The Economist

A Keynes for all seasons

Nov 26th 2013, 13:30 by C.R. | CAMBRIDGE

IN THE years since the publication in 1936 of "The General Theory of Employment, Interest and Money", John Maynard Keynes's name has been irretrievably linked to the idea that fiscal stimulus should be used to combat recession during downturns. Such ideas came to dominate economics in the 30 years after the second world war, so much so that Republican president Richard Nixon declared in 1971 that "we are all Keynesians now".

Although Keynes's ideas went out of favour in the 1980s and 1990s, they came back into fashion as the financial crisis of 2007-09 unfolded. The use of fiscal stimulus to fight recessions in America, Britain and Asia led Keynes's most prominent biographer, Robert Skidelsky, to declare the "return of the master". Keynes's notoriety among the public rose so much that a hip-hop video of him arguing the merits of fiscal stimulus with his rival, F. A. Hayek, went viral on YouTube back in 2010.

But whether Keynes's ideas were ever as simple or consistent as some modern-day Keynesian economists suggest is a matter of great contention. *The Economist* noted as long ago as the 1960s that the ideas of Keynes the man were diverging from contemporary Keynesian economics. While Keynes emphasised austerity in the good times as much as stimulus in the bad, many Keynesians considered stimulus a “one-way road” in the 1960s and 1970s. As Keynes himself wrote in 1937: “The boom, not the slump, is the right time for austerity at the Treasury.”

Even during his lifetime he was concerned that some people were accepting the conclusions of the "General Theory" too uncritically. In 1940, A.C. Pigou, one of the examiners of the Economics Tripos at Cambridge University that year, wrote to Keynes to complain that both staff and students were taking much of his work too literally:

The chief bad thing we found was that a very large number of people had been stuffed like sausages with bits of your stuff in such a way that (1) they were quite incapable of applying their own intelligence to it, and (2) they perpetually dragged it in regardless of its relevance to the question… the parrot-like treatment of your stuff is due to the lectures and supervision of the beautiful Mrs [Joan] R[obinson]—a magpie breeding innumerable parrots.

To the modern reader, the "General Theory" can appear very much a book of its time. It was written in a world facing very different problems from those of today. Keynes developed the theoretical ideas in his work to justify running a budget deficit of just 3% of GDP during recessions in a Britain where the state only accounted for around 25% of the economy. Today’s situation seems a world away in comparison. Peacetime deficits reached 13% of GDP in America in 2009, and in Denmark, Belgium and France, taxation approaches nearly 50% of GDP.

Even Keynes himself, by the end of the second world war, was considering writing a new book to correct and develop much of what he was unsatisfied with in the "General Theory". But due to his untimely death it was Joan Robinson who extended Keynsianism into the future, giving it a left-wing tinge by mixing it with the ideas of Karl Marx in her book "The Accumulation of Capital".

This has confused impressions of what Keynes's ideas were, but even with this overlay removed they are hard to pin down. A perusal of his work in the interwar years makes Keynes, on the surface, look like a very inconsistent thinker. He appears to have supported deflationary policies in the early 1920s and then inflationary ones in the 1930s. He spent most of his life as a free-trade campaigner, only to perform a volte-face in 1930 to support tariffs and then aggressively defend Britain’s use of them against America in the second world war. And he changed his mind many times about other issues too; for example, on the use of capital levies and controls.

But one theme does emerge unscathed throughout his work: a search for macroeconomic stability. According to Mr Skidelsky at Warwick University, much of Keynes’s work was motivated by a desire to return to the stability and growth of the pre-1914 period that had been shattered by the first world war. Although the workings of the Victorian and Edwardian gold standard did a good job of this, they had broken down by 1919.

Keynes’s work in the interwar period was in many ways a reaction to the chaos of the times. "A Tract on Monetary Reform" (1923) attacked policies which caused excessive inflation or deflation in an economy. "The Economic Consequences of Mr Churchill" (1925) critically reviewed the wisdom of Britain’s return to the gold standard at an arbitrary fixed rate of exchange. Once freed from the shackles of gold, stimulus policy became an available tool for stabilising GDP during recessions—as he explored in "A Treatise on Money" (1930) and the "General Theory" (1936). All these works share one underlying feature—the idea that the internal stability of an economy (of prices and unemployment) should be prioritised above abstract principles that were directed at maintaining external stability (of exchange rates or the free movement of capital, for instance) at all costs.

Keynes was more of an empiricist, at heart, than his critics have claimed. He did not consider himself tied down to any particular economic creed. For instance, he pointed out that the most effective and appropriate economic theory for a particular period changes, because the structure of the world economy mutates and evolves over time far more quickly than, say, the natural world and its systems:

Economics is a science of thinking in terms of models joined to the art of choosing models which are relevant to the contemporary world. It is compelled to be this, because, unlike the typical natural science, the material to which it is applied is, in too many respects, not homogeneous through time…Good economists are scarce because the gift for using "vigilant observation" to choose good models, although it does not require a highly specialised intellectual technique, appears to be a very rare one.

So, can Keynes's seemingly contradictory views on economics can provide a message to policy-makers of the future? Perhaps they can contribute more to a general outlook on the dismal science rather the advocacy of any particular policy tool in its own right. As Cambridge University oral tradition claims he often used to say when retorting to criticism of his latest ideas: "When the facts change, I change my mind. What do you do, sir?"