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It is ideas, not vested interests, which are dangerous for good or evil … 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 quite 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.

John Maynard Keynes
The General Theory of Employment, Interest and Money (1936)

Of Defunct Economists, Madmen in Authority and Academic Scribblers

If an individual, family or business has long lived for the day and disregarded the morrow, spending more than it earns, buying what it doesn't need and can't afford, making foolish and reckless "investments" (which actually consume its rather meagre capital) and borrowing more than it can repay, then it must eventually face a reckoning. When that day arrives, what must it do? Few people would prescribe more of the same: that'd be like taking an alcoholic on a pub crawl. Most would agree that a profligate family or business must ultimately mend its ways. Whether it likes it or not, it must live within its means.

Mainstream economists would likely agree – but also hasten to add that collections of families and businesses (i.e., societies) are another matter altogether. If a spendthrift family or business tightens its financial belt, then that's good. But if everybody suddenly does so, they allege, that's bad. In July 2008, for example – just after the Global Financial Crisis claimed Bear Stearns as its first major victim, and shortly before it would take Lehman Bros. as its biggest scalp to date – Peter Bernstein warned that "a mass effort by American consumers to save [as little as] 3.9% of their after-tax incomes would be a disaster for the world economy."

James K. Galbraith (the son of John K.) goes considerably further. He writes ("In Defense of Deficits," *The Nation*, 4 March 2010):

> For ordinary people, public budget deficits, despite their bad reputation, are much better than private loans. Deficits put money in private pockets. Private households get more cash. They own that cash free and clear, and they can spend it as they like. If they wish, they can also convert it into interest-earning government bonds or they can repay their debts. This is called an increase in "net financial wealth." Ordinary people benefit, but there is nothing in it for banks.

Further, he alleges

> It may seem like homely wisdom to say that "just like the family, the government can't live beyond its means." But it's not. In these matters the public and private sectors differ on a very basic point. Your family needs income in order to pay its debts. Your government does not. Private borrowers can and do default. They go bankrupt (a protection civilized societies afford them instead of debtors' prisons). Or if they have a mortgage, in most states they can simply walk away from their house if they can no longer continue to make payments on it. With government, the risk of nonpayment does not exist.
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> Government spends money (and pays interest) simply by typing numbers into a computer. Unlike private debtors, government does not need to have cash on hand … and the person who writes Social Security cheques at the Treasury does not have the phone number of the tax collector at the IRS. If you choose to pay taxes in cash, the government will give you a receipt – and shred the bills. Since it is the source of money, government can't run out.

That's not all. Galbraith also claims:

> It's true that government can spend imprudently. Too much spending, net of taxes, may lead to inflation, often via currency depreciation – though with the world in recession, that's not an immediate risk. Wasteful spending – on unnecessary military adventures, say – burns real resources. But no government can ever be forced to default on debts in a currency it controls. Public defaults happen only when governments don't control the currency in which they owe debts – as Argentina owed dollars or as Greece now (it hasn't defaulted yet) owes Euros. But for true sovereigns, bankruptcy is an irrelevant concept. When Obama says that the United States is "out of money," he's talking nonsense – dangerous nonsense. One wonders if he believes it.
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> Nor is public debt a burden on future generations. It does not have to be repaid, and in practice it will never be repaid. Personal debts are generally settled during the lifetime of the debtor or at death, because one person cannot easily encumber another. But public debt does not ever have to be repaid. Governments do not die – except in war or revolution, and when that happens, their debts are generally moot anyway.
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> So the public debt simply increases from one year to the next. In the entire history of the U.S. it has done so, with budget deficits and increased public debt on all but about six very short occasions – with each surplus followed by a recession. Far from being a burden, these debts are the foundation of economic growth. Bonds owed by the government yield net income to the private sector, unlike all purely private debts, which merely transfer income from one part of the private sector to another.

President George W. Bush seemed to agree. During a news conference on 20 December 2006, by which time it had become clear that air was rapidly leaking from the housing bubble, he urged Americans to "go shopping more." Why? Because, he seemed to say, debt-financed spending drives the economy. Most economists concur: the more people borrow and spend, the wealthier their society becomes.

Conversely, if aggregate expenditure decreases then a downward spiral ensues; and because (they say) a market economy doesn't and cannot self-correct, the tailspin will continue until the government intervenes and spends on everybody's behalf. Once this happens, they assure us, the free-fall ceases, economic conditions stabilise and everybody can once again borrow, spend and grow rich. Hence the annoyed response of President Bush, in an interview with *The Washington Times* on 12 January 2009, to the miniscule band who criticised his endless borrowing, spending, intervening and warmongering. Like Colonel William Calley at My Lai, who destroyed a village in order to "save" it and massacred ca. 350-500 women, children and elderly people in order to "protect" them from the Viet Cong, President Bush said "I've abandoned free market principles to save the free market system … You can sit there and say to yourself 'well, I'm going to stick to principle and hope for the best, or I'm going to take the actions necessary to prevent the worst.'" At times of crisis, he seemed to say, free market principle must yield to interventionist pragmatism.

Why did Bush believe that this course of action was necessary? Why would it prevent the worst? How could he be sure that his policies would not actually make a bad situation even worse? Bush told his interviewer that he relied upon the advice of Henry Paulson (the Secretary of the Treasury) and Ben Bernanke (the Chairman of the Board of Governors of the Federal Reserve System). Paulson's and Bernanke's advice, in turn, faithfully reflected the prejudices of John Maynard Keynes (1st Baron Keynes of Tilton, CB, 1883-1946). Gregory Mankiw, an economist at Harvard University, a former chair of Bush's Council of Economic Advisors and the author of one of the world's best-selling undergraduate textbooks, told *The New York Times* (30 November 2008) that

> If you [are] going to turn to only one economist to understand the problems facing the economy, there is little doubt that the economist would be John Maynard Keynes. Although Keynes died more than a half-century ago, his diagnosis of recessions and depressions remains the foundation of modern macroeconomics.

Lord Keynes was undoubtedly the 20th century's most influential economist. Today's academic literature comprises thousands of books and tens of thousands of articles that, directly or indirectly, extol his ideas. His principal work, *The General Theory of Employment, Interest and Money* (1936, hereafter *TGT*), is almost certainly the most influential economics book of the 20th century. It occupies the 43rd rung on the "List of the 100 Best Non-Fiction Books of the Twentieth Century" compiled in 2004 by *The National Review*; and Martin Seymour-Smith places it 88th in *The 100 Most Influential Books Ever Written: The History of Thought from Ancient Times to Today* (Citadel Press, 1998). The only other work of modern economics that graced this latter list, *An Enquiry Into the Nature and Causes of the Wealth of Nations* (1776) by Adam Smith, ranked 58th. Even Milton Friedman, who claimed that he was a fierce critic of Keynes, was in most fundamental respects an orthodox Keynesian.[1]

Paul Samuelson, Keynes's most influential American advocate, recalled that *TGT*

> is badly written [and poorly organised]; any layman who, beguiled by the author's previous reputation, bought the book was cheated of his five shillings. It is not well suited for classroom use. It is arrogant, bad-tempered, polemical, and not overly-generous in its acknowledgements. In it the Keynesian system stands out indistinctly, as if the author were hardly aware of its existence or cognisant of its properties; and certainly he is at his worst when expounding on its relations to its predecessors. Flashes of insight and intuition intersperse tedious algebra. An awkward definition gives way to an unforgettable cadenza. When it is finally mastered, we find its analysis to be obvious and at the same time new. In short, it is the work of genius.

A few of Keynes' contemporaries viewed him and *TGT* in a very different light. To them, Keynes was the consummate politician-economist who craved and acquired fame and fortune by elevating politicians and officials to the pinnacle of economic and financial significance. Keynes exalted the political class as the guardian of employment, growth and prosperity. He also imputed to it great civic virtue, and blessed it to do what it does best: favour particular producers, oppress most consumers and all taxpayers, debase the currency and foment war at home and abroad. Keynes cloaked the old – and repeatedly refuted – doctrine that consumption and inflation beget prosperity in the new and pseudo-sophisticated garb of mathematical economics.

He also purported to discover something that John Law (1679-1721) first claimed – namely that there exists a source of allegedly unlimited funds that is outside and above the process of saving, investment and production, and which is ever-ready to serve government officials: the government-owned central bank. Echoing Samuel Johnson's famous quip, Henry Hazlitt's line-by-line refutation of *TGT*, entitled *The Failure of the "New Economics" – An Analysis of Keynesian Fallacies* (Van Nostrand, 1959), concluded "I have been unable to find in it a single important doctrine that is both true and original. What is original in the book is not true; and what is true is not original. In fact, even much that is fallacious in the book is not original, but can be found in a score of previous writers."

Despite Hazlitt's thorough demolition of its foundation (see also W.H. Hutt, *The Keynesian Episode: A Reassessment*, Liberty Classics, 1979), after 75 years the superstructure of Keynesianism continues to reign supreme within government. Indeed, the Global Financial Crisis has greatly boosted both its prominence and its reputation. As *The Australian Literary Review* (3 February 2010) put it, "it's hard to think of [an economist other than Keynes] whose thoughts were so embraced, then rejected, only to be endorsed again." In Australia, Kevin Rudd and Wayne Swan presented to the Treasury Secretary, Ken Henry, a copy of *TGT* – inscribed with their gratitude for his resolutely Keynesian response to the GFC. In most

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1 See in particular Roger Garrison, "Is Milton Friedman a Keynesian?" in Mark Skousen, ed., *Dissent on Keynes: A Critical Appraisal of Keynesian Economics* (Praeger Publishers, 1992).

countries during the past several years, politicians and their advisors, whether of the "left" or "right," have fervently espoused the doctrine that governments must spend their way into massive deficits (because they "stimulate the economy") and thereby spend their way out of recessions. They insist that consumption – whether by individuals, businesses or the state – causes employment and growth. Because consumption allegedly begets prosperity, more borrowing and spending and bigger government is (if they claim they're "conservative" they sometimes add the caveat "for the time being") best.

