics—on the processes that link together several elements of power, each operating in partial autonomy following a somewhat different logic.

### A BRIEF POLITICAL THEORY OF ECONOMIC POLICY MAKING

From the standpoint of politics, economic policies derive from the interaction of several sets of societal actors.<sup>1</sup>

Public policy passes ultimately through the hands of office holders, individuals who occupy positions defined by institutional arrangements, be these constitutions or less formal political parties. Politicians must be concerned with the mobilization of consent, the ability to elicit support from those with the power to allow or block whatever the politicians seek to do. In constitutionalist systems, a major source of power involves the ability to win elections. Other forms of power matter in these systems as well, such as coercion (military and police), law ad-

<sup>1</sup>A fuller account of the policy options and political variables shaping their choice may be found in Peter Gourevitch, *Politics in Hard Times: Comparative Responses to International Economic Crises* (Ithaca: Cornell University Press, 1986). Gourevitch compares the crises of 1873–1896, 1929–1949, and 1971–1973 to the present, examining the cases of Sweden, Germany, the United Kingdom, France, and the United States. The notes contain a fuller account of the sources used for this essay.

judication (courts), information (media and schools), and economic power. To govern, politicians must attain office, and then obtain consent while holding office. Politicians judge economic policy alternatives at least in part by the effects these have on the holding of office and the ability to govern.

A second group of key actors in the making of economic policy are economic actors, those individuals and organizations of individuals which occupy another set of key institutional positions, those in the economy which confer a functional power on economic activity. These actors have leverage over policy because of their control over vital economic activities: manual and skilled labor, investment, management, professions. These actors can apply pressure by offering or withholding their services, by working or striking.

How do economic actors evaluate policy alternatives? Policy preferences are strongly, though not exclusively, shaped by economic "location," by the incentives which location in the economy provides; for example, workers and owners in industries facing severe competition from foreign producers are more likely to support tariff barriers than are their counterparts in companies which are highly competitive. Economic interest shaped by economic location is not wholly adequate as a predictor of policy preference, but it tells us a lot. Other influences on preference include economic ideology, religion, ethnicity, and party loyalty.

Like politicians, economic actors cannot act alone. No economic group is strong enough to prevail on its own. It needs allies. Getting allies requires bargains, trades, exchanges, giving up something to get something—in short, politics. Hence, economic actors and politicians interact. Each needs the other. Politicians need the support of economic actors to win office and to govern. Economic actors need the support of politicians to construct winning coalitions for getting their policy preferences accepted.

Each looks at economic policy from a somewhat different angle. Economic actors begin with an economic situation, to which they link an economic policy preference, and then seek out a political strategy to make that preference prevail. Politicians begin with a political situation, for which they need support, and then seek economic policies which provide that support. In sum, politicians seek policies that suit their politics. Economic actors seek politics that suit their policies.

The interaction of politicians and economic actors is not wholly straightforward, that is, it does not happen in simple, direct ways. Rather, the interaction is refracted through institutions. Politicians and economic interests work through mechanisms set up to aggregate preferences, make decisions, and provide modalities of enforcement. These mechanisms themselves influence the character of the interaction, hence the outcome. And the operators of these mechanisms (civil servants and others) themselves have influence over the results.

## THE DEPENDENT VARIABLE

The economic policy outcome of interest to us in this volume is Keynesianism. However, Keynesianism was only one form of policy discussed in the 1930s. There were others, also quite capable of generating intense controversy and attention. There were several policy options available, at least in principle, to decision makers. It was the job of the political process to choose among these options.<sup>2</sup>

Among the policy alternatives was an orthodox one—deflation—and an orthodox deviation from orthodoxy—protectionism. Deflation, the dominant neoclassical view which prevailed before 1929, held that the right way to handle depressions was to do little, allowing market forces to provide the needed self-correction: unemployment would force down costs, which would allow prices to fall to the appropriate level of demand, which would then start the cycle of buying and selling back upward. Governments should aid this process in a procyclical way by cutting taxes (and spending) to help lower costs.

Nearly all governments tried deflation as a first response to the Depression of 1929. As economic conditions continued to worsen and cause rising dissension, most governments turned toward alternatives. As this was not the first depression in economic history, this would not be the first occasion of deviation from orthodoxy. In earlier periods, many countries turned toward protectionism—tariff barriers that forced domestic demand upon domestic production. At the same time, many countries abandoned the neoclassical emphasis on stable exchange rates by devaluing their currency. As Keynes noted, three policy options could be seen as different ways of doing the same thing: demand stimulus, protectionism, and devaluation were all ways of boosting domestic demand for national products.

Two other policy options figured in these debates. Neomercantilism—or in current parlance, industrial policy—involved regulation of markets through price supports, production sharing, aid to specific companies or industries, and special credits; in the 1930s, many called this "corporatism." Nationalization, by contrast, involved public ownership of industry and physical planning rather than market mechanisms for economic decision making.

These alternative policies—neoclassical deflation, protectionism, demand stimulus, neomercantilism, and nationalization/planning—were to varying degrees debated in all the industrial countries during this period. A careful unraveling of the policy trajectory of each country would show specific sequences,

<sup>2</sup> See Gourevitch, *Politics in Hard Times*.

where policies were tried then abandoned, then new policies or parts of policies were tried, and so on. The trajectories are too complex to trace here.

