The Unfortunate Longevity of the Keynesian Ideal

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While I am too young to have experienced it for myself, my understanding is that during much of the 1980s and 1990s Keynesian ideologues had become a bit of a punching bag at professional meetings such as our present conclave. By that time Robert Lucas (1976) had articulated the “Lucas Critique”—which served as just one fiery blast in the uprising that would come to be known as the “Rational Expectations Revolution” by the time I was studying it as an historical event during my own doctoral studies in macroeconomics. The Phillips (1958) curve had been broken to bits based upon the economic realities of the 1970s and early 1980s, and made no empirical sense without an underlying role for inflationary expectations. And Thomas Sargent and Neil Wallace (1975) had established the “Policy Ineffectiveness Proposition”—a proposition that, if true, rendered the Fed incapable of manipulating the levels of unemployment and output without resorting to outright deception of the very body that the central bank, at least presumably, is obliged to serve: the body politic. Indeed, the freshwater economists—to use Robert Hall’s (1976) term—working at institutions such as Carnegie-Mellon, Rochester, Minnesota, and Chicago appeared to be on the verge of a sweeping Darwinian victory in the survival of the fittest ideas regarding how the macroeconomy operates, and what macroeconomic policy can and cannot accomplish. And, for the most part, macroeconomic policy cannot accomplish much—at least according to this view.

It is important to note that much of the much of the aforementioned scholarship focused upon the underlying microfoundations of macroeconomic activity. Indeed, the multiple macroeconomic “syntheses” that ensued admitted a greater role for individual choice, action, and inaction than had been present in the heady days of “Keynesian Economics and the Economics of Keynes.” And the role of microfoundations is an important one—so important that a new field, behavioral economics,
continues to soar upward to dizzying heights in its efforts to better understand, articulate, and model what really makes all of us “tick.” (And, incidentally, behavioral economics books targeted at lay audiences tend to sell very well.)

In the years since the heyday of the rational expectations revolution, new economic challenges have presented themselves in ways that some say call that particular paradigm into question—much like the phenomenon of stagflation confounded many good Keynesian professional economists during the 1970s and 1980s. And if one may refer to the economics of Keynes as the “New Economics”—as many have—then it seems everything “New” is new again.

In contrast to the perils of the 1970s and 1980s, which generated much new scholarship among academics, the Great Recession has not led to a genuine advancement of the frontier of economic science in any significant way. Instead what we have witnessed is a resurgence of existing Keynesian policy prescriptions within the public conscience.

Examples abound, so I shall list but a few here. In response to the Great Recession we passed the American Recovery and Reinvestment Act of 2009, creating $787 billion in additional funds available for projects deemed “shovel-ready” (a term that has gone on to become a punch line used sarcastically by many including President Obama, who had been among its champions). Yet for many Keynesian-minded economists, politicians, and statesmen, the problem with the American Recovery and Reinvestment Act stimulus was not that it was poorly administered, but that it was far too small. For example, Nobel laureate Paul Krugman has argued vociferously that $787 billion in additional spending wasn’t even close to enough to be able to End This Depression Now!, as the title of one of his popular books shouts from its cover.

Of course, fiscal stimulus through additional government spending is not the only channel through which the Keynesians currently driving macroeconomic policy have attempted to steer the economy in a more favorable direction following the events leading up to the Great Recession. The Troubled Asset Relief Program—commonly known as TARP—granted permission to the U.S. Treasury to purchase $700 billion of so-called troubled assets from financial institutions. Though not an explicit attempt to stimulate aggregate demand, TARP may nevertheless be seen as an effort to stabilize overall demand by reducing the level of default risk perceived by all relevant economic agents.

For further evidence that we are all Keynesians once more, consider the actions of the Federal Reserve System during the course of the last five
years. Since late 2008 the Federal Open Market Committee has kept its target for the federal funds rate at a range of zero to 0.25 percent. During the same interval the Fed—through three rounds of quantitative easing—has purchased additional assets from financial institutions. And, at present, the Fed has only begun to unwind its vast ongoing monthly bond purchases initiated under QE3.

