Keynes's ideas and supply-side tendencies reexamined

Keynes as a Conservative

Bruce Bartlett

1983 was the 100th anniversary of the birth of John Maynard Keynes. Consequently, many people are reexamining Keynes, his economics and his philosophy. Conservatives would do well to participate in this reexamination, for they will find much in Keynes which is not only praiseworthy but useful. Indeed, they may ultimately claim Keynes as one of their own!

John Maynard Keynes was born on June 5, 1883, the eldest son of Florence Ada Keynes and John Neville Keynes, a distinguished economist in his own right and author of *The Scope and Method of Political Economy* (1891). He attended Eton and then Kings College, Cambridge, where he enjoyed a thoroughly successful academic career. The rest of his life was spent moving freely among academic, government, literary, and business pursuits. Although successful in virtually every endeavor, Keynes is today best known as an economist and author of *The General Theory of Employment Interest and Money* (1936).

The General Theory is unquestionably the most influential work in economics of the twentieth century. It established what has been the guiding philosophy of economic policy in virtually every industrialized nation since World War II. Its now-familiar prescription for unemployment—deficit spending and public works—still forms the starting point for anti-recessionary policy. Even President Ronald Reagan acknowledged this fact when he accepted large budget deficits as necessary and proposed public works spending to ease unemployment.

Although conservatives rightly attack Keynesian policies as inflationary and, ultimately, counterproductive, they should understand that Keynes never intended for such policies to be the basis for a general economic program (despite the title of his book). Rather, his policies were designed for the specific problem of the Great Depression. Moreover, we must not overlook the profoundly conservative underpinning of the Keynesian prescription of unemployment. It was designed expressly to counteract the growing socialist and communist movements, which found the vast army of the unemployed to be fertile soil for their ideas. Keynes believed that it was far better to modify capitalism, while retaining what he believed were its essential elements, than to have it overthrown by socialism.

In almost every respect Keynes was a conservative, both in philosophy and temperament, although he identified himself as a liberal throughout his life. His conservatism was largely a function of his class. Keynes made this point himself when asked why he was not a member of the Labor Party:

> To begin with, it is a class party, and the class is not my class. If I am going to pursue sectional interests at all, I shall pursue my own. When it comes to the class struggle as such, my local and personal patriotisms, like those of everyone else, except certain unpleasant zealous ones, are attached to my own surroundings. I can be influenced by what seems to me to be Justice and good sense; but the *Class* war will find me on the side of the educated *bourgeoisie.*[1]

Consequently, Keynes's conservatism very much reflected the attitudes of his class, which was the British upper class. Roy Harrod, his biographer, details these conservative attitudes in Keynes:

> He valued institutions which had historic roots in the country; he was a great upholder of the virtues of the middle-class which, in his view, had been responsible for all the good things that we now enjoy; he believed in the supreme value of intellectual leadership, in the wisdom of the chosen few; he was interested in showing how narrow was the circle of kinship from which the great British leaders in statesmanship and thinking had been drawn; and he was an intense lover of his country. . . . He had no egalitarian sentiment; if he wanted to improve the lot of the poor and that quickly—and he believed that far more progress was possible than was being made—that was not for the sake of equality, but in order to make their lives happier and better. . . . He considered the doctrine of State Socialism to be quite obsolete, the reaction from an environment which had now changed out of recognition. Thus both in temperament and doctrine he was opposed to many elements in the Labor Party.[2]

While it is true that Keynes advocated unprecedented state intervention in the economy, it is important to keep in mind that such intervention was fundamentally different from that of the socialist. Keynes wanted to preserve those aspects of capitalism which were necessary and desirable—the price system, the profit motive, individual initiative—while confining state intervention to the macroeconomy. Keynes, unlike many of his followers, never favored direct tampering with prices or wages, always maintained the necessity for profits, and was keenly aware of the importance of individual initiative and entrepreneurship to economic success. In 1931, for example, he blamed much of the British economy's problems precisely on the inability of businessmen to earn an adequate profit:

> We live in a society organized in such a way that the activity of production depends on the individual businessman hoping for a reasonable profit. . . . The margin which he requires as his necessary incentive to produce may be a very small proportion of the total value of the product. But take this away from him and the whole process stops. This, unluckily, is just what has happened. That fall of prices relative to costs, together with the psychological effects of high taxation, has destroyed the necessary incentive to production. . . . Unemployment, I must repeat, exists because employers have been deprived of profit. The loss of profit may be due to all sorts of causes. But, short of going over to Communism, there is no possible means of curing unemployment except by restoring to employers a proper margin of profit.[3]

Even later, in *The General Theory,* Keynes did not say many of the things which are today taken to be Keynesian economics. In fact, in a review of *The General Theory,* David McCord Wright said "a conservative candidate could conduct a political campaign largely on quotations from the *General Theory.*" He then detailed eleven propositions about Keynesian economics which are generally accepted, but are not supported by what Keynes actually said:

> 1. The Keynesian analysis does not in itself "prove" that we "have" to have

socialism, or socialized investment, or that capitalism is "bound" to destroy itself.