Yet when we actually read (rather than merely extol) *TGT*, we find much that's puzzling (to put it politely) and even more that's absurd (to put it bluntly).). A terrific book by Hunter Lewis (*Where Keynes Went Wrong – And Why World Governments Keep Creating Inflation, Bubbles and Busts*, Axios, 2009) helps the general reader to navigate his way through Keynesian madhouse. For example, Keynes said – without any reasoning, citation or evidence – that as a rule people save too much. How to resolve this alleged problem? Through its central bank, the state should print vast quantities of new money. This newly-minted money doesn't just constitute savings: it is "just as genuine as any other savings" (*TGT*, p. 82-83). But conjuring money out of thin air doesn't sound like saving. Even if we grant that it is, why aren't countries like Zimbabwe and Serbia – which during the past two decades have printed more new money than any other – awash in savings? More generally, why will a tsunami of new "savings" alleviate the alleged problem – namely that people already save too much?

Keynes also famously asserted (*TGT*, p. 129)

> If the Treasury were to fill old bottles with banknotes, bury them at suitable depths in disused coal mines which are then filled up to the surface with town rubbish, and leave it to private enterprise on well-tried principles of laissez-faire to dig the notes up again (the right to do so being obtained, of course by tendering for leases of the note-bearing territory), there need be no more unemployment and with the help of the repercussions, the real income of the community, and its capital wealth also, would probably become a good deal greater than it actually is.

But if we can become wealthy simply by collecting boulders, moving them from A to B and then from B back to A, then why do Bangladesh and Haiti remain wretchedly poor? What's most startling, when one actually reads *TGT*, is that Keynes offers absolutely no support – whether logical or empirical – for his manifold claims. He advances many bald assertions and intuitive hunches; numerous aristocratic witticisms and much withering sarcasm drip from his tongue; but simply absent are closely-reasoned chains of logic and reams of corroborating evidence.

When the world's governments reacted to the GFC by launching immense experiments along Keynesian lines, most people assumed that these trials were actually tried-and-true policies and that somebody had long ago demonstrated that they made theoretical and factual sense. Yet the stark reality remains: a garb of arcane mathematics obscures the fact that Keynesianism is a ramshackle grab-bag of interventionist intuitions and prejudices. It's unsettling to discover just how utterly derivative, unsubstantiated and weak these claims are. "Keynes," Ludwig von Mises noted in *Human Action* (1949), "did not add any new idea to the body of inflationist fallacies, a thousand times refuted by economists … He merely knew how to cloak the plea for inflation and credit expansion in the sophisticated terminology of mathematical economics." In *Planning for Freedom* (1970), Mises added "Keynes did not refute Say's Law.[2] He rejected it emotionally, but he did not advance a single tenable argument to invalidate its rationale."

What Keynes Said: Suppress Rates of Interest

Without the intervention of government, Keynes asserted, rates of interest will almost always be "too high." "The rate of interest is not self-adjusting at a level best suited to the social advantage but constantly tends to rise too high," he said on p. 351 of *TGT*. More generally, "rates … have been [too high for] the greater part of recorded history."[3] This, apparently, is why humanity remains mired in poverty. "That the world after several millennia of steady individual saving [sic] is so poor … is to be explained … by high rates of interest" (*TGT*, p. 242). "High … rates of interest are the outstanding evil, the prime impediment to the growth of wealth [they discourage borrowing and thus investment]" (*TGT*, p. 351).

Never mind that Keynes doesn't bother to substantiate his claim that rates have historically been too high. Apparently, it's self-evident. The important point, he insists, is that there's no good reason why rates should have been so high throughout human history, or why they should remain so high now. Why do interest rates tend to be higher than they should be? Keynes beats around the bush. It seems, however, that

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[2] Say's Law is also known as the Law of Markets. Although it actually originated earlier and elsewhere, it has been almost universally attributed to the French businessman and economist Jean-Baptiste Say (1767–1832). The Law states that in a free market economy, people produce goods and services in order to exchange them for other goods and services (which they consume). In the process, a precisely sufficient level of real income is created in order to purchase the economy's entire output. That is to say, in a free market economy the total supply of goods and services will exactly equal the total demand for goods and services during any given time period. This is because my demand for the goods and services that others produce stems from the income I receive from my production of goods and services. Although there may be local imbalances, general gluts and shortages will not occur. Gluts in one market will be balanced by shortages in others.

According to Paul Sweezy (in Seymour Harris, ed., *The New Economics: Keynes' Influence on Theory and Public Policy*, Dobson, 1948), "historians fifty years from now may record that Keynes' greatest achievement was the liberation of Anglo-American economics from a tyrannical dogma … Yet the Keynesian attacks, though they appear to be directed against a variety of specific theories, all fall to the ground if the validity of Say's Law is assumed." Hence the vital importance of Mises' insight: Keynes never refuted – indeed, he merely denounced rather than assessed – Say's Law (see also Thomas Sowell, *Say's Law: An Historical Analysis*, Princeton University Press, 1972).

[3] John Maynard Keynes, *Collected Writings*, vol. 20, *Activities 1929-31: Rethinking Employment and Unemployment Policies* (London, Macmillan, 1981), p. 273.

- people "hoard" their money out of fear. This creates a shortage of lendable funds and thus places upward pressure upon rates (*TGT*, p. 174, 351).
- it is expensive to "bring … borrowers and lenders together." This cost also boosts rates (*TGT*, p. 208, 309).
- there may be a "wide gap between the ideas of borrowers and those of lenders;"[4] as a result, "wealth-owners" simply do not accept lower rates (*TGT*, p. 309).

What, then, to do? It's clear to Keynes that the state can and should reduce rates of interest to a more reasonable level. Specifically, if "wealth-owners" withhold their funds from the loan market, or refuse to accept reasonable rates, then the government should reduce rates by increasing the quantity of lendable funds (*TGT*, pp. 167-168, 197-199, 268 and 298). How to do this? By printing new money which the central bank makes available to commercial banks, and which the commercial banks then lend to individuals and businesses (*ATM*, chap. 2). The greater the quantity of money, the more money will be available to borrowers and the lower the cost of borrowing. "A change in the quantity of money … is … within the power of most governments … The quantity of money … in conjunction with [lenders' willingness to lend] determines the actual rate of interest" (*TGT*, pp. 167-168, 267-268). The greater the quantity of money the government creates, Keynes seems to imply, the lower the resulting rate of interest, the greater the incidence of lending and borrowing and the higher the resultant level of economic activity.

According to Keynes, general fears of government intervention and specific fears about a government-engineered increase in the amount of money circulating in the economy are ill-founded. He emphasises that the new money that the government has printed and injected into the banking system is "just as genuine as any other savings" (*TGT*, pp. 82-83). Further, since "there is no special virtue in the pre-existing [high] rate of interest … [there can be no] evil [in bringing it down by government intervention]" (*TGT*, p. 328). Indeed, if the government reduces rates of interest, then its ultimate target level for these rates should be zero. "I should guess that a properly run community … ought to be able to bring down the … [general rate of business profits and rate of interest] approximately to zero within a single generation" (*TGT*, p. 220).

Provided that the government supplies an inexhaustible well of capital – Keynes seems to assume that it can, but provides not the slightest reason why anybody else should believe it – borrowers should not have to pay interest and businesses should not have to pay dividends! Do you think I jest or misrepresent?

> [Our] aim (there being nothing in this which is unattainable) … [should be] an increase in the volume of capital until it ceases to be scarce, so that the [owner of savings] will no longer receive a bonus.

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[4] John Maynard Keynes, *Collected Writings*, vol. 6, *A Treatise on Money* (London, Macmillan, 1971), p. 339. (Hereafter referred to as "ATM").

> The … owner of capital [is] functionless … He can obtain interest because capital is scarce. But … there can be no intrinsic reason for the scarcity of capital [since government can always print and distribute more of it] … [Making capital freely available] may be the most sensible way of gradually getting rid of many of the objectionable features of capitalism. The *rentier* [that is, landlord or investor] would disappear … and [so would] the cumulative oppressive power of the capitalist to exploit the scarcity-value of capital (*TGT*, p. 376, 221 and 376).

Truly, Keynesianism is the economics of the magician's wand and the magic pudding. Should the government ever reverse course and deliberately raise rates of interest? Of course not! Keynes thought it "extraordinary" that such a thing would ever enter anybody's head (*TGT*, p. 322n):

> The remedy for the boom is not a higher rate of interest, but a lower rate of interest! For that may enable the boom to last. The right remedy for the trade cycle is not to be found in abolishing booms and thus keeping us permanently in a semi-slump; but in abolishing slumps and thus keeping us permanently in a quasi-boom (*TGT*, p. 322).

Booms, Keynes insists, should be embraced and not feared. To think otherwise is a "serious error" (*TGT*, p. 320-322). The problem with most booms is that businessmen succumb to "over optimism" – and proceed, given the "excessively high rate of interest," to make unprofitable investments (*TGT*, p. 322). But if "we" lower the rate of interest, then these same investments will earn a satisfactory rate of return. And since humanity is still poor, "we" should encourage rather than discourage investment. Because people will always make mistakes, there will always be some "misdirected investment;" but this "happens … even when there is no boom" (*TGT*, p. 321). To Keynes, the conclusion is self-evident: "we should avoid [high rates of interest] … as we would hell-fire."[5]

If at first you don't succeed, Keynes urges, keep trying. In particular, if the government prints a great deal of new money and injects it into the banking system, then rates of interest should fall. But if they don't fall far enough or quickly enough to the "optimum level" – namely zero – then the state must undertake "other measures" in order to boost investment (*TGT*, p. 164, 243). "Wealth-owners" whom the state has not yet completely displaced as lenders and who will likely find low rates "unacceptable" might be able to block them. If so, then "the State, which is in a position to calculate … on long views and on the basis of general social advantage … [will have to] directly organise investment" (*TGT*, p. 164).

