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Lawrence R. Klein [Ideological Profiles of the Economics Laureates]

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Abstract

Lawrence R. Klein is among the 71 individuals who were awarded the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel between 1969 and 2012. This ideological profile is part of the project called "The Ideological Migration of the Economics Laureates," which fills the September 2013 issue of *Econ Journal Watch*.

Keywords

Classical liberalism, economists, Nobel Prize in economics, ideology, ideological migration, intellectual biography.

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Lawrence R. Klein

by Daniel B. Klein and Ryan Daza

Lawrence Klein (1920–) was born in Omaha, Nebraska and experienced childhood during the Great Depression. He reflected on the events of his early life:

> Although I was not aware of it at the time, the experience of growing up during the Great Depression was to have a profound impact on my intellectual and professional career. Collegiate life subsequently gave me a basis for understanding this experience and to develop some analytical skills for dealing with the important economic aspects of this era, as well as the exciting times that were to come—World War II, postwar reconstruction, and expansion. (Klein 1992a/1981)

He describes his direction in college:

> When I entered university my interests began to take shape in the world of ideas. I specialized in both economics and mathematics. I could not see their eventual use together to deal with problems that the world faced. Also, I was not equal to the quick-witted star mathematicians at the university, but I kept being attracted by mathematical problems and their potential use in natural, physical, and social sciences—especially in economics. (Klein 2006, 31)

Klein started at Los Angeles City College for his undergraduate studies, earning his degree in economics at the University of California at Berkeley in 1942 and his Ph.D. at MIT in 1944. He moved to join the Cowles Commission, then at the University of Chicago, and later to the University of Michigan where, with Arthur Goldberg, he developed the Klein-Goldberger model. In 1954 he moved to Oxford to do studies on the British economy. In 1958 he moved to and has since been at the University of Pennsylvania, where he founded Wharton Econometric Forecasting Associates.

Roberto S. Mariano, in a highly informative entry on Klein in *The New Palgrave Dictionary of Economics*, says that Klein has been "a pioneer…in developing a worldwide industry in econometric forecasting and policy analysis" (Mariano 2008). At the University of Pennsylvania Klein also helped to establish Project LINK, which, Mariano says, "sought to integrate the macroeconometric models of different countries, which eventually included Third World and socialist nations, into a total simultaneous system…." In an autobiographical essay, Klein notes that the LINK system "now consist[s] of more the 15,000 dynamic nonlinear equations" (Klein 2009, 31). Mariano (2008) remarks: "When one thinks of macroeconometric models, his name is the first that comes to mind." Klein won the Nobel Prize in Economics in 1980 "for the creation of econometric models and the application to the analysis of economic fluctuations and economic policies."

Mariano (2008) reports that, in 1954, "Klein testified in a Detroit hearing that he had been a member of the Communist Party for about six months in 1946." Klein would have been 26 years old. We have read the transcription of the original hearing (U.S. House 1954, 4991-5002). Klein was summoned and made to answer the questions of ominous government bullies. One cannot put much confidence in what someone says to government officials who wield great power for which they are little accountable. If one were to take Klein's testimony at face value, it would mean that he was a member of the Communist Party for perhaps two years (1945–1947), was quite sympathetic to socialism up to age 26 or 27, having for several years been involved, uncomfortably, with Marxist groups, and that he then, around 1947, gave up socialism for a more mainstream sort of interventionist economics. Mariano remarks that in 1954 the "University of Michigan was to promote Klein to full professorship but then reneged" after the Communist Party testimony came out, and Klein then went to Oxford.

Mariano (2008) notes that "one of Klein's best-known works" is *The Keynesian Revolution*, which grew out of his dissertation and was first published in 1947. Richard M. Ebeling says that Klein was "one of the great popularizers of the 'new economics' of John Maynard Keynes" and that *The Keynesian Revolution* "represented the growing consensus of the time among economists and government-policy advocates on how monetary and fiscal tools should be used to manipulate the economy" (Ebeling 2006, 2). The book is remarkable for its confident, forward tone in expounding the new thinking and agenda. In 1959 the American Economic Association awarded Klein the John Bates Clark Medal.

Passages from *The Keynesian Revolution* help to capture Klein's ideological outlook at age 27, when the book originally appeared.