2. The Keynesian analysis does not necessarily prove that there will "certainly" be long-range unemployment after the war (or at any other time).

3. It does not necessarily depend, save in a purely formal sense, either on rigid prices, rigid wages, or "hoarding" to show possibilities of unemployment equilibrium.

4. It does not say that a rising national debt is always necessary or that there is no burden to the national debt.

5. It does not say that spending is always a good thing or that "saving" is always bad.

6. Keynes does not believe that every dollar spent by the government necessarily "multiplies" itself several times.

7. Keynes's analysis in the *General Theory* is not an argument for indiscriminate money wage increases to "redistribute" wealth, or "increase purchasing power." On the contrary, he very explicitly favors a policy of stable money wages.

8. Keynes's analysis does not deny that wage and/or price reduction can at times and under some circumstances cure unemployment; nor need the argument necessarily be a matter of liquidity preference.

9. Keynes does not favor protectionism or tariffs *per se.*

10. He does not "disregard" in the *General Theory* the possible adverse effects of taxes on profits and of high, progressive income taxes generally.

11. The *General Theory* is filled with references to the importance of business expectations and business "confidence." There is no ground for saying that these factors are omitted.[4]

On this last point, George Gilder has gone so far as to say that "the actual works of Keynes . . . are more favorable to supply-side economic policy than current Keynesians comprehend."[5] Gilder says this because he believes that Keynes was making a profoundly important point when he divorced saving from investment, which classical economics has seen as indistinguishable, or at least always equal to each other. To Gilder, Keynes was making the point that saving without entrepreneurship was of no value, and lacking the proper entrepreneurial motivation it was therefore quite possible to have oversaving. Keynes was, in effect, making the individual investor the central figure in his system. And this, to Gilder, makes him a true supply-sider:

> As disdainful of Marxism as of laissez-faire, Keynes rejected all systems that saw the economy as a mechanism, whether of dialectics or markets. He offered for the economy a hierarchical ideal. The creative center of the system was the skilled entrepreneur and the goal of policy was to cultivate his skills and ensure his inducement to invest.[6]

As final proof of Keynes's "supply-side" tendencies, one might also point out that he understood the existence of the Laffer Curve long before Arthur Laffer was born. In "The Means to Prosperity," written in 1933, Keynes said:

> Nor should the argument seem strange that taxation may be so high as to defeat its object, and that, given sufficient time to gather the fruits, a reduction of taxation will run a better chance than an increase of balancing the budget. For to take the opposite view today is to resemble a manufacturer who, running at a loss, decides to raise his price, and when his declining sales increase the loss, wrapping himself in the rectitude of plain arithmetic, decides that prudence requires him to raise the price still more—and who, when at last his account is balanced with nought on both sides, is still found righteously declaring that it would have been the act of a gambler to reduce the price when you were already making a loss.[7]

In many other ways as well, Keynes exhibited distinctly conservative ideas. He was, for example, strongly opposed to economic planning. In his view, properly designed macro-economic policies made it totally unnecessary for economic reasons and retained maximum individual liberty at the same time. Thus, the maintenance of individual liberty was clearly a major goal of his economic program. Keynes made this point most strongly in a letter to *The Times* in 1940:

> For if the community's aggregate rate of spending can be regulated, the way in which personal incomes are spent and the means by which demand is satisfied can be safely left free and individual . . . the only way to avoid the destruction of choice and initiative, whether by consumers or by producers, [is] through the complex tyranny of all-round rationing. . . . This is the one kind of compulsion of which the effect is to enlarge liberty. Those who, entangled in the cold unserviceable maxims, fail to see this further-reaching objective have not grasped, to speak American, the big idea.[8]

Toward the end of his life Keynes even wrote to F.A. Hayek in praise of his book, *The Road to Serfdom* (1944), which argues that economic planning inevitably leads to totalitarianism. As Keynes told Hayek in a personal letter, "morally and philosophically I find myself in agreement with virtually the whole of it; and not only in agreement with it, but in a deeply moved agreement."[9]

