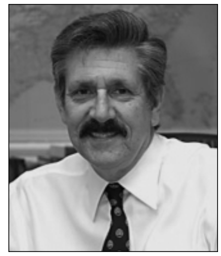
From the President

Keynesian Economics and Constitutional Government



BY RICHARD M. EBELING

Last month 650 economists called for an increase in the federal minimum wage, saying it was the responsibility of the government to "improve the well-being of low-wage workers" by mandating the terms under which people may be employed. Among these economists were five recipients of the Nobel Prize in economics. One of them was Lawrence Klein of the University of Pennsylvania. This should have been no surprise since Klein (b. 1920) has long advocated Keynesian-style policies that threaten the institutions of a free society.

Klein received the Prize in 1980 for what the Nobel committee called his contributions to econometric modeling for purposes of directing economic policy. What is less well known today is that immediately after World War II he was one of the great popularizers of the "new economics" of John Maynard Keynes, especially in his widely read book, *The Keynesian Revolution*, published in 1947.

In *The General Theory of Employment, Interest, and Money* (1936) Keynes had argued that the market economy was inherently unstable and susceptible to wide and unpredictable swings in output, employment, and prices. Worse yet, he asserted, the market could get stuck in a prolonged period of high unemployment and idle resources. Only judicious government monetary and fiscal policy could assure a return to sustainable full employment.

In the decade following publication of *The General Theory* Keynes's ideas captured the hearts and minds of a growing number of economists. The book was soon translated into a variety of foreign languages, including German; that edition appeared in the autumn of 1936. Addressing himself to the Nazi economists of Hitler's Germany in the preface to the German-language edition, Keynes declared that his theory of "aggregate demand" management by government was more easily adapted to a totalitarian economy than a relatively free-market system:

> The theory of aggregate production, which is the point of the following book, nevertheless can be much easier adapted to the conditions of a totalitarian state, than . . . under conditions of free competition and a large degree of laissez-faire. . . . Although I have, after all, worked it out with a view to the conditions prevailing in the Anglo-Saxon countries where a large degree of laissez-faire still prevails, nevertheless it remains applicable to situations in which state management is more pronounced.

While it would be wrong to suggest that Keynes had any direct sympathy for totalitarianism or the Nazi system, he understood clearer than many of his followers that the more the government controlled the economy the easier it would be to implement what soon became known as Keynesian-style policies.

Klein's *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. The book was widely assigned to college students in their economics classes, thus further spreading Keynes's message.

In the final chapter Klein outlined what would be necessary from government if the Keynesian "insights" were to be fully applied for the "social good." In a world guided by Keynes's ideas Americans would have to accept a greater degree of government regimentation than they had in the past. Should they be afraid of this? No, Klein assured his readers: "The regimentation of unemployment and poverty is infinitely more severe than the regimentation of economic planning." He was sure the American people would "quickly come forth with support" for the required regimentation of economic planning.

Richard Ebeling (rebeling@fee.org) is the president of FEE.

The "economic planners" would have to have "complete control over government fiscal policy so that they can spend when and where spending is needed to stimulate employment and tax when and where taxation is needed to halt upward price movements." The traditional congressional budget process would have to be put aside. Klein was sure that "It is inevitable that the Congressional debating techniques will be much too slow and cumbersome to provide the flexibility needed for fiscal policy in a full-employment program." In its place:

> We must have a planning agency always ready with a backlog of socially useful public works to fill any deflationary gap that may arise [through discretionary government deficit-spending powers]; similarly, we must have a price-control board always ready with directives and enforcement officers to wipe out any inflationary gap that may arise. . . . Government spending should be very flexible and subject to immediate release or curtailment, in just the precise amount which will maintain full employment, no more and no less. . . . This is the road to the kind of full employment that we need.

From where would come the money that the government would need for all this fiscal activity? Don't worry, Klein said, the government can just borrow and borrow and borrow. But would it not have to be paid back? Wasn't this merely imposing a higher tax burden on the citizenry in the future? We need have no concern, he declared, since, after all, "public debt can never be a burden, because we owe it to ourselves."

At the same time, government would have to keep individuals from saving too much and spending too little, since excessive savings would diminish the "aggregate demand" on which "full employment" depended. This would require, Klein said, income redistribution from rich to poor because the rich have a higher marginal propensity to save.

To reinforce this objective the motive for personal saving would have to be undermined by the government's taking greater responsibility for such things as retirement planning. "The people acting on individualistic principles do not know their own best interests," he said.

Once discussing some of the implications of his own ideas, Keynes said that in a world consistent with his policy prescriptions, "customary morals, conventions and traditional wisdoms" would have to be set aside. As Klein clearly showed, this included the American tradition of constitutional government and financial self-responsibility.

For the last hundred years constitutionally limited government has been slowly but surely eroded in the United States and around the globe. Governments have grown in discretionary power over the lives and fortunes of the citizenry everywhere we look. Restraints on government have been loosened so those in political authority can do more *to the people* in the name of "for the people."

The traditional purpose of constitutions has been to restrain and specify the powers of government. The presumption is that government is the enemy of liberty and prosperity. Unbridled government threatens to enslave the people through controls, regulations, and prohibitions. Unlimited government power to tax and spend undermines the ability of the people to plan their own lives and peacefully interact with their fellow citizens for mutual improvement.

Keynesian economics and popularizers of its policy prescriptions like Lawrence Klein were major contributors to our continuing trend toward larger and ever-more intrusive government. They persuaded more than a generation of students and economists that the free market is untrustworthy of supplying either jobs or justice. They rationalized the need for unbounded political power in the name of economic stability and distributive fairness. They weakened the belief in the importance of constitutional limits on power.

Even today, after the supposed counterrevolution against Keynesian economics that began during the "stagflation" of the 1970s, those ideas still have their hold over the minds of too many economists, policy makers, and opinion molders. If freedom is to be restored, part of the task will have to be a thorough overthrow of the Keynesian concepts that have been so deeply imbedded into public thinking by people like Lawrence Klein.