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Book Review by Brian Domitrovic

KEYNES'S LAST STAND

Money and Government: The Past and Future of Economics, by Robert Skidelsky.
Yale University Press, 512 pages, \$35



ROBERT SKIDELSKY ISN'T COY. HE TITLES his new book *Money and Government* because these two elements “are the stars of the economic drama.” This axiom is central to the theories of John Maynard Keynes (1883–1946), the British economist whose followers guided 20th-century economic thought and practice in the United States, United Kingdom, and other developed nations. The Keynesian argument for income redistribution and deficit spending emphasizes their macroeconomic benefits: because people of modest means devote the highest proportion of their incomes to consumption, any government serious about rapid economic growth must act to get money into their hands. Conversely, Keynesianism cannot abide such monetary arrangements as the gold standard, which inhibit governmental plans for fiscal expansion.

Money and Government makes an argument by way of telling a story. Skidelsky, also

a British economist whose works include the three-volume biography *John Maynard Keynes* (1983–2000), thinks that the Anglosphere was managing its economies most successfully in the years following World War II, when Keynesianism was intellectually preeminent. With the rise of Margaret Thatcher and Ronald Reagan in the 1970s, however, came a “neo-liberal” counterrevolution that pushed Keynesianism aside.

SKIDELSKY BELIEVES THAT THE FINANCIAL panic of 2008, and ensuing Great Recession, marked this counterrevolution’s lamentable, predictable denouement. He now expects and desires the pendulum to swing back toward Keynes—toward government intervention, that is, and away from *laissez-faire*. “Today we are living through a crisis of conservative economics,” he writes. “[T]he belief that unimpeded competitive markets

deliver optimal welfare” took hold among academic economists and policymakers in the years prior to 2008. This was regrettable: “Governments believed things about the economic system that were not true,” while “[i]n the name of these ideas, finance was allowed to spin out of control; and its implosion produced a world depression.”

A serious problem with this argument is that the counterrevolution against Keynesianism did not occur *ex nihilo*. Rather, the Thatcher and Reagan reforms dispatched stagflation, a problem Keynesianism had judged insoluble. Simultaneously high inflation and high unemployment in the 1970s marked the end of postwar expansion, showing that it had become impossible to push fiscal stimulus or business-cycle “fine-tuning” any further. Unable to reignite economic growth, orthodox Keynesians fell back on advising us to get by without it. In the face of such daunting de-



velopments as resource exhaustion and the population bomb, they contended, advanced economies had passed the tipping point. Only by reducing our expectations and accepting that small is beautiful could we successfully adapt to our ascetic destiny.

THE 1980S' UNCEREMONIOUS COLLAPSE of double-digit inflation, in the context of vigorous growth and a technological revolution, was difficult to digest. Unable to account for these phenomena, Keynesians could only carp about them. If during the Reagan years 18 million new jobs materialized, they were mainly flipping hamburgers. If another 20 million jobs pushed unemployment past structural thresholds in the 1990s, it was because Presidents George H.W. Bush and especially Bill Clinton raised tax rates on the rich. One had to hold one's ears when Clinton affirmed that the era of big government was over and championed himself a fiscal conservative. When military recruitment soared after September 11, 2001, and the subsequent invasions, here was evidence that the economy was suffering from a dearth of opportunity, not a surge of patriotism. Unable to account for the "Great Moderation"—good growth and minimal inflation—Keynesians insisted it was spurious.

Then the 2008 crisis hit. In September of that year Wall Street's most powerful men converged on Washington to inform officials that the famous institutions they ran were basically insolvent. All the government could do was pledge big cash infusions from the public purse and arrange for unprecedented monetary expansion by the Federal Reserve. As stocks lost more than half their value, unemployment surged to 10%, and a tax-cutting Republican president was succeeded by a liberal Democrat, it was exhilarating, almost worth the wait. The Keynesians had been right all along. Their humiliations throughout the Great Moderation's decades had proven to be battles lost in a war that would be won. Classical economics was getting its comeuppance.

Under Obama, high levels of government spending accompanied the Fed's "quantitative easing." The economy slowly expanded, so it could be argued that the switch in time to semi-Keynesianism had, technically, averted another Great Depression. The great prophet, spurned and presumed dead, rescued a world that spurned him. In time, as the new status quo shorn of classical economics' imperiousness set in, the details of what had happened would be recorded and heroized.