Klein assured his readers that Keynesianism was not socialism:

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> There is a great misunderstanding among the American public that the practical reform measures of the Keynesian economists are leading to socialism. It must be emphasized that the Keynesian reforms do not infringe upon the rights of private individuals to own producer goods. The most important characteristic of a socialist economy is that there do not exist private property rights over producer goods. The Keynesian approach visualizes the state as a balancing force which serves only to supplement the behavior of individual capitalists, while the socialist approach visualizes the state as the sole entrepreneur which replaces, entirely, the individual capitalists. (Klein 1947, 167)

Klein outlines "a practical program of economic policy which will be necessary in order to reform capitalism to a system of full employment" (1947, 168). Passages from his outline follow:

> The level of investment can be stimulated most directly by outright government investment. There are many socially useful projects which need to be undertaken … For example, the slums in every metropolitan district of the United States should be cleared away and replaced with modern low-cost dwelling units. Cities should be redesigned to diminish the nuisance of smoke, provide better traffic arteries, allocate space more rationally between dwelling areas and recreation areas, etc. These investments projects have not been and are not being undertaken, yet they are certainly desirable. … Useful investment schemes like these must be undertaken by the sole agency which can afford to take the risk of slow or zero return, the government. It is well known that the magnitude of all such building programs that are socially desirable could insure [re: ensure] full employment in the United States for several years, at least. Here is an obvious method for stimulating the level of investment; the government directly invests in socially desirable projects… (Klein 1947, 170)

> An alternative method…is to lower business taxes. Economists have recently been arguing strongly in favor of reduced business taxes in order to stimulate investment. However, many of these arguments are not correct. … If the tax rate is changed from 40 per cent to 10 per cent, there is no reason why an entrepreneur who is maximizing his individual profits will directly alter his investment decisions. It is a general proposition that the profit-maximizing decisions of business

firms are independent of the income tax structure (progressive or constant proportionality) if the marginal tax rate is always less than unity, as is the case with any reasonable tax system. (ibid., 171)

Interest rate policy can, in general, be expected to be quite ineffective. (ibid., 172)

[F]orces which tend to lower our propensity to save have evolved naturally in our system, but they can also be incorporated into a consciously directed government policy. We can subsidize truthful advertising and education. We can have government investment projects to mechanize agriculture and get the surplus population off the farms into the city in more productive jobs where these migrants will have a lower propensity to save. We can extend the operations of organizations like the [Federal Housing Authority] to provide credit for durable consumer goods at low interest rates. All these policies will depress the savings schedule and help to reach a high-consumption economy. (ibid., 176)

In our modern industrial society built on individualistic principles there are obvious reasons why people save. They save for the rainy days when they will be unemployed, sick, disabled, or too old to work. … The obvious way to diminish savings on account of these primary causes of need is to have the state provide for these needs at the cheapest possible cost. … We need a non-profit institution like the government, which can provide a comprehensive, minimum program of social security in order to reduce the propensity to save. This program must cover the entire population, and it must cover all those contingencies which cause people to save on a large scale for the future. (ibid., 176-177)

There is at least, one further method of discouraging saving. … If we redistribute income from the rich, who have a relatively high marginal propensity to save, to the poor, we will decrease the community's marginal propensity to save. Such policies of income redistribution can be carried out by taxing the rich and paying a dole or other types of contributions to the poor. (ibid., 177)

A backlog of planned public works should always be ready so that unemployed factors can be immediately put to work on useful jobs whenever the private sector of the economy is unable to carry the

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> ball. Government spending should be very flexible and subject to immediate release or curtailment in just that precise amount which will maintain full employment, no more and no less. … There is no reason why intelligent economic planning cannot be of just the correct amount, that amount which gives permanent full employment and stable prices. (ibid., 179-180)

> If the state is to adopt a conscious policy of full employment, it must use some device that will give control over enough privately owned resources to enable it to put the unemployed to productive efforts. An obvious way for the state to acquire the necessary resources is for it to borrow funds with which to purchase the resources. (ibid., 181)

> As long as the interest charge is a small fraction of the income, the burden is not cumbersome. At present interest rates and debt size, the interest payments are small in comparison to the national income. If income continues to grow secularly as it has in the past, there is little danger that the interest charge on any debt that we are likely to accumulate will become cumbersome. (ibid., 182)

In the final words of the book, Klein speaks of the agenda beyond the outline he has provided:

> We too must study [the problem of resource allocation], once we have put all our men and machines to some useful effort. The productive factors must be distributed among industries and occupations in such a way that we get as high a value of full-employment output as is physically possible within our accepted patterns of work and leisure. … The problem of resource allocation was not treated by Keynes, because there were more urgent matters at hand. But resource allocation will again become urgent when the problems that have bothered Keynes are solved. (Klein 1947, 187)

Klein is a prime figure of the heyday of planning economics. Mariano (2008) remarks on Klein's time in the mid-1940s at the Cowles Commission: "This turned out to be a defining period for Klein's professional career. His interactions with an unusually talented group that included J. Marschak, T.W. Anderson, H. Rubin, M. Girschick, T. Haavelmo, T. Koopmans, D. Patinkin, L. Hurwicz, K. Arrow, H. Simon, R. Leipnik, H. Chernoff, and visitors such as J. Tinbergen, R. Frisch and M. Kalecki proved to be a catalyst for his development into an applied econometrician par excellence."