Thus Keynes would not at all be in agreement with those "Keynesians" like John Kenneth Galbraith who continually argue for wage and price controls to contain the inflation resulting from inappropriate use of Keynesian fiscal and monetary policy. We forget that Keynes never advocated continual budget deficits year after year. He believed that budgets should be balanced over the business cycle, with surpluses in good years to offset deficits in bad years.[10] Nor, in fact, did Keynes ever support inflation, except under the *deflationary* conditions of the 1930s. Even Hayek has said that had Keynes lived he would have been "one of the most determined fighters against inflation."[11] This view is supported by a recent review of Keynes's writings by Thomas Humphrey of the Federal Reserve Bank of Richmond, who concludes:

> Keynes was neither the subtle inflationist nor the extreme nonmonetarist that he is sometimes depicted as being. On the contrary his writings reveal that he consistently deplored inflation, that he warned unceasingly of its dangers, and that he urged that its avoidance be made a primary objective of public policy. . . . Nor would he have had anything but scorn for modern Keynesian policies designed to trade off higher inflation for lower unemployment. His insistence on the primacy of the goal of absolute price stability would have been in direct conflict with such inflationary policies.[12]

If these things about Keynes are true, how did we end up with the economic problems we have today which are so widely blamed on Keynesian economics? I agree with Hayek that it is largely due to Keynes's unfortunate tendency to change his views to suit short-run political objectives. He did so because he was supremely confident of his ability to change things around again later. Thus, when Hayek once asked Keynes if he was becoming alarmed by the use to which some of his disciples were putting his theories, his reply was "that these theories had been greatly needed in the 1930s; but if these theories should ever become harmful, I could be assured that he would quickly bring about a change in public opinion."[13]

In the 1930s Keynes saw a threat of socialism arising from massive unemployment that was caused by deflationary monetary policies. He therefore supported inflation as necessary to achieve full employment in order to forestall the socialist advance. Unfortunately, the book he wrote to justify this program he called the *General Theory*, implying that such a program was not designed solely for the economic conditions of the 1930s but for all time. Had the war not interfered with

Keynes's work and had he not died in 1946 he may very well have been able to put forward a new economic program for the postwar world based on the classical principles he discarded in 1936. As Keynes wrote in his very last published article, "I find myself moved, not for the first time, to remind contemporary economists that the classical teaching embodied some permanent truths of great significance. . . . There are in these matters deep undercurrents at work, natural forces, one can call them or even the invisible hand, which are operating towards equilibrium. If it were not so, we could not have got on even so well as we have for many decades past."[14]

In spite of having, unintentionally I believe, unleashed the forces of inflation which are still with us today, we should nevertheless give proper credit to the role of Keynesian economics in successfully holding at bay—as Keynes hoped it would—the forces of socialism. The fact is that without mass unemployment and poverty, there is no natural breeding ground for socialism in the United States or most other Western nations. Keynesian economics did manage to achieve—or at least take credit for—the remarkably long period of prosperity which began after World War II and ran into the late 1970s. Although I certainly don't mean to imply that free market policies could not have achieved the same prosperity, the fact is that the *apparent* success of Keynesian economics gave policymakers a way of neutralizing the unemployment issue *politically*. Although inflation was a consequence, inflation has not, historically, given rise to socialist parties, but rather to conservative ones.

The problem today is that with Keynesian economics having been discredited, and with high unemployment having replaced inflation as the central economic problem, socialist policies are once again ascending for the first time in fifty years. The new socialism, however, does not go by that name, but instead is called "national industrial policy" or "national foresight capability." Unfortunately, it all boils down to economic planning.[15] It is interesting to note that one of the principal advocates of an industrial policy, Professor Lester Thurow, recently found it necessary to level a heavy blast at Keynesian economics in his latest book, *Dangerous Currents*. That he believed such a thing was necessary implicitly shows the extent to which Keynesian economics has been a bulwark against socialism. This point is further enhanced by the fact that many old-line Keynesians have become outspoken opponents of industrial policy. Professor Paul Samuelson, for example, recently testified against an industrial policy before the congressional Joint Economic Committee.

The ironic conclusion of all this may be that to fight back against the new economic planners, conservatives are going to have to revive Keynes. As distasteful as this may be for some, I believe they will find in Keynes much to admire and much they can call their own.