Money and Government aspires to be a Keynesian epic. The book begins 1,000 years ago: "In medieval times, the general view was

that the way things appear is the way they are," the first of many dubious, sweeping generalizations. Others by Skidelsky include:

- "The great mystery of nineteenth-century monetary history is the success of the gold standard."
- "In reality, the only deficits the deficit-hawks really mind are deficits incurred to protect the poor."
- "Enslaved by utopian theories and ignorant of history, the ideologues of the free market have been preparing the ground for the Apocalypse."

THIS IS NOT TO SAY THAT *MONEY AND Government* lacks useful interpretations of history and explanations of economics. It's just that they are braided into so many strong statements of opinion that one is left to doubt the Yale University Press's standards of review. At any rate, the canvass of pre-Keynesian economics is worthy of consideration. Skidelsky makes the point, for example, that the switch from bimetallism to the gold standard in the late 19th century began the process of monetary uniformity that culminated in central banking. The rise of central banks—this is one of the main arguments of the book—in turn created the impression that monetary policy was sufficient to moderate the business cycle and undergird broad prosperity. This impression was false: the market economy, as Keynes would soon point out, naturally suffers from a "liquidity trap."

Prior to Keynes, economist Knut Wicksell had "raised a troubling problem for those who relied on monetary therapy": prevailing rates of economic return could at times fall below rates of bank interest. In *The General Theory of Employment, Interest, and Money* (1936), Keynes went further, considering the long-term effects of the numerous personal fortunes created by the industrial revolution. By the 1930s the rich had grown so rich, and so much more numerous than ever before, that they were beyond caring whether their capital got bank interest as opposed to the prospectively higher returns of real investment. A large proportion of those who had gotten rich had grown indifferent to getting even richer, having lost the "animal spirits" to go out and conquer new worlds.

Any "liquidity preference" among the holders of wealth—"hoarding," a recurring term in *The General Theory*—means grim things for the economy. Keynes contended that as the rich proliferate under the progress of capitalism, ever more money sits idle, investments are forgone, and unemployment and depres-

sions result. The market system falls victim to its own success. An outside agency—government—must step in and help the economy fulfill its potential.

HENCE THE TWO TERMS IN THE book's title, the two "stars of the economic drama." *Money* progressively dawdles with the success of the market economy, so *government* counteracts the process. Via progressive taxation, government takes the money that the rich hoard and makes use of it for real purposes. Via budget deficits, it does the same thing, by means of capturing the bank balances of the rich, given that the banks prefer (or are required) to hold their reserves in government-debt paper. Spending the acquired funds on welfare, jobs programs, and public investment, government stimulates economic activity so that the unemployed are drawn into work and those who are not rich benefit from a dynamic economy. This has the corollary effect of raising the rate of return on investment, which reinvigorates the rich's animal spirits, rendering government intervention successful and unneeded... until the next recession.

Keynesianism does have a sort of *prima facie* plausibility but, on inspection, there are all sorts of problems, few of which Skidelsky acknowledges. The first concerns not the liquidity preference of the rich, but of the banks, the "financial intermediaries." *Perhaps* animal spirits decline with wealth, though Silicon Valley is not a drowsy venue. But do they also decline among those who hold the rich's wealth, importuned as they are for loans and investments by strivers and entrepreneurs? This has to be addressed in order for Keynesianism to have validity. Another problem is progressive taxation itself. Raising tax rates on the rich renders them even less vigorous about creating new wealth. A perfectly Keynesian option would be to lower marginal tax rates, and thereby lower the value of hoarding. There is also the matter of the invariably poor quality of government spending.

What is remarkable is the specific historical context in which *The General Theory* appeared. In the early 1930s several things were afoot in the United States, the world's richest nation. The marginal rate of the income tax soared from 25% to 63%. The redemption price of gold went up from \$20.69 to \$35 per ounce. There was a big new tariff. And business regulations proliferated. In light of these developments, to be baffled that those with money would withdraw it from investment is a delusion, not a conclusion. The real rate of return on the investments of the rich fell mightily with the tax-rate increase; hoard-



ing gold prior to a phenomenal increase in its par price was speculation (even if the courts invalidated the gains *ex post facto*); and capital and wage commitments per unit of output increased with regulation and the tariff. The correlation is clear. Animal spirits dried up in the face of governmental impositions on capital. Why did Keynes choose to say that the phenomenon was endemic to the market system, as opposed to the specific policy environment of the 1930s?

Skidelsky affirms Keynes's decision to call "his book the 'general theory'" and to insist that "under-employment was not a lapse from a normal condition: it *was* the normal condition, interrupted only by 'moments of excitement.'" And he gives a reason: "Keynes's economics was deeply embedded in his ethics." The reader may wonder if the economics was not deeply embedded in the great man's opportunism. Keynes had a reputation for vanity, not to say superiority, and no bigger name bestrode economics for years after 1936. Surely this could scarcely have happened had Keynes chosen, with a degree of reason, to call his 1936 volume *The Particular Theory*.

