JOURNAL OF ECONOMIC ISSUES
Vol. XLIV No. 2 June 2010
DOI 10.2753/JEI0021-3624440229

Full Employment with Liberty: John R. Commons' Perspective and Its Continuing Relevance

Charles J. Whalen

Abstract: Paul Krugman recently suggested that John Maynard Keynes helped economists study and resolve mass unemployment at a time when few of them could understand the problem and institutionalists seemed unable to articulate a clear policy strategy. This article responds by outlining John R. Commons' case for full employment with liberty and his three-part strategy (addressing money, people and politics) for curing joblessness while saving capitalism. Commons' argument and recommendations offer insights that extend beyond Keynesian economics in important ways, and his contributions have special relevance today in light of the recent global financial crisis and still ongoing Great Recession.

Keywords: abundance, capitalism, liberty, stabilization, unemployment

JEL Classification Codes: B25, B52, E32, P16

On June 10, 2009, Paul Krugman delivered a lecture at the London School of Economics. Most of it focused on John Maynard Keynes' contribution to understanding the Great Depression (Krugman 2009). According to Krugman, *The General Theory of Employment, Interest and Money* helped economists understand and solve the most pressing problem of the early 1930s — mass unemployment.

Krugman suggests Keynes broke three barriers preventing the economics profession from addressing widespread joblessness. One was its belief that "supply creates its own demand," which suggests a Great Depression could not be possible. Another was business cycle analysis, which obscured the study of depressions in the early 1930s on both sides of the Atlantic. "Economists obsessed with the ups and downs of investment, but skipped the step of explaining why the point at which people realize they overextended themselves leads to mass unemployment." The third

Charles J. Whalen is a Professor of Economics and Executive Director in the Department of Business and Economics at Utica College. He is also a Visiting Fellow at Cornell University School of Industrial and Labor Relations. *He thanks Linda Whalen for sustained and unparalleled assistance and Stephen Woodbury for graciously helping in a pinch. This paper was presented at the Annual Meeting of the Association for Evolutionary Economics, January 3-5, 2010, in Atlanta, Georgia.*

was the apparent inability of institutional economics to provide a clear strategy for economic recovery despite being the most influential school of U.S. economic thought at the onset of the Great Depression. Keynes moved economics forward by disengaging the analysis of depressions from the broader cycle, demonstrating that the level of spending in an economy could fall short of that needed to make full use of productive capacity, and instructing policymakers to "turn this dial — increase G [government spending]" (Krugman 2009).

Most institutionalists would probably agree with Krugman that Keynes' contributions were helpful in the 1930s and remain useful today as economies around the globe seek to address what journalists have dubbed the Great Recession. There is also no denying that John R. Commons' 900-page, *Institutional Economics* — which addresses a range of topics including business cycles and mass unemployment — may be an excellent example of the pre-*General Theory* literature that Krugman (2009) described as "impenetrable" and of which he said, "[i]t makes you want to bang your head on the table." Nevertheless, Commons' contribution on the subject of high unemployment is worth deciphering, and that is the purpose of this article. It also underscores the continuing relevance of Commons' perspective, which extends beyond "increase G" in important ways. While a severe page constraint adds to the formidability of the task, it also provides an opportunity to show institutionalism can address unemployment with clarity and concision.

Still, why dig through the writings of Commons, especially a book that begins by acknowledging "perhaps nobody" (Commons 1934a, 1) will grasp the author's message? And why should others take interest in this effort? One reason is that, as Krugman (2009) acknowledges and Keynes recognized, economists must eventually return to business cycle analysis — and, given the severity and consequences of the most recent global financial crisis, the sooner the better. Another reason is we know Commons had important insights. Indeed, Kates (2009) suggests Commons contributed key ideas used by Keynes when overturning Say's Law. The article is also motivated by recognition that even Keynes needed interpreters: As Krugman (2009) observes in his lecture, "[m]y generation mostly encountered Keynes refracted through John Hicks."

The Case for Saving Capitalism

Commons saw unemployment as the "outstanding defect of capitalism" (Lewisohn et al. 1925, 52). He also considered the business cycle the most important cause of unemployment (Commons 1922). Nevertheless, he was unwilling to reject capitalism because he saw it as the only alternative that retains a meaningful degree of individual liberty and the hope of high living standards. In *Institutional Economics*, published in 1934, Commons stresses that "capitalism is not a single or static concept," and in his autobiography, published that same year, he writes that the central aim of his research for nearly thirty years was to "save capitalism by making it good" (Commons 1934a, 766; 1934b, 143).