For now, national governments must take all necessary steps to suppress rates of interest and to maintain them at a suitably low level. Eventually, however, global institutions should undertake and co-ordinate this task. In particular, Keynes hoped that what has become known as the International Monetary Fund (he

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5 Robert Skidelsky, *John Maynard Keynes*, vol. 3, *Fighting for Britain: 1937-1946* (London, Macmillan 2000), p. 281.

helped to establish it) would act as a global central bank. If given the power to print unlimited amounts of money and inject it into the global economic system, it could reduce interest rates around the world, maintain them at a very low level and create a worldwide quasi-boom (see, for example, Skidelsky, *John Maynard Keynes*, vol. 3, p. 227, 247, 255 and pp. 302-303).

Finally, we should pay our respects to the "army of heretics and cranks" (*ATM*, p. 193) who in earlier periods agitated for lower interest rates. In *TGT* (p. 340), Keynes openly acknowledged that he was refurbishing and updating "sixteenth and seventeenth century … [economic writers generally known as] Mercantilists." This, to put it mildly, was ironic. Keynes's teachers – and Keynes himself earlier in his career – correctly regarded Mercantilism as a "fallacy" that had "long since been exploded" (*TGT*, p. 334). But by the 1930s, Keynes saw an

> element of scientific truth in Mercantilist doctrine, [especially in the Mercantilists' view] that an unduly high rate of interest was the main obstacle to the growth of wealth [and in their] preoccupation … [to] increase … the quantity of money [in order to] diminish the rate of interest (*TGT*, p. 335, 341).[6]

Why Keynes Is Wrong: If You Suppress Rates of Interest You'll Reap a Whirlwind of Inflation, Asset Bubbles and Busts

Throughout *TGT*, Keynes defines his terms ambiguously, contradictorily or not at all. When he asserts (p. 351) that "the rate of interest is not self-adjusting at a level best suited to the social advantage but constantly tends to rise too high," he doesn't tell us what the "social advantage" is, or what rate is most socially advantageous. About one thing he is, however, crystal clear: he doesn't trust the price system.

Perhaps because he doesn't know it, Keynes doesn't tell us that rates of interest are prices, and that prices are vital signals to buyers and sellers, producer and consumers, and borrowers and lenders. All prices are ultimately interconnected; but rates of interest directly affect most prices. If rates become corrupted, then they emit misleading and false signals; even worse, bastardised rates rapidly spread misinformation throughout the economy. Intervention by governments in credit markets, like other attempts to countermand prices set in free markets with prices set by politicians and bureaucrats, has not – to put it mildly – achieved great success. If the Soviet Union collapsed because it did not allow prices to tell any eco-

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6 Lest anyone think that Paul Krugman of Princeton University is a real economist (instead of a Keynesian political operative), read his blog (entitled "The Conscience of a Liberal") on the web site of *The New York Times*. In his post of 17 March 2010 ("How Much of The World Is in a Liquidity Trap?") he states: "As I've written many times in various contexts since the crisis began, being in a liquidity trap reverses many of the usual rules of economic policy. Virtue becomes vice: attempts to save more actually make us poorer, in both the short and the long run. Prudence becomes folly: a stern determination to balance budgets and avoid any risk of inflation is the road to disaster. *Mercantilism works: countries that subsidize exports and restrict imports actually do gain at their trading partners' expense.* For the moment – or more likely for the next several years – we're living in a world in which none of what you learned in Econ 101 applies [italics added]."

nomic truth, then Keynes's maniacal desire to suppress rates of interest does not allow rates to tell the truth about borrowing and lending.

Keynes says "that the world after several millennia of steady individual saving [sic] is so poor … is to be explained … by high rates of interest" (*TGT*, p. 242). Really? Are high rates truly the heart of the matter? Even Keynes obliquely admits that the safety of principal has always been an issue. In other words, rates have been high partly because it has not been safe to lend (*TGT*, p. 351). In most societies throughout history, property rights have been insecure; as a result, it has not been safe to own property, much less to lend it. The best way to safeguard property has often been to hide it. Why invest if somebody else may well steal its fruits?

Throughout history, the most significant "somebody" threatening and stealing property has not been the common thief: it has been the Leviathan state. Secular rulers, as St. Augustine famously put it in *The City of God*, are "gangs of criminals on a grand scale." Anticipating the work of later scholars, Augustine noted the state originated not through some fictitious "social contract" or voluntary arrangement but rather through force, robbery and murder:

> A gang is a group of men under the command of a leader, bound by a compact of association, in which the plunder is divided according to an agreed convention. If this villainy wins so many recruits from the ranks of the demoralised that it acquires territory, establishes a base, captures cities and subdues peoples, it then openly arrogates to itself the title of kingdom, which is conferred on it in the eyes of the world, not by the renunciation of aggression, but by the attainment of impunity. For it was a witty and truthful rejoinder which was given by a captured pirate to Alexander the Great. The king asked the fellow, "What is your idea, in infesting the sea?" And the pirate answered, with uninhibited insolence, "the same as yours, in infesting the earth! But because I do it with a tiny craft, I'm called a pirate: because you have a mighty navy, you're called an emperor."

Keynes's policy of creating new money in order to suppress rates of interest, and thereby to stimulate investment and economic activity, ultimately backfires. First, "the creation of new money by the central bank" and "inflation" are synonyms. Yes, inflation may well *initially* place downward pressure upon rates. The trouble is that as soon as somebody borrows the new money, he will spend it. And that spending – people who hold "old" money haven't changed their behaviour – places upward pressure upon the prices of goods and services for which borrowers exchange their dollars. What will happen to rates once prices of many goods and services begin to rise? Lenders will notice that the money returned to them at a loan's conclusion will not buy as much as it did at its commencement. How do lenders protect themselves against the gradual destruction of their purchasing power? Either they will lend less or they will charge more per dollar lent. Either way, their reaction to inflation will *eventually* place upward pressure upon rates of interest. Hence an unintended consequence of Keynesianism: policies which intend to reduce rates of interest ultimately raise them. The Swedish economist Knut Wicksell (1851-1926) initially developed this point, and Ludwig von Mises

(1881-1973), Friedrich von Hayek (1891-1991) and Murray Rothbard (1926-1995) extended and elaborated it. Nobody – neither Keynes nor any of his followers – has ever refuted it.

Do the years since the 1990s, when inflation has raged but the Consumer Price Index and various Producer Price Indices have been quiescent, vindicate Keynes? In these years Keynesianism begat inflation – in markets for stocks, bonds and real estate. This inflation fomented bubbles and crashes. After the recession of the early 1980s, governments once again began to print money. Consumer prices rose, but the rise was mild relative to the 1970s. As a result (virtually everybody mistakenly thinks that "inflation" and "annualised percentage rise of the CPI" are synonyms), in the 1990s and beyond rates of interest did not rise as the pace of the government's inflation accelerated; on the contrary, rates tended to fall. Given the rising inflation and absent the drag of rising rates or (except in the early 1990s and late 2000s) recession, economic conditions seemed to boom. Contrary to the 1970s, in recent years central banks have injected vast amounts of new money into the economy without triggering sharp rises of consumer prices or rates of interest. Many people have concluded that these developments vindicate Keynes.

For two reasons, they don't. First, a rise of consumer prices is one of several possible consequences of inflation. But high inflation need not cause a hefty rise of consumer and producer prices.[7] During some intervals (the 1920s was one, and the past two decades has been another) technological, logistical or other developments boost businesses' productivity and reduce their costs. In the 1920s, mass electrification and the rise to ubiquity passenger car and truck transport were the key developments; in the 1990s, the advent of the Internet and the integration of the Chinese and ex-Soviet economies into the world economy (which placed sharp downward pressure upon the prices of raw materials and labour) were the triggers. All else equal, technological, logistical and other productivity-enhancing innovations place downward pressure upon prices. If prices should fall by (say) 3% per year (as they did in the latter half of the 19th century, another period of strong technological and logistical innovation) but actually rise by 3%, what's happening? The answer is that the central bank is creating and injecting into the economy enough new money to raise prices (that is, reduce the currency's purchasing power) by 6%. In short, technological and other developments can mask one of the possible consequences of the government's policy of inflation.

Secondly, the new money ginned by the central bank doesn't flow solely (or even primarily) into markets for consumer goods and services. Since the mid-1990s, and unlike the 1970s, the effects of governments' inflation haven't, by and large,

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[7] It is vital to repeat (a decade of Annual Reports, newsletters, etc., has relentlessly banged this drum): an increase in the prices of consumer goods and services as measured by the CPI is not a *definition* or *synonym* of inflation: it is *one of several possible consequences* of inflation. Others include bubbles in stock, bond and real estate markets, rising interest rates and (in extreme cases) collapses of the currency. Inflation is an increase in the supply of money. In an age of fiat, only one entity can create inflation. No person or business or other private organisation (such as a trade union) can inflate the supply of money: only the central bank (using commercial banks as its agent) can.

appeared in workers' pay packets or supermarkets. Instead, during the past 20 years the new money has flowed disproportionately into stocks, bonds and real estate. To use the common (and imprecise) parlance, if the 1970s was a period of high "consumer price inflation" then "asset price inflation" has plagued more recent years. The problem is that inflation (whose consequences technological developments have masked) and rising prices of assets conspire to create asset price bubbles. What looks like a moderate CPI reassures lenders and thereby helps to restrain the rates of interest they charge. This, in turn, makes it easy for people to borrow ever greater sums in order to buy stocks, bonds and real estate. The demand for these assets created by the borrowed money puts upward pressure upon these assets' prices; as their prices rise, lenders are increasingly willing to lend; and borrowers, observing the steadily rise of prices, are increasingly willing to borrow. Eventually, the new money channelled into these assets creates bubbles.