[1]John Maynard Keynes, "Am I a Liberal?" *The Nation and Athenaeum* (August 8 and 15, 1925), reprinted in *Essays in Persuasion* (New York, 1963), p. 324. [2]Roy F. Harrod, *The Life of John Maynard Keynes* (New York, 1951), pp. 331-2. [3]John Maynard Keynes, "Proposals for a Revenue Tariff," *The New Statesman and Nation* (March 7, 1931), reprinted in *Essays in Persuasion.* [4]David McCord Wright, "The Future of Keynesian Economics," *American Economic Review* 35 (June 1945), 286-7. [5]George Gilder, *Wealth and Poverty* (London, 1982), p. 40. [6]*Ibid.*, p. 44. [7]John Maynard Keynes, "The Means to Prosperity," reprinted in *The Collected Writings of John Maynard Keynes*, vol. 9 (London, 1972), 338. [8]John Maynard Keynes, "Mr. Keynes's Plan. Control of Boom and Slump," (letter) *The Times* (April 10, 1940), quoted in Elizabeth S. Johnson and Harry G. Johnson, *The Shadow of Keynes* (Chicago, 1978), p. 26. [9]Harrod, *Life of Keynes*, p. 436. [10]John Maynard Keynes, "How to Pay for the War," reprinted in *Collected Writings*, pp. 367-439. [11]F.A. Hayek, "Personal Recollections of Keynes and the 'Keynesian Revolution,'" *Oriental Economist* (January 1966), reprinted in *New Studies in Philosophy, Politics, Economics*

and the History of Ideas (Chicago, 1978), p. 287. See also, F.A. Hayek, "The Keynes Centenary: The Austrian Critique," *The Economist* (June 11, 1983), p. 41. [12]Thomas M. Humphrey, "Keynes on Inflation," Federal Reserve Bank of Richmond *Economic Review* 67 (January/February 1981), 13. [13]Hayek, "Personal Recollections," p. 287. [14]John Maynard Keynes, "The Balance of Payments of the United States," *Economic Journal* 56 (June 1946), 185. [15]On industrial policy, see Bruce Bartlett, "The Politics of Reindustrialization," *National Review* (May 15, 1981), pp. 543-48.

Goat Song

Behold the academic goat
with savant chin and pungent coat.
A hardy ruminant is he
with four degrees in venery.
He gnaws his academic post;
he dines with metaphysic host
on Darwin, Marx and Freud on toast.

A little bell around his throat
goes tinka-tink, a-tinka too.
He chews a bit, he bites and chews,
works bald blue eye and yellow tooth.
Buckminster Fuller, last week's news;
it all comes out the same insooth.

Capricorn, the horny goat;
crooked horn and shaggy coat,
just looks around for more to eat.
Go to it, kid. Bon appétit!

— *Jack Flavin*

Supply-Side Economics and The Political Order

Dwight R. Lee

IS SUPPLY-SIDE ECONOMICS enough to revitalize economies that are suffering from stagnating productivity? From a strictly economic perspective the answer would appear to be unequivocally yes. Supply-side economics, despite the impression one gets from the popular press and some political pundits, is not a shallow fad that grew out of political rhetoric. Quite the contrary. Stripped to its basics, supply-side economics is nothing less than a restatement of the most fundamental principle of economics—people respond to changes in relative prices. Reduce the price of leisure and consumption relative to that imposed on production and saving, and people will produce less while attempting to consume more—an attempt that can be successful only in the short run. On the other hand, if the price of leisure and consumption is increased relative to that imposed on more productive pursuits, people will substitute productive activities for consumption activities—a substitution that will lead to more consumption in the long run.

But from the broader perspective of political economy it is not at all clear that supply-side economic policy, by itself, will be enough. The supply-side objective of restoring the incentives for productive investments by reducing the high taxes that are imposed on the return to those investments is necessarily long-run. The time required to plan, implement, and realize the full advantage from investments in physical and human capital is often measured in decades. Unfortunately the attempt to implement supply-side economic policy is being made through political institutions that provide strong incentives to focus on short-run gains and ignore long-run objectives.

To assess fully the challenge facing supply-side economic policy, one has to first understand the myopic political perspective that characterizes prevailing democratic institutions. It is also important to understand how this political myopia can generate tax burdens that discourage economic productivity to the point of actually reducing tax revenues. Not surprisingly, the political process that is capable of increasing taxes to such destructive levels is not likely to be well suited to implement successfully a serious supply-side policy.

After almost fifty years of economic policies that take production for granted and concentrate on demand and distribution, the emergence of supply-side economics is long overdue. But it takes more than sound economic doctrine to replace unsound economic policy. The political success of Keynesian economics surely has less to do with theoretical