Commons divides world economic history into three stages: scarcity, abundance, and stabilization. The era of abundance begins with the industrial revolution in the eighteenth century. But the period also ushers in business cycles, destructive ("cut-throat") competition, labor strife, and large-scale unemployment. Although classical economics had no place for widespread overproduction and joblessness, the problems had become undeniable and resulted in emergence of the era of stabilization in the late nineteenth century (Commons 1925a, 95-120; 1934a, 773-789, 892).

In the era of stabilization, business and government developed various approaches designed to achieve and sustain a recovery in economic production. Efforts to promote a "managed" recovery replaced reliance on the "automatic" method of price-system adjustment. At first, the private sector led the way through cartels, investment banks and holding companies. By the mid-1930s, however, the public sector had taken the lead in major nations across the globe (Commons 1934a, 611-612; 1925b).

Communism and fascism were very real alternatives to capitalism in the 1930s. They also promised — indeed, demonstrated — an ability to cure joblessness. But Commons rejected both.

What troubled Commons most about communism and fascism was they required citizens to sacrifice key political, civil-rights and economic dimensions of individual liberty to achieve employment security. In the political realm, restrictions were imposed to severely constrain — and often prohibit — popular elections, involvement in political parties, and representative government. In fact, in such societies, legislatures were abolished and judges were appointed and removed by dictators, replacing the rule of law with that of the iron fist. In the realm of civil rights, freedom of speech, the press and association — including the right to join labor unions and farmers' cooperatives — were all curtailed; "compulsory membership in regulated associations" replaced participation in voluntary associations. And in the realm of economic freedom, individuals were prohibited from withholding property and labor from the market in search of a satisfactory bargain. Transactions were instead coerced, and although citizens were employed they were most often also poor, a condition which itself "deprives people of economic liberty," argued Commons (1934a, 898-903).

Meanwhile, a number of factors contributed to economic liberty in the United States in the early twentieth century. One was the opportunity for many wage earners to "take up free land or return to their families on the farms when capitalistic industry collapsed."[1] Another was the opportunity for promotion within the ranks of American industry on the basis of demonstrated ability and ambition. ("Europe has not yet learned this trick of promotion. Class feeling keeps the manual worker in his inferior class, and the higher executives come in from the families of privileged and educated classes," Commons wrote.) A third factor was that the nation's various freedoms provided a thriving climate for individual originality and genius — in the arts, sciences, engineering, journalism, and all fields within the academy. Indeed, while Commons was critical of aspects of the "banker capitalism" that he observed in the United States in the 1930s, opportunities for worker advancement and free investigation help explain why he wrote, "[i]t is probable that huge corporations do not grow so much by Marx's technological efficiency as by the booms and depressions of banker capitalism" (Commons 1934a, 886-891).

The American system's ability to generate abundance is a key element in Commons' analysis. "The fundamental contrast between the European and American systems is the contrast of poverty with abundance, of low standards of living with high standards of living," he wrote in *Institutional Economics* (1934a, 886). Commons credits America's high living standards with providing an important reason why the bulk of U.S. citizens remained wedded to the preservation of capitalism in the early 1930s despite the nation's history of macroeconomic instability. The U.S. economy's capacity to produce the output that permitted those high standards — that is, its capacity to deliver a key aspect of economic liberty — also helps explain his preference for saving capitalism rather than replacing it (Commons 1934a, 886-887).

Commons' strategy for saving capitalism — for achieving and sustaining full employment with liberty — can be treated as having three dimensions: financial, human and political. Each is discussed below. A fourth component could also be identified, a conceptual dimension devoted to economic theory. But Commons never developed theory in a vacuum; he incorporated it into the examination and resolution of real-world problems. This article follows his lead.[2]

Money

Saving capitalism must begin with the financial system argued Commons, who viewed the ability to finance large corporations and new inventions as capitalism's main strength. "The banks float the securities of the corporations and arrange commercial credits," Commons wrote, but there is still more to the story; they must also gain the confidence of millions of investors (Commons 1934a, 890). In fact, when searching for the ultimate source of wealth in capitalist society, Commons did not settle upon labor, management or machinery, but on "confidence in the future" (Commons 1921, 268). Thus, financial-market protections — laws regulating the issue and sale of financial instruments to protect investors from corrupt practices and foster confidence in financial markets — are considered essential to a sustained recovery from Commons' perspective (Commons 1934a, 887-891).