It is notable, however, that in the 1930s few countries tried demand stimulus. Some discussions and partial efforts appear to have taken place in Sweden under the Social Democrats and in France under the Popular Front; but the effective policy in Sweden relied mostly on devaluation and market regulation, and the same was true in France. The most extensive fiscal stimulus seems to have taken place in Nazi Germany from 1933–1935 and to a lesser degree in the United States in 1938–1939. The weakest prewar impulse to demand management appears to have been in the United Kingdom.<sup>3</sup>

The major usage of demand stimulus as a policy option occurred after World War II. In the 1930s, political obstacles toward such policies remained great. To understand these obstacles, the situations which allowed some experimentation in those years, and the shifts after the war, an examination of political processes is necessary.

#### APPLICATIONS OF THE THEORY

Political pressure and economic analysis interacted in the 1930s to produce novel arrangements in politics and sharp departures from economic orthodoxy. When the Depression began, all countries started by pursuing the orthodox policy of deflation. This did not work fast enough to satisfy very many people. Economic actors began to question their economic analyses. If unemployment and collapsing profits could not be satisfied by orthodoxy, something else would have to be found. Politicians noted considerable distress among voters, interest groups, party leaders, and others. They too began looking for policy options which would have both better results and stronger support.

Orthodoxy gave ground under pressure. Economic pressure forced the initial moves. The banking community insisted on defending the pound in 1930 and 1931, which provoked a split in the Labour party. But when investors abandoned the pound in September 1931, bankers then told the government it had no choice. This event shows rather starkly the connection between policy and economic actors. But it is atypical in its clarity. More common are structural shifts in the behavior of economic actors and their relationship to the government. Several patterns can be noted.

<sup>3</sup> H. W. Arndt, *The Economic Lessons of the Nineteen-Thirties* (Oxford: Oxford University Press, 1944); Andrew Shonfield, *Modern Capitalism* (London: Oxford University Press, 1965).

#### *The Importance of Farmer-Labor Alliances*

Among the most striking political innovations of the 1930s was the cooperation of farmers and labor associations.<sup>4</sup> Prior to this period these two groups generally fought. Farmers wanted cheap industrial goods and high prices for farm output. Labor wanted cheap food and high prices for industrial goods to support high wages. By and large, this conflict between producers predominated. Economic policy issues put them on opposite sides: free trade versus protectionism, union-organizing rights, urban welfare legislation, agricultural price supports, and extension services.

There were potential grounds for cooperation. Both farmers and workers had grievances against capitalism and the market. Farmers complained about industrialist control of transportation, tight money, retailing, and the instability of agricultural markets. Labor complained about working conditions, wages, unemployment compensation, and other welfare services. In some places, farmers saw that high wages could support higher consumption of quality food products like meat and cheese; and in some places, labor saw that farmers could be consumers of industrial output. But through most of the nineteenth century and well into the twentieth, the potential sources of cooperation between agriculture and labor were overwhelmed by the grounds for antagonism. Producer conflicts predominated.

The Depression of the 1930s changed this. Desperation shook people loose from established moorings. Farmer and labor associations cast about for other options. Orthodox business elements had trouble with their demands. Assistance either to farmers or workers could not fit classical assumptions.

Some political actors were not so bound by tradition. In Sweden, the Social Democratic leadership saw its opportunity.<sup>5</sup> It proposed a trade with the agrarian leadership: price supports and market regulation for agriculture; unemployment compensation and other labor market measures for labor. The deal became known as the cow trade. It formed the basis of over four decades of Social Democratic leadership in Sweden.

<sup>4</sup> Alexander Gerschenkron, *Bread and Democracy in Germany* (New York: Fertig, 1943, 1966); Barrington Moore, *Social Origins of Dictatorship and Democracy* (Boston: Beacon, 1966).

<sup>5</sup> From the substantial literature on Sweden, see Andrew Martin, "The Dynamics of Change in a Keynesian Political Economy: The Swedish Case and Its Implications," in Colin Crouch, ed., *State and Economy in Contemporary Capitalism* (London: Croom Helm, 1979), pp. 88–121; Bo Gustafsson, "A Perennial of Doctrinal History: Keynes and the 'Stockholm' School," *Economy and History* 16 (1973), pp. 114–28; Lars Johnung, "The Depression in Sweden and the United States: A Comparison of Causes and Policies," in Karl Brunner, ed., *The Great Depression Revisited* (Boston: Nijhoff, 1981), pp. 286–315; Donald Winch, "The Keynesian Revolution in Sweden," *Journal of Political Economy* 74 (April 1966), pp. 168–76; Stephen Koblik, ed., *Sweden's Development from Poverty to Affluence* (Minneapolis: University of Minnesota Press, 1975).

The leaders of this alignment talked about demand stimulus. They were aware of these ideas and had participated in international and domestic discussions of them. However, the actual usage they made of pump priming was quite limited. The pre-Social Democratic government had already caved in to the devaluation of the pound by devaluing the Swedish crown. Swedish recovery was fueled by the revival of demand outside Sweden, especially in Great Britain and Germany.