MONEY AND GOVERNMENT ALSO provides an extended lament on the rise of monetary economics after World War II. Skidelsky sees this as a retrograde development, a result of failing to appreciate Keynes's insights. It is of little importance, Skidelsky stresses, whether prices are kept stable by means of judicious central banking. The processes affecting the rich that Keynes described will still take hold. The rich will still accumulate so much that they will increasingly decline to invest, resulting in a slump that harms the least well-off.

Skidelsky interprets the economic decisions of the post-World War II age as a rolling repudiation of Keynesianism. In the early period, when *The General Theory* was still rather fresh, a broad prosperity reigned amidst high tax rates on the top earners and some wealth taxation. In the latter period, as the ideas of Milton Friedman and various other monetarist and "rational expectations" theorists gained influence, price stability became the main policy emphasis. Inevitably, inequality

widened, prompting the liquidity trap. This process went on for so long that the collapse that came in 2008 was, inevitably, enormous.

Skidelsky's penchant for broad generalizations and dubious factual assertions mars his chapters on the rise of counter-Keynesian economics. Robert Lucas, the advocate of rational expectations, is "a logical extremist" whose economics "invites the retort that one can always prevent depression by denying its existence." Skidelsky follows this with a denial of his own, referring to "[t]he long stagnation of the 1980s." And for their part, the "New Classical economists were not fazed by the unrealism of their assumptions; indeed, they regarded this as a strength of their models." Again and again, *Money and Government* fails the "ideological Turing test," which challenges us to present an idea we disagree with so completely and fairly that the exposition could just as easily have come from one of its adherents.

IT IS ALMOST WITH A SENSE OF RELIEF that the reader comes to *Money and Government's* final section, on the Great Recession of 2008-09 and its aftermath. It, however, contrives a new way to disappoint: Skidelsky concentrates almost entirely on David Cameron, the British prime minister from 2010-16, and his chancellor of the exchequer, George Osborne.

As of 2008, the United Kingdom was the fifth largest economy in the world, and a fifth the size of the United States in terms of output. It recovered from the crisis in mediocre fashion. It was, in a word, a sideshow to the main event. Nonetheless, Skidelsky can find in Britain the most dedicated pursuit of non-Keynesian policy. The Cameron-Osborne team displayed an aversion to budget deficits, government infrastructure and welfare projects, and public investment supplanting the private variety. And indeed, Skidelsky shows, British growth came in lower than that of the United States, by about 2.5% from 2007 to 2015, even if it did exceed that of the Eurozone.

The case about the Cameron government's priorities, if not their effects, is fair enough. But the Great Recession's main story was the precipitous collapse of America's housing market

and financial institutions, whose effects were felt globally. In concentrating on the British experience, Skidelsky appears to justify making only passing remarks about the role of "deregulation" in stoking the general crisis and the success President Obama had, not in launching a broad U.S. recovery but in merely preventing another Great Depression.

It is as if the focus on the British case removes the obligation to consider counter-arguments about the origins of the crisis. Was the cause of the recent liquidity trap (if there was such a thing) the rise of the new rich and the new inequality, along with major financial deregulation during the Great Moderation? Peter Wallison of the Congress's Financial Crisis Inquiry Commission disagrees. His painstaking *Hidden in Plain Sight* (2015) identifies a tremendous regulatory boom affecting the housing-finance industry as *the* cause of the bust. It is telling that among the few remarks Skidelsky makes on the origins of the housing bubble, he speaks of the new housing "subsidies" the United States began to offer in the 1990s and 2000s. Yet the new *regulations* requiring banks to make loans to the risky mortgage applicants they would otherwise have rejected *dwarfed* the new subsidies.

Money and Government ends with a rather random endorsement of tariffs, including a paean to Keynes's 1944 proposal for a global authority that would tax national trade surpluses if they exceeded a certain modest level. Skidelsky does not say it, but trade has always been Keynesianism's Achilles heel. As Robert A. Mundell, the first articulator of supply-side economics, recalled from his policy battles in the 1960s, the Keynesian policy he encountered "might have had some merits in a closed economy, but it was completely indefensible in an open economy." If a nation raises tax rates on the rich and takes over private investment opportunities, capital escapes to greener pastures offshore. The animal spirits of investors prove quite resilient. This phenomenon is itself sufficient to render *The General Theory of Employment, Interest, and Money* unworkable, if not incoherent.

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