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THE ANTI-CRISIS THOUGHT OF JOHN MAYNARD KEYNES – THE END OF LAISSEZ-FAIRE

“No economist since World War II had such a strong influence on economic policies such as John Maynard Keynes. His theories are now the treasury of the common knowledge“

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1. J.M. KEYNES – A MAN, A SCHOLAR, A REVOLUTIONARY

John Maynard Keynes (1883-1946) was one of the most influential economists of the first half of the twentieth century. His theory of government to stimulate the economy through public spending and the tools of fiscal and monetary policy (An open letter ...) left an impact on the policy of “New Deal”, launched in the 30s by President Franklin D. Roosevelt in the United States. The crowning achievement of political and scientific life of Keynes was the creation of his magnum opus: “The General Theory of Employment, Interest and Money” (book published in 1936). Immutable fact remains that he did not produce in this work a clearly understood, compact economic theory, but in modern times is regarded as an icon of economics. “The General Theory ...” has many opponents, but the author of this paper agrees that “the Keynesian Revolution” is one of the most remarkable episodes in the history of economic thought: never – before or in after years – had there been such a rapid and mass “conversion” of economists to a new theory, never – either before or after – had

economists become supporters of a new theory so fast and in such large numbers. “Blaug, 2000, p. 681). Mark Blaug rightly notes that J.M. Keynes made an “attempt” on the unchanging faith in natural regenerative forces of the market mechanism. The Keynesian Revolution, therefore, meant an end to the dominance of the “laissez-faire doctrine.” (Blaug, 2000, p. 681).

Table 1
Selected events in the life of JM Keynes

1883	Cambridge, England – born.
1897	Started learning at Eaton – one of the most exclusive schools in England.
1902	Took the study of philosophy, history, mathematics and economics at King's College, Cambridge, his professors were, inter alia, A. Marshall and A. Pigou.
1906	Work in the Office of Indian Affairs.
1908	Cambridge, took up teaching positions of economics.
1911	Became editor of "Economic Journal, the most influential economic journals in Britain, he held this position until 1945.
1914	Advisor of the Ministry of the Treasury responsible for matters relating to the financing of war expenditure.
1919	"The Economic Consequences of the Peace".
1925	1925 – Marriage to Lydia Lopokova, ballet dancer.
1926	"The End of Laissez Faire".
1930	Curator of the National Gallery, manager of a financial King's College and the Sadler's Wells Ballet.
1936	" <i>The General Theory of Employment, Interest and Money</i> ".
1940	Member of Staff Advisers to Treasury.
1941	Director of the Bank of England.
1944	President of the British delegation to the Bretton Woods conference.
1946	Died of a heart attack.

Source: Lüchinger, R. (2007). *12 ikon ekonomii. Od Smitha do Stiglitz*, Warszawa: Wydawnictwo Studio Emka, p. 102; Stankiewicz, W. (2007). *Historia myśli ekonomicznej*, Warszawa: Polskie Wydawnictwo Ekonomiczne, p. 278

J.M. Keynes himself was a man who had the best education available for the English elite, which was assured to him by his father, John Neville Keynes (1852-1949), an employee of the university administration Cambridge (Hultberg, Hoppe, Rothbard, Salerno, 2004, pp. 5-26). John Neville was a student of Alfred Marshall and his friend. Father's influence and good contacts with eminent scientists of an excellent university, education at Eton and then at King's College enabled the young Keynes a perfect start, not only scientific but also political. At the University of Cambridge Keynes studied

mathematics, philosophy, history and economics, but he did not dedicate himself too much to an academic career. Initially, he was a state official, and in 1908 he became a lecturer at Cambridge (Stankiewicz, 2007, pp. 277-278) and then he was editor of the "Economic Journal" and subsequently held various advisory positions or senior positions in prominent government offices.

2. THE END OF LAISSEZ-FAIRE?

The policy of *laissez-faire* (*laissez faire, laissez passer*, from French – Allow the economy to develop, do not hinder) is the doctrine formulated by the French physiocrats whose most prominent representative was Francois Quesnay (1694-1774) (Stankiewicz 2007, p. 93 et seq.). It was most fully realized in the nineteenth-century England after the industrial revolution. It is a view which proclaims freedom of the individual, freedom of industry and free trade, bringing the role of the state to that of a night watchman and presents the human nature as selfish (the concept of *homo economicus*). Thanks to selfish actions of individuals the society derives collective benefit because a personal interest never stands in contradiction to the interest of the general public. The basis of the *laissez-faire* doctrine is a belief in the existence of a perfect market mechanism.

This idea was developed by Adam Smith in his work 'Inquiry into the Nature and Causes of the Wealth of Nations' (1776) which is considered the first systematic work in the field of economics, and its author the father of classical economics. According to Smith, 'the public welfare can be achieved only when everybody pursues a definite goal as well as they can.' (Kohler, 2007, p. 34). Thus, a liberal view lies at the heart of his work, and his metaphor of the invisible hand of the market (an automatic regulator of economic life) seems to be the most famous in the world, not only among economists.