Newly "printed" money, injected into the economy through the banking system by government, is inflation – properly defined and understood. But the river of inflation follows different courses during different eras. If the funny-money congregates in stocks, bonds and real estate, then bubbles inflate. Notice, then, that the boom that precedes the bust is not a creature of the free market; both are monsters created by government's central bank. Mises, Keynes's most systematic and devastating critic, put it this way:

> The cyclical fluctuations of business are not an occurrence originating in the sphere of the unhampered market, but [are products] of government interference with business conditions designed to lower the rate of interest below the height at which the free market would have fixed it.[8]

This means that, *contra* Keynes, artificially-low rates of interest will in the long run lead not to a *quasi-permanent boom* but to a *cycle of boom and bust* (although the path of bust may lead either through "consumer price inflation" or "asset price inflation").

Mises exposed many of Keynes's other misconceptions about interest. Perhaps most notably, it's downright Orwellian to refer to newly-printed government money as savings. Money created *ex nihilo* by the government isn't savings; indeed, this funny-money destroys savings. Whatever the merits or demerits of the monetary printing press, or its electronic equivalent, it isn't and it doesn't produce savings. The word "savings" describes income that has been earned but not consumed; rather, it's set aside for investment or a rainy day. It takes much self-control to save, but the government requires absolutely no self-discipline to print money. Quite the opposite: inflation is the indicator *par excellence* of governments' profligacy. Nor should anybody imagine that, as Keynes insisted, the government's newly-created money will augment or "top off" traditional savings. Instead, the inflation will ultimately erode the purchasing power of real savings and thus injure the saver (especially the saver of modest means).

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8 Ludwig von Mises, *Human Action: A Treatise on Economics* (Fox & Wilkes, 1966), p. 562.

In the wake of the bursting of the Dot Com Bubble, the Federal Reserve (headed by Alan Greenspan) slashed the federal funds rate to 1%; and in the wake of the Panic of 2007, the Fed (headed by Ben Bernanke) slashed it to 0.25%. By fixing the funds rate well below the CPI, many economists contended that the Fed reduced the "real" (net of CPI) rate below zero. Keynes advocated something much more extreme: nominal rates of interest at 0%. Yet he seemed utterly oblivious to the fact that if the borrower can borrow money for free, then the lender must logically regard the money as valueless. If so, then why would the lender want the borrower to return the money, and why should the lender care if the borrower doesn't? Mises explained how utterly nonsensical this is:

> There cannot be any question of abolishing interest by any institutions, laws or devices of bank manipulation [such as the government injecting new money into the economy through commercial banks]. He who wants to "abolish" interest will have to induce people to value an apple available in a hundred years [at a price that is] no less than a present apple (*Human Action*, p. 529).

Can the Keynesian program of creating vast amounts of money and suppressing rates of interest abolish scarcity? Consider two views about the causes of poverty:

1. Billions of people live in poverty because food, clothing, shelter and amenities are scarce (and hence expensive for the poor). In order to help the poor escape poverty, all of us must live within our means, save and invest. Only by these means can more and better goods and services be produced more cheaply, so that the poor can better afford them and thereby raise their standard of living.

2. The problem isn't that goods and services are scarce: it's that money is scarce. Government should therefore create so much new money that everybody has enough of it.

Clearly, view #2 is fallacious. It hasn't worked in the past (if it had, there would be no poverty today) and there's no reason to believe that it will work in the future. Even if the central bank gave $1 million of new money per year to every poor person, it would avail the poor nothing: there would be much more money in the world, but no more food, shelter, clothing, etc. The torrent of new money would simply place tremendous upward pressure upon prices. People who were poor on $10,000 per year would therefore be poor on $1 million per year – and, it's vital to add, people who hitherto weren't poor on $150,000 per year would now be destitute. *Inflation, in other words, doesn't alleviate poverty: it creates it.* Ask the middle-class Germans of the 1920s, Argentines of the 1970s or Zimbabweans of today.

Consider now a third alternative:

3. The problem isn't that goods are scarce: it's that lendable funds are scarce. If the government provided unlimited funds to borrowers, they could use

> those funds to build new factories and businesses, and within a generation nothing would be scarce.

This is Keynes's view,[9] and it's just as fallacious as #2 (to which it is closely related). Printing money and lending it to people will have exactly the same result as printing money and giving it to people. Either it will make existing goods and services cost more, or it will place upward pressure upon the prices of stocks, bonds and real estate. Each "solution" will actually cause rather than resolve problems.

What Keynes Said: Spend More, Save Less and Grow Wealthy

"Consumption," said Keynes, "is – to [state] the obvious – the sole … object of all economic activity" (*TGT*, p. 104). He didn't mean consumption someday or even consumption tomorrow: he meant consumption now.

> The "purposive" man is always trying to secure a spurious and delusive immortality … He does not love his cat, but his cat's kittens; nor, in truth, the kittens, but only the kittens' kittens, on so on forward forever to the end of cat-dom. For him jam is not jam unless it is a case of jam tomorrow and ever jam today.[10]

The trouble, according to Keynes, is that the capitalists of the 19th century used "bluff and deception"[11] to transform discipline, self-denial and thrift into a kind of religion. Christianity, he also asserted, joined hands with this secular religion of saving. Leaders such as John Wesley, the founder of Methodism, preached that "you should save all you can" (see the citation in *The Weekly Standard*, 26 May 2008). In this way, Keynes explained,

> The morals, the politics, the literature, and the religion of the … [19th century] joined in a grand conspiracy for the promotion of saving. God and Mammon were reconciled. Peace on earth to men of good means. A rich man could, after all, enter into the Kingdom of Heaven – if only he saved (*Essays in Persuasion*, pp. 84-85).

The "classical" economists of the 18th, 19th and the early 20th centuries allegedly played a pivotal role as secular priests charged with explaining and defending the

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9 And Keynes was merely the latest in a line (the first was John Law's *Money and Trade Considered: With a Proposal for Supplying the Nation with Money*, Edinburgh, 1705) of writers who attempted to give a veneer of respectability to the always-fallacious and perpetually-popular idea that the growth of the quantity of money in circulation stimulates economic activity. Law attributed Scotland's poverty to the "reduced" money supply and thus carries mercantilist ideas to their logical conclusion. In his own words: "The quantity of money in a state must be adjusted to the number of its inhabitants … One million [pounds sterling] can create employment for only a limited number of persons … A larger amount of money can create employment for more people than a smaller amount, and each reduction in the money supply lowers the employment level to some extent."

10 John Maynard Keynes, "Economic Possibilities for Our Grandchildren," in *Essays in Persuasion* (New York, Norton, 1963), p. 370.

11 John Maynard Keynes, *The Economic Consequences of the Peace* (Harcourt, Brace & Howe, 1920), p. 19.

dogma of saving. Indeed, the "cult of saving conquered England as completely as the Holy Inquisition conquered Spain" (*TGT*, p. 32). According to Keynes, the story told by the "classical" economists is nothing more than a fable. It does not capture what happens in real life. Here, poverty exists and persists, and unemployment and slumps beset us. Keynes concluded that there's something very wrong, with what these heartless economists have told us about saving.

The principal error in the "classical" vision, he claimed, is that savings may not be channelled smoothly and fully into a widening stream of investment. If they are smoothly and fully invested, all is well and good and society will prosper. But there's no certainty that savings will be invested. Perhaps savers want too high a rate of interest – one that's higher than borrowers can afford or want to pay (*TGT*, p. 309). Perhaps owners and managers lack the confidence or conviction required to borrow and invest. Or perhaps the saver will simply hoard rather than invest his cash. Either way, it's "absurd" to think that the decision to save $1 will give rise to the decision to invest $1 (*TGT*, p. 210).

Nor, according to Keynes, should we deceive ourselves into believing that a mismatch between saving and investment is a rare or an unlikely occurrence. On the contrary: "there has been a chronic tendency throughout human history [for savings to exceed investment,]" and this apparent problem has become more acute, not less, as society has advanced (*TGT*, p. 347). In particular, during economic slumps we want to save more because we fear the loss of our jobs. This just makes things worse, because the additional savings are most unlikely to find an outlet in investment. The unused savings sit idle, the flow of money through the economy decelerates further and the slump deepens. What "we" must understand, under these circumstances, is that "the more virtuous we are, the more determinedly thrifty, the more obstinately orthodox … the more our incomes will have to fall … Obstinacy can bring only penalty and no reward. For the result is inevitable" (*TGT*, p. 111).

There are better and worse ways, says Keynes, to address the problem of a savings glut. We could hope for

1. "[enough] unemployment to keep us … sufficiently … poor … and our standard of life sufficiently miserable to bring savings [down]" (*TGT*, p. 105, 217-218).

2. Or we could instead hope that "millionaires [will stop their relentless saving and instead] find their satisfaction in [putting their savings to use by] building mighty mansions to contain their bodies when alive and pyramids to shelter them after death, or, repenting of their sins, erect cathedrals and endow monasteries" (*TGT*, p. 220).
3. Or we could pray for a natural disaster or war: "[throughout history, natural disasters such as] earthquakes, even wars, have served to increase wealth [by using up savings] (*TGT*, p. 129).[12]

4. Or we could petition governments, even those wholly devoted to the free market ("laissez-faire") principles to "fill old bottles with bank notes, bury them at suitable depths in disused coal mines which are then filled … with town rubbish, and leave it to private enterprise … to [invest in digging] the notes up again" (*TGT*, p. 129).

Keynes asserts that there are better ways to reduce unused savings. One way is for "society" to bring interest rates down so that businesses can afford to borrow all savings. As discussed earlier, savers may try to block this by refusing to lower the rates they will accept. If so, the government can and should overrule them by printing new money and injecting it into the loan market. This will add to the total of available savings, but if rates of interest are lowered enough the extra money will not hurt. At a sufficiently low rate, investors will borrow all of it. An alternative to lowering rates in order to reduce unused savings is to "consume … more [that is, spend more as consumers so that we save less] or work … less [that is, reduce our income and thus our ability to save]." Got that? Consuming more or working less will dissipate the glut of savings; and the evaporation of this glut will make us richer. Indirectly, then, either consuming more or working less will make us richer. Keynes said these alternatives work "just as well" as more investment (*Essays in Persuasion*, p. 384; Skidelsky, *John Maynard Keynes*, vol. 3, p. 279.