Commons supported expansionary monetary policy during an economic downturn, but also argued that preventing future unemployment involves requiring the Federal Reserve to pursue a policy of stabilizing the rate of inflation once the economy recovers (Commons 1934a, 804-805). In Krugman's brand of Keynesian economics, government spending can be used to restore full employment and then economists and policymakers can return to the issues and tools of conventional microeconomics (Krugman 2009). From Commons' business-cycle perspective, however, preventive measures are needed to control the overall extension of credit and the rise in prices during prosperous times; if not, credit will be overextended and another crisis will eventually emerge. Commons (1934a, 611) added: "It is more difficult, by concerted action, to start a recovery from a long period of depression than it is, by similar action, to stop an inflation that causes the succeeding deflation." He maintained that pursuit of such price stabilization would cause the Federal Reserve to influence the supply, demand and price of credit in at least four ways: through the discount rate, open-market operations, moral suasion, and international concerted action (Commons 1934a, 789-805; 1922, 19-21; 1925c).

A broad diffusion of stock ownership — and of personal investment instruments, such as savings accounts and insurance policies — is also part of Commons' strategy for saving capitalism. A nation with millions of shareholders would, of course, be less attracted to alternative economic systems, but there are also economic benefits. For example, the diffusion helps stabilize stock-market values and augment business capital, suggested Commons (1934a, 887-890).

The continuing relevance of the financial dimension of Commons' recovery and reform agenda is unmistakable. His call for strict financial-market regulation, for example, appears as fresh as today's headlines.

Today, Tymoigne (2009, 17) proposes a "proactive regulatory framework" in response to the recent global financial crisis. He offers the following principles as a guide to financial-system regulatory reform: 1) manage innovations ("not all innovations are good"); 2) modify views of creditworthiness to accommodate a cash-flow view (default probability asks, "Will you pay?" but a cash-flow view asks, "*How* will you pay?"); 3) realign the financial sector with the broader needs of the economy (reward long-term performance, for example); and 4) devote more attention to systemic risk (via national cash-flow accounting and detection of Ponzi-type activity). These principles have the same aim as Commons' call for regulation of investment instruments; they seek to channel the profit motive in a direction that fosters investor confidence and a more sustainable financial system (see also Commons 1935). A proposal by the U.S. Treasury Department (2009) also reflects this spirit and is even more comprehensive.[3]

Although price increases are not currently a major U.S. economic concern, Commons' version of inflation targeting, which would take effect only after restoration of full employment, also remains relevant. Rather than seek price-level control in a rigid manner and for its own sake, Commons sought only broad stabilization of the "general credit situation" and the aim was to avoid price-level fluctuations that would eventually disrupt investment and employment (Commons 1925c, 45; 1937). This amounts to a proactive monetary-policy framework that dovetails with the just-mentioned regulatory framework. Moreover, with Commons' ends as a guide, there is little doubt that a modern version of his approach to monetary policy would include stabilization of asset price inflation — to prevent run-ups in, for instance, the market for stocks or real estate.

Commons devoted little attention to broadly extending an investment stake in the economy, but even the mention of it puts him ahead of many contemporary economists. President George W. Bush often spoke of fostering an "ownership society," but Jacob S. Hacker (2006, 6) demonstrates that this was largely the gloss on a "great risk shift" that transferred financial burdens from corporations and government to "the fragile balance sheets of American families." Nevertheless, broader ownership has been investigated by a number of serious scholars and practitioners (see for example, Ashford and Shakespeare (1999), Ackerman and Alstott (1999), and Gates (1998)). The potential civic and economic benefits — including those mentioned by Commons — indicate it deserves greater consideration from today's institutionalists.

People

Turning from the financial to the human aspects of Commons' effort to make capitalism "good," one finds that he calls for the following policy initiatives: direct government spending to tackle joblessness, a public unemployment insurance program financed in part by a tax on employers that would increase with the tendency to discharge workers (called "experience rating"), and legislation protecting workers (via minimum wages and maximum hours, for instance) and trade unionism (Commons 1934a). Each of his recommendations was incorporated into the New Deal, not just to assist workers directly, but also to aid recovery by boosting and stabilizing aggregate demand. It is particularly notable that Commons looked to fiscal policy in the way Keynes would later make famous:

> To create the consumer demand, on which business depends for sales, the government itself must create the new money and go completely over the head of the entire banking system by paying it out directly to the unemployed, either as relief or for construction of public works. (Commons 1934a, 589-590)

In the current Great Recession, Commons' recommendations continue to provide assistance. The American Recovery and Reinvestment Act of 2009 rests on the Commons-Keynes view of the need for fiscal stimulus. The value of unemployment insurance (UI) with an experience rating has been demonstrated by Anderson and Meyer (2000), who analyze past state policy variations and show that the rating system reduces UI claims; this suggests unemployment today would be even more severe without the policy Commons promoted. The minimum wage and collective bargaining also help contain the severity of the downturn.

