

John Maynard Keynes

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It has become fashionable of late to invoke the memory of late British economist, John Maynard Keynes, as did Mark Carney recently, when referring to Keynes's 'Paradox of Thrift'. I was rather surprised when Carney quoted Keynes: central banks are notoriously known as being anti-Keynesian. Yet, recessions do make strange bedfellows, and desperate times call for desperate inspiration!

This said, there is considerable misunderstanding regarding Keynes, who is the most important economist and policy maker of the 20th century. This confusion led to his ideas being either ignored or labeled radical. Of course, nothing is further from the truth. Keynes was an admirer of market systems, but argued that they are prone to some inherent weaknesses that prevent us from growing. I would even go as far as to say that Keynes single-handedly saved the capitalist system from itself. There is no doubt that many policies followed in the aftermath of the 1929 depression were inspired by Keynes. Had governments not followed his policy advice, the world may have stayed in a depression for much longer. With the world heading toward another depression, as forewarned by Olivier Blanchard, the IMF's top economist, Keynes's policies must again be adopted.

But that was then and this is now. Are Keynes's ideas, published in 1936, still relevant today? After all, has the world not changed significantly since that time, making Keynes obsolete? Well the world has changed but the fundamental mechanics of how markets operate still remain the same, and Keynes's brilliant insights are perhaps even more relevant today than they ever were. Keynes gave us the tools we need to analyze a monetary economy, rather than a barter system upon which, sadly enough, many of the mainstream economic policies are still based, with the obvious disastrous effects they had. In a monetary economy of production, macroeconomic paradoxes are quite common: what is good for the individual may not be good for the economy as a whole, and Keynes warns us about not only the paradox of thrift, but also the paradox of debt, among others.

What then were Keynes's most insightful ideas that we can apply today. First, uncertainty is a dominant feature of our economic system: we 'simply do not know' the future, and it cannot be reduced to probabilities. As a result, it affects the behaviour of economic agents. Under uncertainty, agents can act with 'sudden bursts of optimism and pessimism'. Right now, banks, firms and households are certainly pessimistic about the future. Surveys of business or household confidence are a way of capturing this feeling. Indeed, this is particularly true in these trying times: it is the fact that we cannot tell what the future will look like that makes households, firms and banks want to save and hoard. Yet, this can only make things worse.

Second, Keynes argued that there were no built-in mechanisms to bring the economy out of recession: there is no 'invisible hand'. In fact, markets are prone to exuberant and often irrational behavior. This subprime mess is certainly proof of this. In the absence of these mechanisms, the economy must be managed: laissez-faire is an unrealistic assumption of how markets operate.

Third, the economy is strictly driven by demand: markets grow when agents consume, spend and invest. The more we spend, the more the economy grows. But when the demand falls, then it is incumbent on the government to spend on our behalf. This is one of Keynes's most fundamental policy conclusions. Currently, demand is not strong enough to get us out of recession, and given the acute uncertainty about the future, no one wants to spend. It is therefore the responsibility of governments to spend and pick up the slack. But there are two types of spending the government can do: day to day spending, which should usually be balanced, and infrastructure spending, which could be always in a deficit. This is because infrastructure spending is more of an investment in the future of the country. When governments spend, they inject much needed fiscal stimulus into the system, which finds itself in the hands of private agents, who begin to be less pessimistic about the future.

Fourth, our economies are credit-led or debt economies, and banks are at the heart of the growth process. Banks are never constrained by deposits, but they are constrained by the availability of good or creditworthy borrowers. For them to begin lending anew, they must find more creditworthy borrowers. Because of the unknown future, however, banks are so pessimistic about the possibility of borrowers repaying their loans: they are stop lending. When the government spends, however, it contributes at reducing the uncertainty about the future by increasing the demand for goods, thereby giving banks a reason to lend again.

Fifth, Keynes advocated a monetary policy aimed at euthanizing the rentier class. This implies a policy where interest rates are set close to zero. This has already happened in the United States and the Bank of Canada should do the same: the central bank can have the rate of interest of its choice, reminds us Keynes. This may stimulate investment, but also will make private debt loads easier to manage. Moreover, it will reduce debt payments on fiscal deficits, and make fiscal policy also more manageable.

It would appear therefore that Keynes's insights are relevant today as they were in 1936, and his policy prescriptions then are applicable to today. The government should therefore spend on infrastructure and not hesitate to accept the responsibility of governing. The central bank should also lower nominal rates to close to zero and leave them there for as long as possible.

Lastly, and more importantly, the policies of Keynes are not simply applicable to periods of recessions. They are a general blueprint to economic growth, even in times of prosperity. Keynes's description of capitalism operates in both good and bad times, and so his policies should be followed.