A "practical" way to consume more or work less, and thus to become wealthier, is to tax "the rich" at high rates and redistribute the wealth to those who are needy and thus sure to spend it (*TGT*, p. 372-373). If they would only keep clearly in mind that "the growth in wealth, so far from being dependent on the abstinence [savings] of the rich, as is commonly supposed, is more likely to be impeded by it" (*TGT*, p. 373), then even the benighted will see that "death duties" – that is, estate taxes – as well as steeply "progressive" rates of income tax will help society to prosper. A final – and to Keynes, failsafe – means of increasing consumption is for the government either to borrow or confiscate from "the rich." This will remove their excess (and excessive) savings. Having borrowed or confiscated their money, the government can then spend it, which will inject it into circulation and thereby stimulate the economy. In this case, the government becomes the spender of last resort.

Why Keynes Was Wrong: Spend More, Save Less and Grow Poorer

Between 1700 and 1900, the living conditions of British workers improved dramatically. During the 18th and 19th centuries Britain's population quadrupled. Only a growing economy, fuelled by savings and investment, could feed, house and

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12 Keynes said many bloody stupid things, and this probably takes the cake. It's not just idiotic: it is downright evil. Would he have continue to believe this if a V-1 or v-2 had destroyed *his* house? He's either utterly unaware, or chooses studiously to ignore, the "parable of the broken window." Created by Frédéric Bastiat in his essay *That Which Is Seen and That Which Is Unseen* (1850), it brilliantly illuminates the hidden costs associated with the destruction of others' property. This parable also underlies Henry Hazlitt's classic *Economics in One Lesson* (Fox & Wilkes, 50th Anniversary Edition, 1998).

employ all those extra mouths. As Friedrich von Hayek noted, many of our forebears owed their lives – and therefore we owe our lives – to that growing economy: "capitalism created the proletariat," he said in an interview in 1983, "but not by making anyone any the worse off; rather, by enabling many to survive who would not otherwise have done so."

In a soundly growing economy, i.e., one in which the government doesn't inflate the supply of money (and otherwise stays out of the way) and people live well within their means, both workers and the owners of capital can simultaneously increase their consumption and saving. Assume that (a) you save 20% of your income, (b) your salary is stagnant and (c) thanks to the investments made from your savings your income grows at a rate of 3% per year. If year after year you continue to spend 80% and save 20% of your growing income, both your consumption and savings will double after ca. 25 years.

Even if your only ambition is to spend more, saving and investing make sense: they give us the means to spend more, and you won't have to wait 25 years to notice it. Assume that you and a friend have an identical total income, but his is derived totally from salary and yours includes investment income as well as salary. Your friend spends all he earns, whereas you save 20% of your income. Assume that both your and his salaries are stagnant, but (thanks to your saving and investing) your income grows at 3% per year. Under these conditions, within 8 years you'll be able to spend more than your profligate friend, and with each passing year your total income – and thus your standard of living – will surpass his by an ever wider margin.

If Keynes dominated British economics during the 20th century, then John Stuart Mill (1806-1873) – one of the "classical" economists whom Keynes derided – dominated it during the middle of the 19th century. Mill refuted several fallacies that Keynes resurrected in *TGT*. In particular, Mill made mincemeat of the idea (later popularised by Keynes) that savings might accumulate, unused, and clog the economy. This, Mill demonstrated, is a "palpable absurdity."[13] Why? Assuming that property rights are reasonably secure, the lure of profit ensures that most savings are eventually invested. Unlike consumer expenditure, investment helps production to grow – and thus leads to more income, more consumer expenditure and saving down the road. As Mill showed, there's just one caveat: to make these things occur, prices (including wages) must be unhampered and the system of profit and loss must be left unmolested.

This doesn't mean that no savings ever lies "idle." We may even have "a large proportion of capital … idle" (p. 367). This is because production is always changing. Consumers' demand for some goods and services is always increasing, and their demand for others is always decreasing. In response to these and other

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13 John Stuart Mill, "Of the Influence of Consumption on Production" in *Essays on Some Unsettled Questions of Political Economy*, cited in Hazlitt, *The Failure of the New Economics*, p. 366.

changes, some businesses are always expanding and others always shrinking. As a result, some capital, labour and land will always lay idle. Without these changes, dislocations and reallocations of the factors of production, our standard of living would be far closer to subsistence than to where it is today.

Mill cautions that whenever we see all capital employed and almost all businesses thriving and everybody working, we shouldn't rejoice. We're not witnessing healthy economic progress: we're observing a bubble. Under these conditions, Mill said, "some general delusion is afloat" (p. 367).[14] Let's not misunderstand Mill: it's not that he's happy only when large numbers of people are out of work. If wages floated freely, then almost anybody who wants work should be able to find it without a long wait. But there must be some frictional unemployment (that is, people between jobs): that's how the economy progresses. Without frictional unemployment, we'd still be riding in horses and buggies. To aim for full employment and no idle resources, as Keynes does, is to aim for a bubble; and bubbles always burst, bringing depression and deep unemployment in their wake. Australian mining bulls, are you listening? Mill concludes

> When the delusion vanishes, those whose commodities are relatively in excess must diminish their production or be ruined; and if during the high prices they have built mills and erected machinery, they will be likely to repent at leisure (p. 367).

Mill's analysis demonstrates that the individual, business or nation which spends more and saves less – which lives beyond its means – inhabits a fool's paradise. The government's inflation can for a time (and perhaps for a long time) inflate the boom, but it cannot permanently abolish the bust. What James Callaghan told the Labour Party conference in 1976 was true then and remains true today:

> We must ask ourselves unflinchingly, what is the cause of [our economic troubles]? Quite simply and unequivocally, it is caused by paying ourselves more than the value of what we produce. This … is an absolute fact of life, which no government, be it left or right, can alter … We used to think that you could just spend your way out of a recession and increase employment by cutting taxes and boosting government spending. I tell you in all candour that that option no longer exists; and that insofar as it ever did exist, it worked only by injecting bigger doses of inflation into the economy. And each time that happened the average level of unemployment rose. Higher inflation followed by higher unemployment: that is the history of the last 20 years.

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14 Mill's caution is quite timely. In an address (entitled "Mining Booms and the Australian Economy") to the Sydney Institute on 25 February 2010, Ric Battellino, the Deputy Governor of the Reserve Bank of Australia, surveyed 160 years of Australian mining booms. He concluded not just that mining is presently booming: it's booming like never before and will continue to do so for decades to come. But not to worry: "the key difference this time" is that today's monetary and fiscal policy frameworks "are more soundly based" than their predecessors. That's hardly comforting: recall that the RBA saw nothing but blue skies and green grass in early 2007. Indeed, coming from a man who on 12 December 2007 declared "there's no hint the share market is grossly overvalued," Battellino's complacency is downright alarming.

What Keynes Said: Look to the State for Economic Leadership

If investment is too meagre to absorb all savings, and if lower rates of interest do not boost investment sufficiently, then the state should invest on behalf of the people. How, in a given situation, will the state know that lower rates are not low enough, and that state-directed investment is needed? The key indicator, says Keynes, is employment. If cheap money produces "full" employment, then direct investment by the state isn't required. But if unemployment emerges or persists, then it is. The state can but need not print the money it "invests" – it can also tax the wealthy or borrow. If it borrows, this will not necessarily cause its budget to fall into deficit. This is because its "investment" may be kept off-budget or in a separate capital budget (Skidelsky, *John Maynard Keynes*, vol. 3, p. 273).

The state's usual job is to fill (and, once filled, keep full to the brim) the investment tank. But there are other reasons, said Keynes, to welcome a larger role for the state in investment. On the whole, he agreed that members of the political caste would invest more sensibly than the hoi-polloi in private markets. His opinion of private investors is withering. They are handicapped (he alleged, as always, without citation or corroboration) by profound ignorance, uncontrollable emotion and speculative tendencies (see in particular *TGT*, pp. 150-153, 156-158 and 161-162). By contrast, and based upon its "long views … general social advantage … and … collective wisdom" (*TGT*, p. 164),[15] the state is able to allocate capital calmly and rationally. In 1932, Keynes chided the Chancellor of the Exchequer, Harold Macmillan, for not being "nearly bold enough with your proposals for developing the [direct] investment functions of the state" (*Collected Writings*, vol. 21, p. 109). In 1936, Keynes said that he favoured "a somewhat comprehensive socialisation of investment" and also that "I see no reason to suppose that the existing [private] system seriously misemploys the factors of production which are in use" (*TGT*, pp. 378-379). By this he seemed to mean that private enterprise is well-equipped to run the show after the wise Sir Humphreys within the state have decided what and how much shall be invested when and where. In 1939, Keynes enthusiastically promoted an "amalgam of private capitalism and state socialism" (*Collected Writings*, vol. 21, p. 492).