Why the resurgence of the Keynesian ideal? I would suggest two possibilities—both of which are true to some degree. First, the realities of political economy make economic life difficult for rational politicians and bureaucrats—even if they understand well the magnificence of the price system. Though I deeply believe that the price system is part of God’s rich providence, the “unseen” and the “invisible” are nevertheless a very tough sell to the body politic—especially during difficult economic times. Thus politicians and bureaucrats—faced with the perils of a 24-hour news cycle, campaign cycles, and cycles of reappointment and funding—generally do precisely what we have come to expect them to do in a perceived crisis: they act. They act for the simple reason that not acting is perceived to be irresponsible or uncaring, and appearing irresponsible or uncaring in political life can bring a quick end to one’s career. Connecting the dots, then, Keynesian policies are attractive to our representatives in government because—at least in part—Keynesian policy responses allow politicians and their appointees to appear active during a crisis rather than passive. And there are strong public-choice incentives for politicians and bureaucrats to look busy rather than idle.

Second, many among us remain true believers either in the economics of Mr. Keynes or in some denominational offshoot of the Keynesian faith as it has been handed down to us by our academic mothers and fathers. Such economists believe that, even if palliative care for the economy today courts peril tomorrow in forms such as inflation or slower long-term growth due to crowding-out, economists armed with sufficiently sophisticated models can and should act in ways that seem humane today if it is possible to do so. It is also worth noting that American economists everywhere—including at the University of Chicago—were clamoring for fiscal and monetary stimulus even before the 1936 publication of the General Theory. J. Ronnie Davis’s (1971) doctoral dissertation provides a fascinating account of this episode in the history of economics.

Such a consensus to stimulate aggregate demand in the early 1930s stretches credibility today. The simplified story that we instead tell each other nowadays pits the monetarists, the classicals, and the Austrians against the Keynesian way of thinking. Although each school attacks
the Keynesians from different positions of core belief, there nevertheless exists—at least generally speaking—a consensus among all of these schools about what constitutes a “good” macroeconomy, and the Fed’s mandate provides a succinct summary in an amendment to the Federal Reserve Act passed by Congress in 2000:

The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long-run growth of the monetary and credit aggregates commensurate with the economy’s long-run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.

The Fed’s “dual mandate”—maximum employment and price stability—is quite an explicit normative claim about what a healthy economy is, yet most macroeconomic battles are not fought over whether these goals are indeed the goals worth pursuing. Most academic quibbling centers instead on questions such as the extent to which fluctuations in monetary aggregates drive the business cycle, whether $S$ indeed equals $I$, or whether discretionary policy actions can be properly timed in a way that is relatively consistent. But there is little, if any, debate over whether maximum employment and price stability are, in fact, proper goals of macroeconomic policy.

We must assume, based upon the available evidence, that Lord Keynes would hardly disagree with the dual mandate of the Fed. After all, Keynes (1936) made an even narrower claim regarding our economic purpose in his General Theory: “Consumption—to repeat the obvious—is the sole end and object of all economic activity” (p. 104).

But goals such as “maximum employment” or “consumption” are, quite frankly, the wrong goals, because they are the product of a flawed anthropology of the human person. Today I would like to criticize modern macroeconomics for its emphasis upon these goals and not upon others. When classicals, monetarists, Keynesians, and Austrians do battle nowadays, all of those conflicts take place upon a particular battlefield that the Keynesians dictated long ago, using a common set of easily quantifiable economic vital signs as the measure of economic success or failure. The greatest shortcoming of the scholars in Chicago and even Austria is that, in their zeal to prove Keynes wrong, they conceded the terms of macroeconomic debate to Keynes and his successors.

I would hope that, especially in this room, we can all agree what genuine economic flourishing might look like. Human beings created in the image
of God are called to lives of meaning, purpose, and virtue. Having been created in His image, we continue to carry out his creative work in the service of others—whether in market activities or not. Economics is not about mere consumption or maximum employment; economics is about value.

Consider two powerful examples that are not my own. When a grandmother teaches her granddaughter to knit, that is an economic activity that creates value. Motherhood is an economic activity with tremendous potential to create economic value—though the pay is lousy and the hours are awful. But economics is not only about the value we create outside of markets. Economics is also about the value that we create during our working lives. And at the risk of sounding like a cold-hearted economist, the price system is one critical way in which both Christians and non-Christians discover where their unique talents, interests, and skills are needed most in the service of both others and the kingdom. Consider for a moment a young person’s decision to enter a well-paying career such as neurosurgery. Outside of this room there are some critics of markets who would assume that our hypothetical young person is greedy and after a big pay day and a life of crass consumerism. But economists like us understand well that if brain surgery currently pays well, then that is a signal that society genuinely needs more young people to consider neurosurgery if that happens to be where their comparative advantage—as well as their deep joy—may lie.