Commons' perspective also leads us to additional insights. For example, it underscores the potential macroeconomic benefit of labor-law reform that reduces some of the current obstacles to worker organizing and collective bargaining. It also draws attention to the value of the following: proposals that would call on the government to serve as employer of last resort (Kaboub 2007); the comprehensive human-resource development strategies inspired by Vernon Briggs (Whalen 2010); and the initiatives of the Obama administration's Middle Class Task Force, which aims to protect the incomes of America's working families and retirees.

Politics

Finally, there is what Commons considered the biggest challenge to capitalism, freedom, and democracy: the difficulty of restraining the power of the "high-salaried executives and political machines" of the banking establishment. Near the end of *Institutional Economics*, Commons writes that American banker capitalism "is an economic government of bankers more powerful than the political government. Its sanctions are not the physical force of the state — they are the more powerful sanctions of credit, profit and loss" (Commons 1934, 895-903). It is remarkable how his concerns resonate in our time.

Skepticism over the appropriateness and implementation of the $700 billion Troubled Asset Relief Program is just the tip of the iceberg. In the 1990s, Minsky (1996) warned of the arrival of "money-manager capitalism." Others have used different terms, including "plutocracy" (Phillips 2002), "plutonomy" (Frank 2007), and oligarchic "corporatism" (Brooks 2008). Thomas Palley (2007) and Krugman (2009) call it "financialization," a process whereby the markets, institutions, and elites of the financial sector acquire tremendous influence over public policy and economic outcomes. Regardless of its name, however, all agree the trend is accompanied by widening U.S. inequality and an erosion of the living standards of many working families. The high living standards of a democratic capitalism are threatened in our time as in that of Commons.

Commons saw only one solution: processes that give voice to representatives of diverse economic interests must shape the nation's policies. For example, he long maintained that an advisory committee containing elected representatives of all economic stakeholders should guide the Federal Reserve. Could it work in the 1930s? On the one hand, Commons looked at the Italian experience with proportional representation of economic interests and saw failure. On the other hand, he looked to countless American administrative commissions and observed that the most effective operate with the help of a diverse, stakeholder advisory committee (Commons 1934a, 900-901).

Can it be done today? Not without much effort, especially since U.S. workers are largely unorganized. The challenges are exacerbated by the global scope of labor, product and financial markets. Nevertheless, Commons' vision of full employment with liberty offers the hope of greater macroeconomic stability and unrivaled abundance. Even the establishment should find that attractive.

Notes

1. In the mid 1930s, Commons (1934a, 886) recognized "farms are less and less a refuge for the unemployed," which underscored the need to foster full employment via managed recovery.
2. Two notes on Commons' theories are warranted. First, Commons develops and applies a variety of theories in his books and essays, including a general theory of economic transactions, a theory of reasonable value, theories of world history and capitalist development, a theory of labor movements, a transactional theory (rather than a quantity theory) of money, and a profit-margin theory of business cycles; see, for example, Atkinson (2004) and Whalen (1989; 1993). Second,

institutionalists like Commons saw no need for a formal theory to explain why a loss of business confidence leads to large-scale unemployment because they operated from the vantage point of what Dudley Dillard (1987), drawing on Keynes, calls a monetary theory of production. It recognizes not only that production precedes exchange, but also that finance precedes production. Finance is based on a mere expectation of returns, and when expectations are disappointed anywhere in the economy a loss of confidence can sweep through the system, cutting off credit. Without financing, production eventually (often quickly) grinds to a halt, workers are discharged, and fewer goods and services are available for purchase.

3. *Financial Regulatory Reform: A New Foundation* is organized around the following goals:

> 1) Promote robust supervision and regulation of financial firms; 2) establish comprehensive supervision of financial markets [including enhanced regulation of securitization markets and comprehensive regulation of over-the-counter derivatives]; 3) protect consumers and investors from financial abuse; 4) provide the government with the tools to manage financial crises; and 5) raise international regulatory standards and improve international cooperation. (U.S. Treasury 2009, 3-4)

References

Ackerman, Bruce and Anne Alstott. *The Stakeholder Society*. New Haven: Yale University Press, 1999.