In Keynes's mind, the state's control of the economy should extend beyond interest rates, investment and taxation. Perhaps less fairly, his attitude was schizophrenic. In 1940, he said that unfettered prices were indispensible, but also that he favoured the establishment of public boards to manage the prices of commodities (Skidelsky, *John Maynard Keynes*, vol. 3, pp. 82-83)! In *Essays in Persuasion* (p. 318), he opined that the state must involve itself in "many of the inner intricacies of private business." But even so, a "wide field … of [private] activity [will be] unaffected" (*TGT*, pp. 378). Keynes also seems to say that over time the distinction between the activities of state-owned and privately-owed enterprises will fade. Private firms will become "semi-socialised" and "Public Boards" and "Private Companies" will

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15 See also John Maynard Keynes, *Collected Writings*, vol. 21, *Activities 1931-39: World Crisis and Policies in Britain and America* (London, Macmillan, 1982), p. 145.

differ only with respect to the appointment of directors.[16]

Keynes distanced his ideas from totalitarianism. "We can accept the desirability and even the necessity of [economic] planning without being a Communist, a Socialist or a Fascist" (*Collected Writings*, vol. 21, p. 84). But he didn't completely dismiss Communist or Fascist economic management: "Italian Fascism … seems to have saved Italy from chaos and to have established a modest level of material prosperity" (p. 85). And in his Foreword to the German edition of *TGT*, published with the express approval of Josef Goebbels, he stated "the theory of aggregate production that is the goal of the following book can be much more easily applied to the conditions of a totalitarian state than the theory of the production and distribution of a given output turned out under the conditions of free competition and of a considerable degree of *laissez-faire*."

Keynes found much that was "detestable" about Stalin's Russia. At best, he regarded Communists as a species of deranged "Methodists" (*Essays in Persuasion*, p. 299, 310). But what Stalin and Soviet central planners had achieved by 1936 was "impressive." They were "disinterested administrators … [who had put] in operation … the largest scale empiricism and experimentalism which has ever been attempted" (*Collected Writings*, vol. 28, pp. 333-334). Indeed, "let us not belittle these magnificent experiments or refuse to learn from them … The Five Year Plan in Russia, the Corporative state in Italy … and state planning [under] democracy in Great Britain … Let us hope that they will all be successful" (*Collected Writings*, vol. 21, p. 86, 92).

In many respects, Keynes's views about investment are inconsistent to the point of incoherence. How to make sense of them? Keynes, always believed emphatically in the correctness and righteousness of state-run capitalism – as long as the "right" people ran it. And he, of course, was the very epitome of the "right" kind of person. "I believe the right solution [to the economic questions of the day] will involve intellectual and scientific elements which must be above the heads of the vast mass or more or less illiterate voters" (Skidelsky, *John Maynard Keynes*, vol. 2, p. 224.) But are political leaders, even heads of governments, any less economically illiterate than voters? Did not Keynes's second book, entitled *The Economic Consequences of the Peace* (1920), quite rightly ridicule the leaders of Britain, France and the U.S., along with all the other blinkered, hidebound and downright stupid men who have traditionally ruled nations?

Keynes's answer seems to be that politicians must yield the economic reins to the "experts." The economy "is a matter which ought to be left to the experts. They ought to understand the machine. They ought to be able to mend it when it goes wrong" (*Collected Writings*, vol. 20, p. 515). As early as 1914, in an article in *The Economic Journal*, a young Keynes had concluded that experts have "solved … the

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16 Robert Skidelsky, *John Maynard Keynes*, vol. 2, *The Economist as Saviour 1920-1937* (Macmillan, 2000), p. 266.

intellectual and scientific part of the problem [of how to run an economy].” On p. 299 of vol. 2 of his three-volume biography, Robert Skidelsky observed that a belief in the correctness and righteousness of expert opinion “runs like a leitmotiv through [Keynes’s] work and is the important assumption of his political philosophy.” Since Keynes was the dominant economic expert of his era, this faith in expert opinion was at least in part a faith in himself and a reflection of his unflagging self-confidence.

The other side of the coin of Keynes’s self-confidence was his contempt for the intelligence of people of modest status and means. Most economic issues, he believed, were by their nature so complex that the average person simply couldn’t understand them. Therefore, he thought, it is not inappropriate for experts (who, it’s clear to Keynes, know what’s best for others) to resort to sleight of hand or even mild deception in order to obtain the consent of the ruled for actions which rulers deem essential. In *TGT* (p. 235), Keynes noted that the general public wants “the moon,” by which he means perennially high wages, and that to maintain high wages there must be plenty of money in circulation. The “remedy” is thus to “persuade the public that green cheese [government printed money] is practically the same thing [as real money] and to have a green cheese factory (i.e., a central bank) under public control.”

Why Keynes Was Wrong: Governments Neither Take “Long Views” Nor Express “Collective Wisdom”

Keynes asserted that if (a) investment is too low to absorb all savings and (b) lower rates do not boost investment sufficiently, then (c) the state should invest on behalf of the general public. We have seen that if property rights are secure and markets are unfettered, then (a) doesn’t hold; that is, self-interest and the desire for profit will channel most savings into investment. We’ve also seen that the state’s manipulation of rates ignites the boom that causes the bust. But even if these two premises held, they fail to support Keynes’s conclusion.

In *Capital* and other publications, Karl Marx so busily denounced what he called capitalism that he never bothered to demonstrate how socialism would actually work. Similarly, Keynes is remarkably sketchy about the operating details of Keynesianism. He’s also astonishingly naïve about politicians and bureaucrats. He’s utterly oblivious to the fact that politicians and officials are no more likely to recognise an overheated economy – let alone a bubble – than anybody else. Even more importantly, even if they do, they’re typically unwilling or unable to fix it. Perhaps because he was an Edwardian high-caste Brahmin, it never occurred to him that in a mass democracy politicians and bureaucrats would think twice before displeasing voters. Henry Hazlitt (orphaned on the streets of New York City at nine years of age, and who knew far more from direct experience about poverty than Keynes ever did in the abstract) couldn’t resist using Keynes’s mocking style to ridicule The Old Inflationist:

> [Keynes has told us that] the people who have earned money are too short-sighted, hysterical, rapacious and idiotic to be trusted to invest it themselves.

> The money must be seized from them by the politicians, who will invest it with almost perfect foresight and complete disinterestedness (as illustrated, for example, by the economic planners of National Socialist Germany, Fascist Italy and Soviet Russia).
>
> For people who are risking their own money will of course risk it foolishly and recklessly, whereas politicians and bureaucrats who are risking other people's money will do so only with the greatest care and after long and profound study. Naturally, the businessmen who have earned the money have shown that they have no foresight; but the politicians who haven't earned the money will exhibit almost perfect foresight.
>
> The businessmen who are seeking to make cheaper and better than their competitors the goods that consumers wish, and whose success depends upon the degree to which they satisfy consumers, will of course have *no* concern for "the general social advantage;" but the politicians who keep themselves in power by conciliating pressure groups will of course have *only* concern for "the general social advantage." They will never dissipate any money … [and] there will never be a hint of bribery or corruption …

What Keynes Said: In a Crisis, Print, Lend, Borrow and Spend

Booms, says Keynes, should be embraced and not feared. He was aware that "misdirected investment" (*TGT* p. 321) accompanies booms, and also that busts may help to "get rid of a lot of deadwood" (*Collected Writings*, vol. 20, p. 319). Presumably because Keynes assumes that the government possesses an inexhaustible well of capital, even misdirected investment is better than no investment at all (*TGT* p. 327). It's a "serious error" (*TGT*, p. 322) to think that slumps are in any sense a necessary condition of economic progress – either because they play a purgative role or because they put an end to speculation or recklessness. Instead, and as we've seen, policymakers should strive to "abolish slumps" and instead seek to perpetuate a "quasi-boom" (*TGT*, p. 320-322).

Accordingly, the government must intervene decisively in order to prevent or mitigate an incipient financial crash or economic slump. Busts and recessions indicate that we have made a "colossal muddle," that we have "blundered in the control of a delicate machine" and that repairs are urgently needed (*Essays in Persuasion*, p. 136). Bold corrective action should be administered at the first sign of trouble, and this action should be as "radical" as necessary (*Collected Writings*, vol. 20, p. 325). Early in 1932, more than two years into what became known as the Great Depression, Keynes warned that "a collapse of this kind feeds on itself" and complained that

> It is very much more difficult to solve the problem today than it would have been a year ago … The … authorities of the world have lacked the courage or conviction at each stage of the decline to apply the available remedies in sufficiently drastic doses (*Collected Writings*, vol. 20, pp. 40-41, 45).

The script for preventing a financial crash and economic depression, Keynes implies, was written a generation or two before him. Suitably modified by his views, he urges us to follow it. In 1873 (a year in which, by the way, a major financial panic occurred), Walter Bagehot, editor of *The Economist*, published a book entitled *Lombard Street*. It argued that the Bank of England, then a private institution with semi-official status, should stand ready during panics and crashes to act as a "lender of last resort." If members of the public are nervous and begin to withdraw their funds from commercial banks, then the affected banks should be able to replace those funds by borrowing from the Bank of England. Of course, rules must apply. In particular, (a) any banks which borrow from the Bank of England must be solvent; (b) these banks must give to the Bank sound collateral (such that, no matter what happened, the Bank of England would not suffer any loss) in exchange for loans; and (c) they must pay a stiff rate of interest for these loans.

Bagehot's proposal was contentious. Even more controversially, he added that the Bank of England should make as many of these loans and in whatever amounts that were necessary to reassure the general public and halt "runs" on banks. Specifically, the Bank of England should lend on these terms and under these conditions even if it had already made as many loans as its reserves and banking legislation (as it then stood) allowed. In other words, Bagehot urged that the Bank of England should do whatever was necessary to prevent a "run" on one or more banks – even if it had to abandon sound banking procedure and break the law (namely, its statutory reserve requirement). Bagehot's principal critic, Thomas Hankey, MP, anticipated what today is called "moral hazard." Hankey retorted that if the Bank of England became a "lender of last resort" then commercial banks would have an irresistible incentive to issue more profitable but riskier loans (and otherwise behave incautiously) because they knew that if they encountered trouble the Bank of England would rescue them. Why act prudently when the Old Lady of Threadneedle Street has your back?