When most Christians make significant life choices they pray, read scripture, listen for God to reveal himself directly, consider the gifts and talents with which they have been blessed. They consult Christian brothers and sisters, and they gather information about what a day at work is like in a variety of professions. And then they stop. But we Christian economists should encourage everyone we know—especially our pastors and priests—to also consider the valuable vocational information conveyed to us at low cost by the price system. After all, the price system is His, too.

To this I would add that another dimension of our flawed anthropology is the fact that we ignore what happens to us when we work. Put simply, economic activity is not merely about what we achieve at the end. God has more in mind for us than that. Instead, through the process of our creative work God is transforming each of us into a more accurate picture of the person he ultimately intends each of us to be.

This flawed anthropology of the human person is what makes our current Keynesian policy responses so deeply troubling. The Keynesian ideal is imbued with the notion that if we simply know enough economics then
we can manipulate people into actions that create maximum employment. This is not economics as moral theory; this is economics as a video game. It is no surprise that the Keynesian ideal caught hold in the same general period that men and women of science began to believe that systematic management of human beings was both possible and useful in all areas of society. For example, it is within this same period that John Dewey introduced systematic management into modern education. And though we seldom mention it now, Keynes served as Director of the British Eugenics Society from 1937 to 1944. As late as 1946, shortly before his death, Keynes declared eugenics to be “the most important, significant and, I would add, genuine branch of sociology which exists.”

Yet economics prior to this era was never about systematic management. For example, even the very expression “the economy” is a modern invention. Keynes never uses it in the *General Theory*. The closest he ever gets is in just two instances: “economic system” (p. 249) and “economic society” (p. 269). In his book *Rule of Experts*, Timothy Mitchell (2002) asserts that as late as the 1930s, no one used the definite article in front of “economy.” The word “economy” meant something like frugality or good stewardship. It was at some undefinable point between the 1930s and 1950 that we began to refer to “the economy”— reifying it, treating the social system as a separate thing with its own existence, implying that it has some level of autonomy from the human decision-making that takes place within it (pp. 81-82).

Thus Keynes, his Bloomsbury group, and Dewey became the personification of the “man of system” derided by Adam Smith (1759) in his *Theory of Moral Sentiments*:

The man of system … is apt to be very wise in his own conceit; and is often so enamoured with the supposed beauty of his own ideal plan … that he cannot suffer the smallest deviation from any part of it. He goes on to establish it completely and in all its parts, without any regard either to the great interests, or to the strong prejudices which may oppose it. He seems to imagine that he can arrange the different members of a great society with as much ease as the hand arranges the different pieces upon a chess–board. He does not consider that the pieces upon the chess–board have no other principle of motion besides that which the hand impresses upon them; but that, in the great chess–board of human society, every single piece has a principle of motion of its own,
altogether different from that which the legislature might choose to impress upon it. If those two principles coincide and act in the same direction, the game of human society will go on easily and harmoniously, and is very likely to be happy and successful. If they are opposite or different, the game will go on miserably, and the society must be at all times in the highest degree of disorder (pp. 233-34).

The policy responses of the last five years are, in my view, the creations of men of system who forget that they are influencing precious, unique humans bearing the Imago Dei. Instead of making arbitrary assumptions regarding what people should have—such as a house, and today, if possible—we instead need to create an opportunity society in which each of us faces the fewest impediments along the path to serving each other—and our Master—precisely as he intends. An economy is not a system to be managed; an economy is organic. High employment and long-term economic growth simply do not happen as the result of some majestic manipulations by men of system intended to achieve them. They are, instead, the natural outgrowths of human activity carried out within an institutional arrangement in which all of us are able to discover how to live, to serve, and to grow.

Endnotes

1 I am thankful to the Association of Christian Economists for arranging this important session, and to the other panelists. I am grateful to Greg Forster for our ongoing collaborations that have significantly informed this paper. v克拉ar@gmail.com.
2 I believe that I have Elise Amyx and/or Anne Rathbone Bradley, both of the Institute for Faith, Work & Economics, to thank for these examples.
3 Quoted in Freeden (1979).

References