Anderson, Patricia and Bruce Meyer. "The Effects of the Unemployment Insurance Payroll Tax on Wages, Employment, Claims and Denials." *Journal of Public Economics* 78, 1-2 (2000): 81-106.

Ashford, Robert and Rodney Shakespeare. *Binary Economics*. Lanham, MD: University Press of America, 1999.

Atkinson, Glen. "Labor and the Menace of Competition." In *The Institutionalist Tradition in Labor Economics*, edited by Dell P. Champlin and Janet T. Knoedler, pp. 39-49. Armonk, NY: M.E. Sharpe, 2004.

Brooks, David. "The Establishment Lives!" *The New York Times*, September 23, 2008. http://www.nytimes.com/2008/09/23/opinion/23brooks.html. Accessed December 5, 2009.

Commons, John R. *Industrial Government*. New York: Macmillan, 1921.

——. "Unemployment Prevention." *American Labor Legislation Review* 12, 1 (1922): 15-24.

——. *Reasonable Value*. Ann Arbor: Edwards Brothers, 1925a. Contains the typeset notation: To Be Revised.

——. "Marx Today: Capitalism and Socialism." *The Atlantic Monthly* 136, November (1925b): 682-693.

——. "The Stabilization of Prices and Business." *American Economic Review* 15, 1 (1925c): 43-52.

——. *Institutional Economics: Its Place in Political Economy*. New York: Macmillan, 1934a.

——. *Myself*. New York: Macmillan, 1934b.

——. Review of *Capitalism and Its Culture*, by Jerome C. Davis. *American Economic Review* 25, 3 (1935): 491-492.

——. "Capacity to Produce, Capacity to Consume, Capacity to Pay Debts." *American Economic Review* 27, 4 (1937): 680-697.

Dillard, Dudley. "Money as an Institution of Capitalism." *Journal of Economic Issues* 21, 4 (1987): 1623-1647.

Frank, Robert. "Plutonomics." *The Wall Street Journal*, WSJ Blogs, The Wealth Report, January 8, 2007. http://blogs.wsj.com/wealth/2007/01/08/plutonomics/. Accessed December 5, 2009.

Gates, Jeff. *The Ownership Solution*. Reading, MA: Addison-Wesley, 1998.

Hacker, Jacob S. *The Great Risk Shift*. New York: Oxford University Press, 2006.

Kaboub, Fadhel. "Institutional Adjustment Planning for Full Employment." *Journal of Economic Issues* 41, 2 (2007): 495-502.

Kates, Steven. "Subverting Say's Law: Keynes, Commons and Harlan McCracken." Twenty-Second Conference of the History of Economic Thought Society of Australia, July 10, 2009. http://hetsa2009.com/abstracts_index.html. Accessed December 4, 2009.

Krugman, Paul. "The Return of Depression Economics: The Night They Reread Minsky." Lionel Robbins Lecture, London School of Economics, June 10, 2009. http://cep.lse.ac.uk/_new/interviews/default.asp. Accessed December 4, 2009.

Lewisohn, Sam A., Ernest G. Draper, John R. Commons and Don D. Lescohier. *Can Business Prevent Unemployment?* New York: Alfred A. Knopf, 1925.

Minsky, Hyman P. "Uncertainty and the Institutional Structure of Capitalist Economies." *Journal of Economic Issues* 30, 2 (1996): 357-368.

Palley, Thomas. "Financialization: What It Is and Why It Matters." Working Paper No. 525. Annandale-on-Hudson, NY: The Levy Economics Institute of Bard College, 2007.

Phillips, Kevin. *Wealth and Democracy*. New York: Broadway, 2002.

Tymoigne, Eric. "Securitization, Deregulation, Economic Stability, and Financial Crisis." PowerPoint slides. Allied Social Science Associations Annual Meeting, San Francisco, CA. January 4, 2009.

U.S. Treasury Department. *Financial Regulatory Reform: A New Foundation.* Washington, DC: Department of the Treasury, 2009.

Whalen, Charles J. "John R. Commons's Institutional Economics: A Re-examination." *Journal of Economic Issues* 23, 2 (1989): 443-454.

——. "Saving Capitalism by Making It Good: The Monetary Economics of John R. Commons." *Journal of Economic Issues* 27, 4 (1993): 1155-1179.

—— (ed.). *Human Resource Economics and Public Policy: Essays in Honor of Vernon M. Briggs Jr.* Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 2010.