But the break with orthodoxy became institutionalized by the political changes associated with this new alignment. The coalition used government power to develop regulated markets for labor and agriculture as well as various forms of public service. Political power forced business owners into an accommodation. The election of 1936 made it clear that the new political alignment was not reversible. In its wake, tripartite negotiations began among labor, farmers, and business under government leadership. They produced the Saltsjobaden accord of 1938: labor agreed to avoid strikes and accept private ownership of companies and investment; business agreed to high wages and a full employment commitment.

It was this agreement which continued the economic experimentation of Swedish governments. The commitment to full employment arising out of this political arrangement generated a need for policies that would implement it. The regulatory system of labor market intervention was one such policy. Demand management was another. The Swedes worked on this early.

The role of demand management ideas in this process was largely a political one. It did not immediately shape government policy. This came later, mostly during and after World War II. Rather, demand management ideas helped to redefine the political environment. It changed political leaders' views of the definition of friends and enemies. Classical orthodoxy, like classical Marxism, had a stark view of conflicts, which pit groups against each other. Demand management saw the potential for a collective game, where high purchasing power everywhere was good for everybody. This helped people find allies. Certainly other factors played a large role in the emergence of this compromise among historic antagonists. But the alliance itself was vital to progress in economic policy.

Comparison to other countries is instructive. Farmer-labor alliances were vital to the New Deal. From the Civil War to the election of 1932, the economic issues of U.S. politics were strongly shaped by conflicts between agriculture and industry. On commercial policy, most farmers were free traders, while the industrialists of the U.S. heartland were protectionist. There were certainly exceptions in both cases (Eastern shippers and financiers thought internationally; midwestern dairy and meat producers thought about urban markets, hence industrial interests). But with the McKinley-Bryan battle of 1896, agrarian-populist concerns

left many labor and urban ethnic groups disaffected. Some farmer-labor experiments were tried in states like Wisconsin and Minnesota.<sup>6</sup>

It took the Depression to generalize these to national politics. Through the New Deal coalition, agriculture and labor worked out an accommodation rather like that of their Swedish counterparts: strong support for agricultural prices and market regulation in exchange for union-organizing rights, unemployment benefits, and Social Security. Major political support for the first and second New Deals came from the large bloc of urban and farmer voters and interest groups. So did support for the demand stimulus experiment of 1938. As many authors have noted, Roosevelt did not start out having much interest in deficit-financed pump priming. The attitude toward budget balancing was relatively orthodox. The policy changes of the first half-decade of the New Deal came in commercial and monetary policy (tariffs, devaluation, floating currency), in regulation of markets (in labor, industry, agriculture), price supports, welfare subsidies, and the like. Demand management emerged by experience, after other things were tried. Efforts to balance the budget in 1936–1937 caused a recession. By then policy makers understood the relationship. Six years of experimentation with policy made them more willing to think in different terms. Political support for activism in those years ultimately set the groundwork for Keynesian forms of activism.<sup>7</sup>

In France, farmer-labor collaboration was vital to the Popular Front. Political cleavage lines in that country were sharply fragmented by many issues besides those of political economy (religion, political ideology, foreign policy, and constitutionalism, to name a few). But there again, farmer and labor organizations had not had an easy time working through political arrangements for common policy purposes. The alignment of the Radicals with the Socialists and the Communists that emerged in the 1930s derived largely from the political goal of saving the Republic from right-wing attacks. However, it had the effect of allowing substantial experimentation with policy toward worker issues, agriculture, and demand stimulus. The alliance was fragile. Neither the political accommodation nor much of the economic one lasted.<sup>8</sup>

<sup>6</sup> From the vast literature on the United States, see W. A. Williams, *Roots of the Modern American Empire* (New York: Random House, 1969); Margaret Weir and Theda Skocpol, "State Structures and the Possibilities for Keynesian Responses to the Great Depression in Sweden, Britain and the United States," in Peter Evans, et al., eds., *Bringing the State Back In* (New York: Cambridge University Press, 1985), pp. 107–68; Tom Ferguson, "From Normalcy to New Deal: Industrial Structure, Party Competition and American Public Policy in the Great Depression," *International Organization* 38 (Winter 1984), pp. 41–94.

<sup>7</sup> Herbert Stein, *The Fiscal Revolution in America* (Chicago: University of Chicago Press, 1969).

<sup>8</sup> Francois Goguel, *La politique des partis sous la III<sup>e</sup> République* (Paris: Le Seuil, 1946); Henry Ehrmann, *Organized Business in France* (Princeton: Princeton University Press, 1957).

Two coalitional failures underline the importance of farmer-labor alignments: the United Kingdom and Germany. In Great Britain, the weakness of agricultural organizations helps account for the failure of the Lib-Lab coalition and for the relative lack of policy experimentation as well. With the onset of the Depression there was much talk of a Lib-Lab coalition (between the Liberal party, where Keynes was active, and Labour). It never came about. Great Britain had the smallest agrarian sector of any of the countries in question; it lacked a mass base of small farmers able to provide swing support for new policy moves. While many contingent factors shaped alignments, we may see the relative weakness of agriculture in British political economy as a contributing structural factor.<sup>9</sup>

The Lib-Lab coalition had the ingredients for policy innovation: a diverse base of support in the electorate and key economic interest groups and the intellectual ideas, developed by Keynes and endorsed by labor leaders like Bevin. Without the coalition, there was less experimentation. Britain certainly did deviate from its classical orthodoxy: devaluation and tariffs surely did not fit the free market principles developed in the nineteenth century. And these did have some significant effects on revival. But the British experience in these years was narrower and more orthodox in its deviations.