Bagehot triumphed over Hankey; and Keynes, of course, sided with Bagehot. Keynes's only concern was that during a panic or crisis the Bank of England would act too timidly or belatedly. If it made unlimited funds available to threatened financial institutions, he said, it could stop virtually any downward spiral. Keynes concluded that Bagehot's approach, if applied vigorously, is generally correct but requires refinement. In particular, interest rates must be much lower, standards of lending must be much more accommodating and the overall scale of the state's intervention and assistance must be higher. Bagehot wanted the rates of the Bank of England's emergency loans to be high enough to punish wayward banks; Keynes, on the other hand, wanted low rates to prevail throughout the financial system at all times, both normally and during emergencies. In a crisis, Bagehot wanted the Bank of England to lend only against very strong collateral; Keynes, in contrast, wasn't nearly so fussy.

Keynes recognised that if interest rates are already very low when the crisis strikes, then there's little that even cheaper credit can do. No matter how cheap the credit, people may be too frightened to borrow. In this case, "direct state intervention is needed" (*Collected Writings*, vol. 21, pp. 59-60). This intervention may take the form of subsidised long-term loans at very low rates, or other subsidies to industry. In addition, the state should prepare plans to expand and accelerate its own direct investment program and implement it at the first sign of need (*Collected Writings*, vol. 20, p. 348; vol. 21, p. 395).

An article entitled "Can America Spend Its Way Into Recovery?" (written by Keynes and published in the popular American magazine *Redbook* in 1934) began with the words "Why, obviously!" The article confidently asserted that the very behaviour that would make "a man poor" could apparently make "a nation wealthy."[17] Yes, the extra government spending required during a slump would almost certainly exceed the government's receipts from taxation – no matter how high the rates of tax, receipts will fall during severe busts. Hence the requirement for a deficit and the need either to borrow or to print money. But not to worry: because the nation's debt would usually be to its own citizens, "we owe it to ourselves." Moreover, tax rates should never be increased in order to finance the new debt. Instead, the money borrowed and spent will revive the economy; with the economic revival will come a rebound of tax revenues; and these revenues will finance the deficit and debt. According to Keynes, government spending of borrowed money under conditions of less than full employment constitutes what his successors would call a free lunch (*Collected Writings*, vol. 20, p. 349).

Keynes emphasised that in tough economic times *any* spending to *any* purpose is better than no spending. The main thing is to "get the money spent" (*Collected Writings*, vol. 21, p. 337). Of course, it will always be hard to get the "dead-heads" (i.e., the incorrigibles devoted to thrift, balanced budgets, and sound money and banking, the rule of law and the constitution) to agree that any project is legitimate; but in truth, Keynes assures us, such projects – roads and bridges were Keynes's favourites; today we say "infrastructure" – abound (*Collected Writings*, vol. 21, p. 60).

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[17] In reply, *Punch* (25 April 1934) ridiculed Keynes mercilessly. It described the boy who grandly announced "I Want to Be a Consumer." "But what do you mean to be?" asked the kindly old Bishop as he sat the boy on his knee. "We must all choose a calling to help society's plan. So what do you mean to be, my boy, when you grow to be a man?" "I want to be a Consumer," earnestly replied the fresh-faced lad. "I've never had aims of a selfish sort. For that, I know, is wrong. I want to be a Consumer, Sir, and help the nation along. I want to be a Consumer and consume both night and day; for that's the thing that's needed most, I've heard Economists say. I won't just be a Producer, like my friends Bobby and James and John; I want to be a Consumer, Sir, and help the world on."

"But what do you want to be?" the Bishop asked again. "For we all have to work, as must, I think, be plain. Are you thinking of studying medicine or taking a bar exam?" "Why, no!" exclaimed the lad as he helped himself to jam. "I want to be a Consumer and live in a useful way; for that's the thing that's need most, I've heard Economists say. There are too many people working and too many things are made. I want to be a Consumer, Sir, and help to further trade. I want to be a Consumer to do my duty well; for that's the thing that's need most, I've heard Economists tell." And so the boy resolved, as he lit a cigar, to say: "I want to be a Consumer, Sir, and I want to begin today."

Why Keynes Was Wrong: In a Crisis, Printing, Lending, Borrowing and Spending Simply Sow the Seeds of the Next Crisis

Are recessions unnecessary? Can the state, ably advised by Keynesian economists, abolish or at least mitigate them? Today, politicians, bureaucrats and many economists seem to think so. Unfortunately, producers, consumers and investors pay a heavy price for this misconception. Alan Greenspan agreed that recessions should be abolished, and in the wake of the bursting of the Dot Com Bubble (which his inflationary policies did much to create) resolved to do just that. The minutes of the meetings of the Fed's Board of Governors in 2000-2001 reveal that he deliberately sought to persuade consumers to borrow more (as late as 2006, he publicly urged Americans to acquire variable rate and Adjustable Rate Mortgages). He seemed to argue that a deep or long recession in a country so encumbered by debt would lead to an intolerable number of large-scale bankruptcies. How to address this problem of over-indebtedness? Greenspan argued that the Fed should help commercial banks to create even more debt!

If the Fed had allowed a genuine recession to follow the Dot Com Bubble, then the investment mistakes of the 1990s would have been purged. Assets would have passed from weaker to stronger hands, bad debts would have been liquidated and the decks cleared for sound growth. Instead, total debt in the U.S. ballooned from 2.8 times GDP in 2000 to 3.7 times in 2008 (*Grant's Interest Rate Observer*, 3 April 2009). Bad debt created after 2000 piled upon the bad debt created before 2000, and new bad investment decisions pyramided upon old bad investment decisions. A real recession, like its predecessors in the 1970s and 1980s, would clearly have been painful. But it would also have spared the country the much greater pain that it has endured since 2007 – and we fear, might endure in the years to come.

Alas, the Bush and Obama administrations, like Greenspan (and his successor, Ben Bernanke),[18] moved heaven and earth to delay the pain of recession. How to "rescue" the economy? By reviving the failed paradigm of borrow and (mis)spend. Since 2007, the U.S. Government and Federal Reserve have adopted a fully-fledged Keynesian stance. They had prescribed Keynesian remedies before, but their dosage and scale had never been so great. Between January 2007 and February 2009, the Fed conjured $1.2 trillion dollars out of thin air. Injected into the banking system, these new dollars were multiplied ca. ten-fold. Other Fed commitments and the vast increase of the U.S. Government's budget deficit produced

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18 On 21 November 2002, Bernanke uttered words that would have made Keynes jump for joy. In a speech to the National Economists' Club in Washington, D.C., Bernanke stated:

> "Like gold, U.S. dollars have value only to the extent that they are strictly limited in supply. But the U.S. government has a technology, called a printing press (or, today, its electronic equivalent), that allows it to produce as many U.S. dollars as it wishes at essentially no cost. By increasing the number of U.S. dollars in circulation, or even by credibly threatening to do so, the U.S. government can also reduce the value of a dollar in terms of goods and services, which is equivalent to raising the prices in dollars of those goods and services. We conclude that, under a paper-money system, a determined government can always generate higher spending and hence positive inflation."

a Keynesian prescription totalling ca. $14-16 trillion (it's impossible to be sure, because the Fed is accountable to nobody, certainly not to the Congress, and has flatly refused to divulge the extent of several key initiatives).

And that was just during the Bush administration (*The Washington Times*, 20 April 2009) – Obama has intervened even more frantically. More generally, each administration strove mightily to prevent the liquidation of bad debt, and to create and maintain "floors" under the prices of financial assets. As in Japan following the bubble of the 1980s, government intervention has frozen the economy in general and the banking system in particular into a nether-world, neither dead nor alive, and created "zombie" banks and companies (critics now call General Motors Corp. "Government Motors"), in order to prevent the needed liquidation and reconstruction.

Alan Meltzer, the Fed's semi-official historian, has argued that this tsunami of new money will eventually produce a CPI "higher than … in the 1970s" (Bloomberg, 14 April 2009). Warren Buffett agrees (Bloomberg, 20 May 2009). Christina Romer, who chairs Obama's Council of Economic Advisors, has devoted much of her academic career to the analysis of policy responses to post-war recessions. She has found little evidence that fiscal stimulus has helped to end them (a readable review of her research appeared in *The New York Times* on 2 December 2008). John Cochrane, a professor at the University of Chicago Business School, concluded on his blog (3 February 2009):

> I've been looking through graduate course outlines and textbooks, and I can find nowhere in the last 50 years that anybody in economics has said that [deficit spending as a] fiscal stimulus is a good idea. What are we doing giving [such] advice … [when] there's nothing [in what] … we teach our graduate students that says fiscal stimulus works?

The "compassionate" actions of Bush and Obama have set the stage for an even bigger crisis – and harsher pain – in the future. The German economist Wilhelm Röpke said "the more stabilisation, the less stability." The Austrian, Friedrich von Hayek, added "the more we try to provide full security by interfering with the market system, the greater the insecurity becomes."[19] The inescapable truth is that the threat and occurrence of bankruptcy is an essential element of the free economy. Apart from secure rights to property and unfettered prices, the carrot of profit and the stick of loss are the most essential elements of the market system. Bankruptcy thus serves two essential ends. It makes people think carefully about risk and uncertainty, and to look – in several directions – before they leap. Just as importantly, it liquidates the errors of the past and redirects assets into more competent (or at least more solvent) hands. Röpke put it most succinctly: "our economic system (in the final analysis) is regulated by bankruptcy" (p. 248).

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19 Wilhelm Röpke, *The Economics of the Free Society* (1937, Libertarian Press, 1994), p. 219; Hayek quoted in Sanford Ikeda, *The Dynamics of the Mixed Economy: Towards a Theory of Interventionism* (Routledge, 1997), p. 183.

George Bush and John Howard were indifferent (and on occasion even somewhat apologetic) Keynesians. Barack Obama and Kevin Rudd, however, express few doubts and reservations. They even sound like Keynes: "the failure to act," Obama said on 8 March 2009, "and act now, will turn a crisis into a catastrophe …. [Without stimulus] … we may not be able to reverse [the] … crisis." Just as Keynes did, Obama habitually refers to government "investments" whenever he speaks of government expenditures. Just as Keynes did, Obama asserts that his opponents prefer to "do nothing."[20] Just as Keynes did, Obama babbles of the imperative to "boost demand."