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In a 1948 article in the *American Economic Review* entitled "Planned Economy in Norway," Klein wrote:

> The Norwegian reconstruction program has been based on planning techniques which can be classified among the most positive programs in Western Europe. National economic planning in Norway should be of particular interest to professional economists because of its modern character which is a result of the influence of Norwegian economists in the drafting of the program. (Klein 1948, 795)

In 1980, in his Nobel lecture "Some Economic Scenarios for the 1980s," Klein used the Project LINK econometric model to project economic trends into the future. He projected that between 1980 and 1990 the OECD countries would experience annual GDP growth of 3.0 percent while the "Centrally Planned Countries" would experience annual growth of 4.3 percent (Klein 1992b/1981, 431, Table 6).

In a 1992 autobiographical essay, Klein writes:

> Philosophically, I do not believe that the market system, in even its purest form, provides adequate self-regulatory responses. The economy definitely needs guidance—even leadership—and it is up to professional economists to provide public policy makers with the right information to deliver such leadership. As for the methods of doing this, I see no alternative to the quantitative approach of econometrics, but I do realize that all policy issues are not quantitative and measurable. At times, subjective decisions must also be made. (Klein 1992c, 186)

It seems that Klein's views on money in macroeconomics have changed somewhat. He writes:

> Over the years, particularly in studying the macroeconomy, I have come to appreciate, more and more, the role of money and of the whole monetary sector. I think that *monetarism* is fundamentally flawed, and dangerous when used as a doctrinaire policy approach, but I do believe now that *money matters*; it is not everything, but it does matter. (Klein 1992c, 188, emphases in original)

On rational expectations, Klein has stated:

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> I believe that the approach of rational expectations (or, better expressed, own-model-generated expectations) is asking too much of the data. It asks the data both to generate the expectations and provide the model estimates with simulation. That is overworking the data. (Klein 1987, 442)

In 2004, Klein gave an interview to the *Wall Street Journal*. He was asked about his opinion of the Bush Administration's dividend tax cut. Klein responded: "The tax cut increased the deficit significantly without being a big support for capital formation. … The main reason why I object to a dividend tax cut is this: there are other ways to stimulate investment through tax concessions that insist that the company invests. One is the investment tax credit and another is accelerated depreciation. … I would be much more sympathetic to [such a] tax cut or a tax concession rather than a dividend cut" (Klein 2004). He continued on the effectiveness of the Bush tax cuts:

> We don't see it yet. But we do see an increase in the deficit. The increase in the deficit itself for this fiscal year is on track to be between \$400 billion and \$500 billion. A lot of that has to do just with the dividend tax cut. I think the tax policy in general is not well conceived. It should have been for people who would have been highly likely to spend a good share of it, and it was not engineered that way. The engineering of the tax cut is more a matter of tax reform than tax reduction. And when we're fighting a war, running a deficit and trying to get the economy moving, it's not a time to experiment with tax reform. What we need is a tax concession for the relatively lower and middle income groups who will be likely to spend it. (Klein 2004)

Klein, however, was not opposed to overseas outsourcing by American companies:

> Well, I've been involved in a major study on offshoring. The typical example is the Indian software industry in Bangalore and Hyderabad. People are opposed to it because it seems to be taking white-collar jobs from America and moving them to low-wage countries. India is not the only country, but it's the biggest single country. … I would argue that it's not a bad thing to happen. There may be some loss of jobs in the short term, but in the longer run, we get those jobs back because we get more exports in other areas. We've been through this before…with television sets. That didn't really undermine our economy because we turned to more sophisticated activities.

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> The basis of the argument is a classical, old-fashioned argument of the gains of trade. Everybody can gain, but it takes time. In our studies of offshoring, I've found that for a year or two, we might lose some jobs but we could try to compensate for that. In the longer run, we would gain by lower costs. (Klein 2004)

When asked: "Would you consider signing another statement with Nobel laureates against current economic policy?" Klein responded:

> It would have to be very specific. I would sign a statement saying that the administration's policy is faulty and not effective. I'm against the whole war situation, and that's what is giving rise to the [economic] problems. (Klein 2004)

Regarding foreign policy issues, it should be noted that Klein was "a founding officer and active moving force of the Economists Allied for Arms Reduction (ECAAR), now Economists for Peace and Security (EPS)" (Mariano 2008).

In a 2012 book chapter regarding the recent recession, Klein and his collaborators recommend that policymakers "improve fairness and transparency of the financial markets, thereby perfecting the market equilibrium, protecting investors, and stabilizing the market. The ultimate goal is to prevent crisis so that people's happiness and health can be protected and improved" (Yan et al. 2012, 24-25).

Klein (2009, 32) notes that in 1976 he served "as Jimmy Carter's coordinator of his economic task force." Klein has signed several petitions: against sweatshops, against the Bush tax cuts, in support of raising the minimum wage, and endorsing John Kerry for president in 2004 (Hedengren et al. 2010).

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Tjalling C. Koopmans

by Daniel B. Klein, Ryan Daza, and Hannah Mead

Tjalling Koopmans (1910–1985) was a Dutch economist whose Nobel-winning work was on optimal planning. It appears that he was not very vocal about his ideological views, even when some of his peers were.

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