In Germany, farmer and labor groups were unable to come to accommodation within the framework of a constitutional order.<sup>10</sup> Such an alignment was explicitly proposed: the WTB plan was written up by activists in trade unions and farm organizations. It had the policy outlook of the Swedish cow trade and the U.S. New Deal. But the actual organizational leaderships could not agree on how to bring their organizations and membership in line. Too many elements of conflict blocked the way. Socialist groups tended to see farmers as petty capitalists. And business organizations refused to give up their orthodox dislike of market interventions in order to subsidize agriculture.

The Nazis were not so scrupulous. They were quite willing to advocate significant farmer assistance. And they won very strong political support for doing so. The sociology of Nazi support is rather complicated. They did poorly among organized union members and among Catholics. Among Protestants they did pro-

portionally about as well in a given socioeconomic category as that group had in the general population. They did disproportionately well among farmers.

The Nazi coalition was a perverse one, not only because of what it did (terror) but also because of its mode of construction. In other countries, the coalitions were formed by direct bargaining among group and party leaders. However, the Nazi coalition was formed by destroying organizations, repressing their leaders, and mobilizing mass support through new, party-controlled organizations. This perversity should not obscure an important point of comparison. As in the other countries, the Nazi support base was unusual. They linked together historically antagonistic groups, which had in earlier periods found cooperation difficult if not impossible. The inability of groups to reach a policy accommodation within the constitutional framework of the Weimar Republic contributed to the paralysis which the Nazis so skillfully exploited. Their authoritarian coalition provided the political basis for their own deviations from economic orthodoxy. As in other countries, the Nazis intervened in markets through regulatory mechanisms. And more than in other countries, the Nazis appear to have tried more extensive deficit-spending pump priming, even before the onset of military expenditure later in the decade. Their policy approach was not at all that which business groups would themselves have tried had they held power directly.

In each country, then, policy experimentation required political support. A major source of that support lay in farmer-labor coalitions. Labor support for full employment policies has always been a key ingredient for such policies. But it has never been enough. Agriculture has provided one major source of support. Business support is another.

#### *Business Attitudes Toward Demand-Stimulus*

Like any large, complex group, business has not been uniform in its attitudes toward economic policy options. No government can operate effectively in a constitutional capitalist polity without the support of a substantial portion of owners and managers of business. This truism applies to the politics of demand stimulus. Important elements of business have been supportive of breaks from economic orthodoxy, but the sharp disagreements among business elements have been critical to the policy debate.

To simplify greatly, we may differentiate business groups according to different "marginal propensities" toward "progressive" or "conservative" political alignment. Business groups must always make some choices of political economy, of how to link up market imperatives with political realities. A "progressive" posture links business, labor, and agriculture around programs of better wages and working conditions, institutionalized industrial relations, social insur-

<sup>9</sup> Robert Skidelsky, *Politicians and the Slump* (London: Macmillan, 1967); Donald Winch, *Economics and Policy: A Historical Study* (New York: Walker, 1969); Dennis A. Kavanagh, "Crisis Management and Incremental Adaptation in British Politics: The 1931 Crisis of the British Party System," in Gabriel Almond, et al., eds., *Crisis, Choice, and Change* (Boston: Little, Brown, 1973), pp. 152-223.

<sup>10</sup> Dietrich Bracher, *The German Dictatorship* (New York: Praeger, 1970); David Abraham, *The Collapse of the Weimar Republic* (Princeton: Princeton University Press, 1981; rev. ed., 1987); H. W. Turner, *German Big Business and the Rise of Hitler* (New York: Oxford University Press, 1985); Richard Hamilton, *Who Voted for Hitler?* (Princeton: Princeton University Press, 1982); Gershonkron, *Bread and Democracy*.

ance systems, and constitutional government involving respect for civil liberties, political rights, and some power sharing. A "conservative" posture links these groups around programs that favor investment-led growth, limited wages, weak unions, limited social insurance, and, in some instances, the use of state power to coerce labor into passivity.<sup>11</sup>

Political alignments and conflict turn on the axis of cleavage, on the issue being fought over. In some respects, business groups, be they progressive or conservative, have common interests in relation to labor: control of investment, strong managerial authority over wages, work organization, employment, taxation rates, and so on. On other issues, business groups may come into conflict: over foreign economic policy, credit costs, inflation rates, subsidies and taxes, regulation, and so on. One industry's product may be another industry's input. And when different branches of business find themselves with divergent interests and goals, each may seek allies from other social categories.

