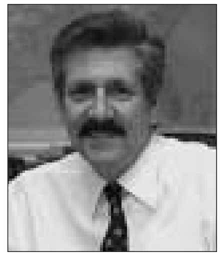
From the President

John Maynard Keynes: The Damage Still Done by a Defunct Economist



BY RICHARD M. EBELING

Seventy years ago, on February 4, 1936, the English economist John Maynard Keynes (1883–1946) published what soon became his most famous work, *The General Theory of Employment, Interest, and Money*. Few books, in so short a time, have gained such wide influence and generated so destructive an impact on public policy. What Keynes succeeded in doing was to provide a rationale for what governments always like to do: spend money and pander to special interests.

In the process Keynes helped undermine what had been three of the essential institutional ingredients of a free-market economy: the gold standard, balanced government budgets, and open competitive markets. In their place Keynes's legacy has given us paper-money inflation, government deficit spending, and more political intervention throughout the market.

It would, of course, be an exaggeration to claim that without Keynes and the Keynesian revolution inflation, deficit spending, and interventionism would not have occurred. For decades before the appearance of Keynes's book, the political and ideological climate had been shifting toward ever-greater government involvement in social and economic affairs, due to the growing influence of collectivist ideas among intellectuals and policymakers.

But before the appearance of *The General Theory*, many of the advocates of such collectivist policies had to get around the main body of economic thinking which still argued that in general the best course was for government to keep its hands off the market, maintain a stable currency backed by gold, and restrain its own taxing and spending policies.

The classical economists of the eighteenth and nineteenth centuries had persuasively demonstrated that government intervention prevented the smooth functioning of the market. They constructed a body of economic theory which clearly showed that governments have neither the knowledge nor the ability to direct economic affairs. Freedom and prosperity are best assured when government is, in general, limited to protecting people's lives and property, with the competitive forces of supply and demand bringing about the necessary incentives and coordination of people's activities.

During the Napoleonic wars of the early nineteenth century, many European countries experienced serious inflations as governments resorted to the printing press to fund their war expenditures. The lesson the classical economists learned was that the hand of the government had to be removed from the handle of that printing press if monetary stability was to be maintained. The best way of doing this was to link a nation's currency to a commodity like gold, require banks to redeem their notes for gold on demand at a fixed rate of exchange, and limit any increases in the amount of such bank notes in circulation to additional deposits of gold left in the banks by their depositors.

They also concluded that deficit spending was a dangerous means of funding government programs. It enabled governments to create the illusion that they could spend without imposing a cost on society in the form of higher taxes; they could borrow and spend today, and defer the tax cost until some tomorrow when the loans would have to be repaid. The classical economists called for annually balanced budgets, enabling the electorate to see more clearly the cost of government spending. If a national emergency, such as a war, were to force the government to borrow, then when the crisis passed, the government should run budget surpluses to pay off the debt.

These were considered the tried and true policies for a healthy society. And these were the policies that Keynes did his best to try to overthrow in the pages of *The General Theory*. He argued that a market economy was inherently unstable, open to swings of irrational

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investor optimism and pessimism, which resulted in unpredictable and wide fluctuations in output, employment, and prices. Only government, he believed, could take the long view and rationally keep the economy on an even keel by running deficits to stimulate the economy during depressions and surpluses to rein it in during inflationary booms. He therefore attacked the notion of annual balanced budgets; instead, government should balance its budget over the "business cycle."

To do this job, Keynes said, governments could not be hamstrung by the "barbarous relic" of the gold standard. Wise politicians, guided by brilliant economists like himself, had to have the flexibility to increase the money supply, manipulate interest rates, and change the foreign-exchange rates at which currencies traded for each other. They required this power so they could generate any amount of spending needed to put people back to work through public-works projects and government-stimulated private investments. Limiting increases in the money supply to the quantity of gold would only get in the way, Keynes insisted.

Keynes believed not only that the market economy could not keep itself on an even keel, he also believed that it would be undesirable to allow the market to work. He once said that to have the market determine prices and wages to balance supply and demand was to submit society to a cruel and unjust "economic juggernaut." Instead, he wanted wages and prices to be politically fixed on the basis of "what is 'fair' and 'reasonable' as between the [social] classes."

The level of wages imposed by trade unions, for example, was to be viewed as sacrosanct, even if many workers were priced out of the market because the level was higher than potential employers thought those workers were worth. The government, instead, was to print money, run deficits, and push up prices to any level needed to make it again profitable for employers to hire workers. In other words, perpetual price inflation was to be the means to assure "full employment" in the face of aggressive trade unions.

No Check on Spending

In addition, when the balanced-budget rule was overthrown there was no longer any check on government spending. As James M. Buchanan and Richard E. Wagner pointed out in *Democracy in Deficit* (1977), once government is freed from the restraint of making taxpayers directly and immediately pay for what it spends, every conceivable special-interest group can appeal to the politicians to feed their wants. The politicians, desiring votes and campaign contributions, happily offer to satisfy the gluttony of favored groups. At the same time, the taxpayers easily fall prey to the delusion that government can give something for nothing to virtually everyone at no cost to them.

Indeed, politicians can now play the game of offering more and more dollars to special interests, while lowering taxes. The government simply fills the gap by borrowing, imposing a greater debt burden on future generations. Either taxes will have to go up in the years ahead or the government will turn to the printing press to pay what it owes, all the while claiming that it's being done to generate "national prosperity" and fund the "socially necessary" programs of the welfare state.

In one of the most famous passages in *The General Theory*, Keynes said that "the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back."

Seventy years after the appearance of *The General Theory*, many practical men of affairs and politicians in authority remain the slaves of defunct economists and academic scribblers. The tragedy for our times is that among the voices they still hear in the air as they corruptly mismanage everything they touch is that of John Maynard Keynes.