The fundamental point about the state's expenditure – which is starkly simple and probably for that reason usually overlooked or derided as "simplistic" – is that it must come from somewhere. This "somewhere" is ultimately tax-paying individuals and businesses. A government must raise revenues either through taxation, borrowing or inflation. Regardless of its approach, not only is no new wealth created: the possibility of otherwise creating new wealth is foregone. On 19 October 2001, *The Wall Street Journal* concluded that "it's pretty much impossible to find an introductory macroeconomics textbook that recommends … fiscal stimulus. If Keynes appeared in any of the heavy-duty academic centres around the world, he would find his idea referred to as a 'classic fallacy.' Most economists have moved on to other models". Almost ten years later, on 27 February 2009, John Cochrane told Bloomberg News: "the idea that [government] spending can spur the economy was discredited decades ago … It is very comforting in times of stress to go back to the fairy tales we heard as children but it doesn't make them less false."

Is Britain Finished? If So, Have Keynesians Finished It?

German National Socialists couldn't do it in 1940, but perhaps William Beveridge (1st Baron Beveridge, 1879-1963) and his successors (more than few of whom were Conservatives, all of whom worshipped John Maynard Keynes and, beginning in the Second World War, erected a ruinously expensive welfare-warfare state) have irreparably weakened the sovereignty of the United Kingdom and the

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20 As *The Australian* ("Don't Ever Call Him the Do-Nothing Prime Minister," 9 April 2009) has noticed, false mutual exclusivity is one of Kevin Rudd's favourite rhetorical weapons. Either you do as he says, or you do nothing. But the alternative to interventionism "doesn't mean you [do literally] nothing. I mean, we could reform the system. We could return to sound money. We could balance our budget. We could change our foreign policy. We could take care of our people at home. We could lower taxes. There's a lot of things that we can do. But the worst thing that we can do is perpetuate the bad policies that gave us this trouble in the first place, and that is that we no longer, over the last quite a few decades, [believe] in free-market capitalism … And you can't solve the problem of inflation, which is the creation of money and credit out of thin air, by [conjuring] more money and credit out of thin air. We have to change basic policy … What they're doing now, they're propping up a failed system so the agony lasts longer. They're doing exactly what we did in the Depression. What the government is doing now … is trying to prop up prices. You want the price structure to adjust. You want the price of houses to go down. You don't want to fix the price of housing. You can't price-fix. We've had too much of that" ("Ron Paul Has Nothing Good to Say About the Wall Street Bailout Plan," *The Los Angeles Times*, 21 September 2008).

ancient liberties of the British people. Since the middle of 2007, HMG and the Bank of England have implemented a hyper-Keynesian policy. The Bank has slashed the two week "repo" rate (its counterpart to the Overnight Cash Rate in Australia) to 0.5%. Through a program called "quantitative easing," it has also printed money at a pace not seen since the Second World War. This has enabled HMG to increase spending by 26% within 18 months and to incur the country's largest-ever peacetime budget deficit (12% of GDP). For good measure, and working together, the Bank and the Government have nationalised almost half of Britain's banking industry. That's never happened before. Short of exhuming Karl Marx from his grave at Highgate Cemetery in London and putting him in charge, it's hard to see how the state could intervene more massively and extensively. (As if to celebrate his figurative exhumation, on 25 March 2009 rail unions announced their first national strike since 1993, and British Airways' cabin crews prepared to resume their first strike since 1997.)

For the first time ever, except during the Second World War, in 2009 HMG's expenditure exceeded 50% of GDP. That's something that Harold Wilson and Tony Benn tried mightily to achieve during the 1960s and 1970s. During the reign of "New Labour" since 1997, government spending has risen from 40% of GDP to 52% in 2009, and is projected to reach 54% in 2010. This means that since 1997 the ratio has on average risen by one percentage point per year. The increase has been fastest during the last two years, but it has been rising without interruption since 2001. It's been financed partly by tax increases, but mostly through a soaring budget deficit. Other countries' deficits have increased since 2007, but Britain's has risen more quickly. Moreover, like the U.S. and unlike most other countries, government spending rose smartly during the boom of 2002-2007. As a result, it is now higher in Britain than in most continental European countries, after previously having been much lower. According to Mark Steyn ("Your 'Downturn,' Their 'Upturn,'" *Maclean's*, 18 March 2010), "in Wales, Northern Ireland, and Scotland, government spending accounts for between 73 and 78 per cent of the economy, which is about as high as you can get without embracing full-scale Sovietisation. In the English city of Newcastle, three-quarters of the working population are employed by the government."

But goes up must come down. On 25 March, the Institute of Fiscal Studies estimated that if the government were re-elected and kept its promise to shield hospitals, schools and foreign aid from cuts for at least two years, then all other parts of the budget must be slashed by 25% in order to meet the government' promise to reduce the budget deficit to 4% of GDP by 2015. The Chancellor of the Exchequer, Alistair Darling, told the BBC on 26 March that, regardless of the results of the upcoming election, HMG will have to impose "deeper and tougher" cuts to spending than Margaret Thatcher did during the early 1980s.

The parallels between Gordon Brown's response to the GFC and Tony Blair's aggression in Iraq are startling. In both instances, a campaign of "shock and awe" was planned without thought for collateral damage. And just like in Iraq, victory has been declared prematurely. "While we were hit with a great recession, we now know that the world has indeed avoided another Great Depression," Brown told Reuters on 10 March. New data released on the same day showed that industrial production had sunk to levels last seen in 1991, and the number of Britons in paid employment sunk to the level last seen in 1996. Taking into consideration Brown's civil-service jobs jamboree, the number of people currently employed in the private sector has collapsed to levels last seen in the mid-1980s. Bond markets are bracketing Britain with Greece, Italy, Portugal and Spain, and Moody's has commenced the steps required to downgrade its credit rating.

Public debate about the British economy apparently cannot occur without a brawl among economists. On 14 February, a group that included the former Bank of England policymakers Tim Besley, Howard Davies, Charles Goodhart and John Vickers published an open letter in *The Sunday Times*. They demanded that the government control the ballooning deficit. If it didn't, they warned that the "recovery" would be threatened and a run on the pound might occur. That brought a stinging response from Keynesians, who continue to urge that the UK must spend its way out of recession. Joseph Stiglitz and Robert Solow were among the signatories of letters written by a group of 67 economists insisting that massive deficit spending was the only way to salvage the economy. The letters, published on 20 February in *The Financial Times*, argued that "a sharp shock [that is, a sudden reduction of expenditure]" now "would be positively dangerous."

The Keynesians' open letter to the *FT* recalls another. In 1981, a group of 364 economists wrote an open letter lambasting the policies of Margaret Thatcher. And just as the Keynesians were utterly mistaken three decades ago, they're completely wrong now. As it did then, today Britain has the worst of all possible worlds: a stagnant economy, a crippling budget deficit and rising prices – in short, and as it did in the 1970s and early 1980s, it's experiencing the "stagflation" that Keynes insisted is impossible. The Keynesian consensus is that things would be far worse without the government's "stimulus." They add that if the economy isn't pumped with the steroids of inflated demand, it will collapse back into recession. The fact that it remains mired in a deepening recession seems utterly to escape them.

For more than two centuries, Britain has produced a disproportionate share of the world's most notable economists: Adam Smith, David Ricardo and John Stuart Mill surely figure prominently on the list. In chronological terms, Keynes is the most recent. It would be fitting if Britain, which is the birthplace and cradle of Keynesianism, will also be its deathbed. Let's just hope that the death of Keynesianism doesn't mean the death of Britain.

Conclusion

"The point," said Chris Bowen MP in "Hey, Big Spender" (*The Australian Literary Review*, 3 February 2010), is that Keynes provides "the best guide we have to the causes [of] and solutions to economic downturns. He continues to provide theoretical succour to those who believe that there must be a better course of action than sitting by and watching as an economic downturn spreads misery." We don't think that's the point at all. Rather, the point is that "even a manifestly erroneous doctrine," as Mises said in *The Theory of Money and Credit* (1912), "should be refuted by careful analysis and the unmasking of the fallacies implied. A sound doctrine can win only by exploding the delusions of its adversaries." From John Stuart Mill in the 19th century to Mises and Hayek throughout the 20th, economists have again and again refuted the myths and fallacies that Keynes resurrected in *The General Theory*. Keynesianism, in short, is the "how to" manual for inflation, artificial booms and genuine busts. The trouble is that, although they mightn't be able to distinguish its tenets from a bar of soap, certain kinds of people take to it like ducks to water.

The truth is inescapable, and cannot forever be obscured in the garb of mathematical economics: if an individual, family, business or state has long lived for today and disregarded tomorrow, spending more than it earns, buying what it doesn't need and can't afford, making foolish "investments" (much of which is actually consumption) and borrowing more than it can repay, then it must eventually face a reckoning. Politicians like James Callaghan eventually learnt this lesson; in Australia, Peter Walsh always knew it and has never forgotten it. Both knew that inflation invariably harms the poor and vulnerable "outsiders" and rewards the privileged "insiders."

But most people want desperately to hear otherwise, and we live in an era when "experts" are more than happy to oblige – namely to tell them that a credit card which has breached its limit is no reason to economise: rather it's a reason to get another card with a higher limit. Accordingly, he who prescribes more inflation, borrowing and spending as a "cure" for the ills caused by inflation, borrowing and spending – indeed, who regards these things as virtues rather than vices – is a godsend. These days, Australians, Americans, Britons and others want to hear that a profligate family, business or government need neither mend its ways nor live within its means. Hence virtually all politicians will eagerly grasp Keynes's fallacies – and use them to drain our pockets and restrict our liberty.

"It is ideas, not vested interests, which are dangerous for good or evil," said Keynes (*TGT*, p. 384). Further, "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 quite 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" (*TGT*, p. 383). That much, if very little else, Keynes got dead right.

Chris Leithner