As historical conditions change, the social location of the ideological categories "progressive" and "conservative" shifts. Among the most vital influences upon the social location of the labels has been the international economy, in particular, battles between free trade and protectionism. On the issue of the proper relationship to the international economy, business groups have split very intensely. Roughly speaking, competitive firms and leading-edge industries within a country have supported free trade. These have often been dynamic and expansive high-technology industries, generally those at the export stages of the product cycle.<sup>12</sup> Conversely, firms facing strong competitive challenges and difficult international market conditions have supported protectionism. That disagreement cuts across other issues on which the owners of capital might agree: control of unions, defense of property rights, conflicts with the agrarian sector, business regulation, and so on. But on many occasions, these disagreements have been strong enough to break through common "class" positions and assert "sectoral" ones. At times these conflicts have led business leaders to make common cause with "class" enemies ("labor") or sectoral ones ("agriculture").

In nearly all countries in Europe and North America, one can find examples of these alignments. The Anti-Corn Law movement in the United Kingdom is the most famous—business, labor, and even farming elements united in the press for free international trade. Their counterparts in the United States include the Democratic party from the Civil War down to the 1920s, an alliance of southern farming which was free trade, and internationalist northern business elements with

some labor support against other domestic manufacturing elements and their work force. The move for free trade was one of the prime elements leading businessmen to seek labor allies. Free trade industrialists were generally the most willing to explore such alliances.

The Depression of 1929 shattered these relationships. Business groups shifted about in complex gyrations. When the Depression began, most groups overcame earlier disagreements in favor of deflation—the orthodox line of cutting government and labor costs to restore market viability. But under the hammer blow of worsening economic conditions, consensus crumbled. The collapse of international trade naturally undermined internationalist arguments and bolstered domestically-oriented ones. Industrialists looked to domestic markets to replace foreign ones and stabilize economic conditions. In place of an open but fluctuating world economy, they were increasingly tempted by more autarchic conditions—predictability at the expense of opportunity.

The mechanisms for creating stability varied. Tariffs were a familiar alternative, "the natural reflex of the Republican party under pressure," as one pundit put it. Regulation of domestic markets was another: price supports for agriculture, corporatist market-sharing arrangements, and regulatory commissions, of great variety and invention. *De facto* nationalization and public enterprise were widespread: coal mining in Great Britain, a spread of companies in Italy, TVA in the United States. Devaluation of the currency won support everywhere.

Deficit spending arrived in this context as one option among many. It was understood that way by contemporaries—devaluation, tariffs, or pump priming through deficits were simply different ways of mobilizing domestic demand when foreign ones disintegrated. Thus, it is important that demand stimulus entered the public discourse of policy debates as an aspect of economic nationalism. Initially, the support base for demand stimulus came from the noninternationally minded: labor facing high unemployment, farmers overwhelmed by international overproduction, and a variety of business groups. In earlier times, basic industries like steel and textiles had been leaders in protectionism and deeply antagonistic toward labor movements and labor demands. Now, under the press of the Depression, these historic enemies converged in support of breaks with orthodoxy. In various places, demand stimulus was one of those breaks.

These alliances, involving labor, agriculture, and some business allies, were by no means uniform in their political expression. Indeed, the opposite is the case. The political formulas—their ideological framework, organization, coherence, and degree of explicit bargaining—varied considerably. In Sweden, bargaining was the most explicit, direct, and visible (the Saltsjobaden accords of 1938). In the United States, the alignment comprised similar groups in a constitutionalist democratic framework of social democratic values, but it was not for-

<sup>11</sup> See Gourevitch, *Politics in Hard Times*, chap. 6; Ehrmann, *Organized Business*; Richard Kuisel, *Ernst Mercier: French Technocrat* (Berkeley: University of California Press, 1967).

<sup>12</sup> James Kurth, "Political Consequences of the Product Cycle," *International Organization* 33 (Winter 1979), pp. 1–34; Helen Milner, *Resisting Protectionism* (Princeton: Princeton University Press, 1988).

mal and not even explicitly social democratic. In Germany, the linkage was authoritarian and imposed. Labor organizations were destroyed, along with opposition parties. All organizations were controlled by the Nazi party. Policies promoting employment, social services, market stabilization, and the like were imposed on various groups, without much representation by their leaders. What happened cannot be seen as what business leaders may have done on their own—they were too divided and orthodox for that. Rather, the outcome was the result of a political process in which a diversity of constituencies allowed the Nazis to break with economic conventionalism. The formula that emerged in Germany was perverse and horrifying, but the link between political and economic experimentation can be found there as in other places. In Germany more than anywhere the linkage between demand management and economic nationalism was clearest. No government sought more autarchy, and none went so far with demand management experiments in the early 1930s. But in other countries lacking the perversity of fascism, the nationalist component of early interest in Keynesianism can also be detected: the first years of the New Deal and the debates in France and Britain in the first half of the decade.

After a few years of continued experimentation and change, however, Keynesianism shook loose this linkage with economic nationalism to become a pillar of internationalism. In the 1930s, this process could only happen where constitutional political forms continued to allow political movement. In Sweden, the United States, and elsewhere, the supporters of demand management switched sides as the international economy revived. Internationalist industries moved to restore the conditions favorable to trade and export. They sought to repair the international monetary system and reciprocal trade agreements. In seeking these moves, they needed allies and were willing to turn to agriculture and labor to find them. They learned to accept some of the demands of these groups, and in that respect were able to do better than their domestically oriented brethren.

Here some important differences among industries proved relevant. Steel, textiles, and other older sectors had the disadvantages of considerable overcapacity around the world, nondynamic technology, and labor market conditions which put them in constant conflict with trade unions. The internationalist high-technology industries were newer, with lower wage bills, less standardized labor, and more interest in labor-purchasing power. The latter found it easier to explore alliances with other social categories.

An older pattern of relationships was rediscovered, linking “progressive” industrial sectors to labor and farm allies. The older coalitions revived in new forms—the anti-Corn Law, free trading, constitutionalist movements found in international Keynesianism a new formula for political success. Sweden provided the most developed version of the model before the war: business–farmer–labor

understandings were based on full employment, subsidies for agriculture, demand management, labor market interventions, free trade, and private enterprise. Other countries worked out policies and political formulas after the war.

### *Economic Ideology*

In exploring political support for economic experimentation we have looked so far at the economic aspects of group support—what types of groups appear to have wanted which policies. This line of reasoning emphasizes demographic or “objective” features of policy support. A different approach looks at the realm of ideology. It assumes that “objective” situations are often unclear. Within groups there may be reasonable disagreement over which policy best suits a given situation. Where reality permits varying interpretations, ideology is extremely important. Ideology can be seen as a cognitive map, a way of economizing in the face of excess or imperfect information, a way of bringing some order and sense out of the jumble of possible viewpoints and understandings of reality.

In this regard, countries, leaders, and groups approached the confusing and disrupting reality of the 1930s rather differently. Experimenters and traditionalists appeared as different types everywhere, cutting across ideology and party. Wigforss in Sweden and Roosevelt were experimenters. They looked for economic ideas that suited political conditions—not totally, but with a high degree of pragmatism. Hilferding and Snowden, despite their socialist/Social Democratic party affiliations and roles as ideological spokesmen, by contrast held firm to traditional views of how capitalist economies worked. These views corresponded to that of many neoclassical bankers and industrialists, into which demand management and other deviations from orthodoxy did not fit. Woytinsky and Bevin, the pragmatists in the two labor parties, lost out.

Similar disagreements can be found everywhere. Hitler was more pragmatic (opportunistic) in his policy outlook than other figures in his country, on all sides of the spectrum. It is not easy to find sociological patterns to the pragmatism/traditional division. But it is clearly important. Pragmatic leaders were able to construct innovative political coalitions in part because their economic pragmatism gave them a better definition of coalitional opportunities. Classical policies defined friends and enemies rather starkly in class lines, the mirror of orthodox Marxism. Demand management, along with protectionism, defines political groups and their relationships rather differently. Political innovation as well as economic innovation was thus influenced by ideological flexibility and by rigidity.



### *Institutions*

Political outcomes, economic or other, are affected by institutional mechanisms of decision making. An understanding of societal actors—both their economic situation and their ideological outlook—provides crucial information about the actors who work through the political system. But the mode of aggregating those interests—the rules, procedures, and bureaucracies—can have a considerable effect on the policy outcome.<sup>13</sup>

Recent discussions of institutions in social science literature have focused on “capacity”—the organization of rules and administrative skills needed to carry out a particular policy. This can be an important explanatory variable. Its importance depends on the type of policy to be pursued. Protectionism without the ability to enforce tariffs is useless. Industrial policy may require the ability to intervene in the life of firms and industries, an ability which the United States and Great Britain lack, while Germany, Japan, and France have it in abundance.

Demand stimulus, interestingly, does not require a very high capacity for intervention. Rather, it may require a high capacity for analysis. Pump priming supposes rather good information on the effects of a given level of pressure. That takes considerable information and a high level of analytic capacity. But it does not require ample capability of policing, enforcement, supervision, and administration, at least compared to industrial policy, nationalization, or even tariffs. Because demand stimulus requires a relatively low level of intervention, it may well have been easier to introduce without the kind of political controversy that the development of more extensive techniques of government control has generated.

Institutional arrangements have had a powerful impact on the politics of economic policy making in a different way—via the effects of such arrangements on the distribution of power. No institutions are power neutral. Rules and procedures always help or hinder some groups over others. It is possible to show how institutions affected the policy debates about demand stimulus by tracing out the specific effects of each pattern of arrangements on politics in each country. That is impossible within space limitations here, but one or two examples can illustrate the point.

The Germany of the Weimar Republic is a particularly rich example. There were important groups in pre-Nazi Germany interested in economic experimentation through a new political coalition yet in a constitutionalist framework—something like the Swedish model. Institutional arrangements hindered the formation of that coalition and favored others: the judicial system favored the far right over the far left; so did the army and much of the bureaucracy; at a crucial

moment the presidency lay in the hands of anticonstitutionalist forces. Putting industry, labor, and agriculture together in a constitutionalist framework had always been difficult in Germany; institutional obstacles made things worse.

In the United States, federalism and the separation of powers both provided obstacles to change. Veto groups are aided in the U.S. system. Reform is hard and difficult to institutionalize; this is a frequently cited reason for the difficulty the New Deal coalition had in institutionalizing itself, in the ability of conservative farmers and business interests to limit the scope of change; and for the failure of industrial policy-type programs oriented toward business.

Institutional arrangements shape power relations among social actors. In this way they always affect political debates over economic policy.

### *The International System*

The international system itself has a profound impact on the politics of economic policy choice in countries. It does so by shaping the calculations of actors within countries as well as the resources at their disposal. At certain moments the international system may even alter internal arrangements—institutional, economic, social, and ideological—through direct intervention.<sup>14</sup>

Several examples underscore this point. Size matters a good deal, as the Swedish case brings out. As a small country, Sweden could not possibly hope to mobilize enough domestic demand to sustain the standard of living desired. Sweden's route to prosperity required finding a niche in an intensely specialized international division of labor. Germany and the United States, with vastly larger populations and regional bloc possibilities, could attempt economic nationalism.

The effect of this difference in size operates through the calculations of domestic actors. The inwardly oriented lobbies in Sweden were simply smaller than their counterparts in other countries. In those countries, the nationalists and internationalists disagreed on the best strategy for the nation in relation to the world economy. The world did not impose certain choices on Germany, Great Britain, or the United States. Policies were choices—alternatives selected by a political process. What the international arena did was strengthen or weaken certain arguments and the resources of those advancing them.

The most spectacular example of the ability of the international system to intervene directly in international arrangements is that of postwar Germany. Allied intervention destroyed the regime of the 1930s. Through several processes—partition, institutional reform, de-Nazification, social change during the war, and

<sup>14</sup> Peter Gourevitch, “The Second Image Reversed,” *International Organization* 32 (Autumn 1978), pp. 881–912.

<sup>13</sup> Krasner, *Defending the National Interest*; Peter Evans, et al., *Bringing the State Back In*.



economic reorganization—Germany's social structure, ideology, and institutional structure were profoundly altered. The Federal Republic had many fewer Protestant radicals, both left and right, no Junker-based officer corps, a higher percentage of Catholics organized after the war around Christian Democracy, and new experiences to undermine anticonstitutionalist promilitarist traditions.

The health or weakness of the international economy itself has a considerable impact on domestic policy and political calculations. The collapse of international trade and of domestic demand from 1929–1933 altered the calculations of all actors about the rewards of various economic policies and of political calculations about how to get there. Similar effects can be observed in the economic prosperity of the 1950s and 1960s. Good economic times helped integrate the economic and political actors into the postwar accommodation of the mixed economy. In a sense, economic disaster set the groundwork for interest in the demand-managed mixed economy, and economic prosperity helped provide it with legitimacy.

Finally, the success of the international economy has itself altered the incentive structure of economic and social groups within each country. As the international division of labor has intensified, more and more companies have become international. They make and sell goods everywhere. They depend on foreign countries for sourcing, markets, and finance. Of course, internationalization makes for competition, but it does increase integration. It has become harder and harder for many companies to be sure they would benefit from economic nationalism. Internationalism has become domestically stronger in each country. Despite its origins in economic nationalism, Keynesianism thus contributed to internationalism.

### *The Impact of World War II*

World War II and its aftermath reopened the political economy arguments of the 1930s on, to varying degrees, new political ground. The policy debates of the postwar years continued the controversies of the prewar debate, sharply modified by the wartime experience. In a sense, the policy arguments of the 1940s sought to avoid earlier horrors: in economic terms, the horrors of vast unemployment; in political terms, the horrors of fascism, civil war, bolshevism, and intense political conflict.<sup>15</sup>

Power relations were altered by the conflict. In nearly all European countries, labor was greatly strengthened. The mobilization for war, the occupation and

<sup>15</sup> Fritz Scharpf, "Economic and Institutional Constraints of Full-Employment Strategies: Sweden, Austria, and West Germany, 1975–1982," in John Goldthorpe, ed., *Order and Conflict in Contemporary Capitalism* (Oxford: Oxford University Press, 1984), pp. 257–90.

resistance on the continent, and the discrediting of fascism all served to make labor movements key players in postwar debates. At the same time, many business elements also supported a greater degree of stability than the prewar years provided. And agriculture wanted the continuation and extension of its supports.

The policy arguments took place in a framework of constitutional government. The political balance led to a compromise, the mixed economy, which combined private control of investment and management with some degree of nationalization and support for the rights of labor, welfare, and regulation. However, the individual elements in this approach had to be integrated into an overall schema designed to secure full employment. Demand management in the framework of a regulated market economy fit the bill. Under common political conditions, the Swedish model was generalized to all cases.

### CONCLUSIONS

As postwar prosperity lasted, so did the consensus around the mixed economy. Internationalism, demand management, and centrist politics reinforced each other. Then things began to unravel. The international economy in the 1970s experienced problems and shocks. Experts disagree on the balance between structural obstacles and historically specific shocks, like the OPEC oil price increases, but by the mid-1970s, problems were spreading. Increased international competition made the world look something like the 1880s: not a sharp business cycle slump as in the 1930s, but rather a crisis of productivity, cost cutting, expanding output, and new entrants into the international division of labor. Amidst prosperity came rising unemployment accompanied by cycles of inflation and deflation.<sup>16</sup>

Under those pressures, the postwar accommodation started to unravel. Agriculture found its demands thoroughly integrated into the political system. Indeed, as the agricultural population shrank, agriculture went from being a definer of political cleavages to being an interest group. As this happened, its political influence grew rather than diminished. Agriculture could be wooed. Everyone became willing to pay the price in order to get support. Agriculture became a key

<sup>16</sup> George Ross, Andrew Martin, Peter Gourevitch, and Peter Lange, eds., *Unions Change and Crisis and Unions and Economic Crisis* (London: Allen & Unwin, 1982, 1984); Peter A. Hall, *Governing the Economy* (New York: Oxford University Press, 1986); Peter Katzenstein, *Small States in World Markets* (Ithaca: Cornell University Press, 1985); John Zysman, *Government, Markets and Growth* (Ithaca: Cornell University Press, 1983); Andrea Boltho, *The European Economy: Growth and Crisis* (Oxford: Oxford University Press, 1982); Leon Lindberg and Charles Maier, eds., *The Politics of Inflation and Economic Stagnation* (Washington: Brookings, 1984); Suzanne Berger, ed., *Organizing Interests in Western Europe* (New York: Cambridge University Press, 1981); Michael Piore and Charles Sabel, *The Second Industrial Divide* (New York: Basic Books, 1986).

swing group. That development posed problems for labor. As the international economy ran into trouble, so did the earlier "progressive" alliances. High-tech internationalist businesses found that labor costs and managerial power mattered to them. They became skeptical of wage costs and social service-generated taxes. In short, labor was losing allies.

In terms of ideology, important changes had also followed from the successes of Keynesianism and the welfare state. In the 1930s, the state had been seen as an ally of the propertied elites. Capturing it meant putting it to work for the poor and dispossessed. By the 1970s, the state seemed to work for a new set of established interests. As difficulties mounted, attacking state action seemed an increasingly plausible line of reasoning. Where state inaction had once been a cause for concern, state action was now blamed for many evils.

Strained by policy disagreements and ideological quarrels over economic policy, the postwar coalitions were also weakened by other political disputes—foreign policy quarrels, social movements about ecology, gender, and migrants, and cultural developments as well. Under these pressures, the political innovations of an earlier period have seemed less workable, and the political foundations for demand management have eroded. Political and economic divergences have grown. Older arguments have resurfaced, in somewhat different form and language to be sure but nonetheless with real force. The amplitude of debate has widened. Thatcher and Reagan exemplify the revival of neoclassical arguments that has occurred everywhere. The authority of unions, the social services of the welfare state, market-stabilizing arrangements—all seemed more secure twenty years ago than they do today.

On the other side of the neoclassical revival is the reemergence of neomercantilist arguments. Interest in industrial policy, in microeconomic interventions to help specific industries and companies, has grown everywhere. Countries pursue it to differing degrees and with varying distributions of benefits. Sweden and Austria use mercantilism quite differently than the United States and Great Britain. But the technique has grown, undermining the influence of nationalization, planning, protectionism, and other earlier modes of intervention.

To some degree, even demand stimulus has come back, but in a quite different language and political context. It has been used in a conservative version by Reagan, with an emphasis on military spending, and briefly attempted in a somewhat nationalist, leftist version by François Mitterrand in France. But with diffusion has come weakness, both as an economic principle (can demand stimulus be used with already massive deficits? Does it aid in sector-specific economic adjustment?) and as a political one (how does it define friends and enemies? Is it progressive or conservative?).

The conflicts around Keynesian ideas are not over, and their end points are not

clear. It is premature to say that the coalitions formed in the 1930s and 1940s are over. It is not premature to say that they are in a process of mutation. What a study of these decades does show about the political origins of Keynesian ideas is precisely the importance of politics in shaping the adoption, use, and rejection of these ideas.

Here, as in any case of economic policy making, the problems of mobilizing support for policy are crucial. Politicians sitting at the center of state decision making must find support for policies from a number of actors who have varying modes of resistance or assistance at their disposal. Economic actors can impose their will at times and in certain ways. In general terms, though, they need policies from states, and thus they need politics and politicians. Political leaders are needed to construct coalitions to produce results.

Crises are times of danger, as the career of Adolf Hitler constantly reminds us. But they are also moments for hope, as Swedish social democracy suggests. The future always requires imagination. Politicians require imagination to find new ways of linking their goals to policy options. Interest group leaders need imagination to find new ways of defining friends and enemies, and the terms of trade of alliances. Social scientists require imagination to conceptualize policy options, social categories, ideologies, historical structures, and the various ways these can combine.

In a multivariate analysis, there are two poles of possible interpretation: a deterministic mode, in which large forces move sluggishly to confine and define actors; and a voluntarist mode, in which many things are possible and people make choices and shape their destiny. As metaphors both have relationship to reality. The deterministic side expresses one's pessimism. Things drift badly. The voluntarist side is optimistic. People can make things better. The heroes of this tale are those activists who thought up combinations that linked progressive political ideals with the realities of markets and power: Wigforss in Sweden, Woytinsky in Germany, Bevin and Keynes in Britain, and Roosevelt in the United States. Creativity can be demonic, as with Hitler or Stalin. But even demons have lessons to teach, and from them we can learn whether there are ways to avoid them.