In the pamphlet 'The End of Laissez-Faire' (1926) J.M. Keynes presented a brief historical review of the economic policy of *laissez-faire*. The author does not pay much attention to this thread, but what is worth mentioning is the comparison this great scholar had drawn to show similarities between Darwinism and the *laissez-faire* policy. Charles Darwin, as J.M. Keynes claims, referred to physical love, "acting" through sexual selection accompanied by natural selection, i.e. survival of the fittest. However, an individual refers to the love of money, he or she acts to pursue the goal of profits (Here, we can also speak of natural selection) which is accompanied by the production of what is most desired on the largest possible scale (in terms of the exchange value).

Keynes also noticed that the popularity, prestige and power of the *laissez-faire* policy were the result of the existence of obvious scientific deficiencies of two opposing alternatives – protectionism and Marxist socialism. He explained that it is not true

that individuals possess time-honored “natural liberty” in their economic activities. Hence, as he stated, it cannot be deduced from the principles of economics that enlightened personal interest is always in accordance with the public interest. He also noticed that it is not true that personal interest is generally enlightened. Experience does not show that individuals, acting collectively, are always less “caring” than when acting alone (Keynes, 1926).

J.M. Keynes believed that an ideal range of the organization and control system is somewhere between the individual and the modern state. He stated clearly that “the important thing for the government is not doing things which individuals are currently doing (better or worse), but doing what is not done at all.” So this means that he attributed auxiliary functions to the State, not the main center steering role. Joseph Salerno stated that Keynes had aimed at introducing changes in the technique of modern capitalism through collective action (Salerno, 2004, p. 190).

According to Keynes, the greatest economic evils of our time are fruits of risk, uncertainty and ignorance. It happens because individuals, by a happy coincidence or thanks to possessed skills, are able to derive material benefit from uncertainty or ignorance causing inequalities in wealth, and also because, for the same reasons, big business is a lottery. The same factors are the cause of unemployment.

Although he agreed with the principle that the market should be free from government intervention, he suggested that the government could play a constructive role in protecting individuals against the worst injury caused by economic fluctuations – the unemployment. When the Great Depression broke out a few years later, his work seemed far-sighted.

3. CRISIS? WHAT HAD KEYNES WRITTEN ABOUT?

The crisis forced economists and policymakers to review current views on methods of state economic policy. These changes are most associated with the name of JM Keynes (Skodlarski, Matera, 2004, p. 179) who strongly criticized the classical theory and created his own theory of the market in his work “The General Theory of Employment, Interest and Money.” Although Keynes believed deeply in economic liberalism, he noticed that capitalism with its free market was unable to ensure full utilization of productive factors or full employment. Keynes was not a socialist, but he wanted to save capitalism (Krugman, 2008, p. 16). In spite of the fact that some of Keynes's views could be reconciled with socialism, he gave clear expression of differences in his political sympathies (Wojtyna, 2000, p. 69).

Trying to place the achievements of J.M. Keynes in the history of economic thought, it seems that they can be described as a successful attempt to reconcile two opposing trends – optimistic and pessimistic. On the one hand, the theory of Adam Smith on the market as the coordinator of the activities of individual operators and

a tool of optimal allocation of resources, on the other hand, a socialist thought exposing contradictions of capitalism. Perhaps Keynes developed the most significant theory that skilfully reconciles these two contrasting traditions (Wojtyna, 2000, p. 68). Some economic historians define his theory as a theory of regulated capitalism (Starling, 2003, pp. 260-261). A. Szeworski in the foreword to the third Polish edition, in turn, defines his work as a primary catalyst of views on the role of market and state in the economic process.

In the first chapter of his greatest work this prominent economist of the twentieth century emphasized that his deliberations should be regarded as the juxtaposition of his views with classical thought. "I will try to prove that the postulates of classical theory cannot be applied in general, but only in a particular case, as the situation which it assumes is the extreme of many possible states of equilibrium." (Keynes, 2003, p. 5).

The phenomenon of cyclical changes in the economy is explained in Chapter 22 of his work. Keynes refers to the phenomenon of the crisis as the cyclical characteristics of the economy and stresses that the substitution of the downward trend for the upward trend (the economic situation is meant) usually occurs suddenly and violently, but there is no such an acute and violent course when the situation is reverse.

M. Blaug, an eminent economist, concludes that Keynes's most masterful pen can be read in the last three chapters of the "The General Theory", which is true in the opinion of the author of the study. Earlier in the article, it was mentioned that the general theory is a theory of the market, but it is worth noting that it is the market which is imperfect, which is often found in the phase of the crisis. Let us, therefore, make the starting point of the chapter of "The General Theory" containing remarks on the business cycle. Keynes recognizes that the business cycle is the result of cyclical changes in the marginal capital efficiency¹. He clearly emphasizes that the basic explanation of the crisis should be looked for in a sudden collapse of the marginal efficiency of capital and not in the growth in the interest rate. He also emphasizes that this collapse is usually accompanied by an increase in the interest rate and this, in turn, entails an even greater decline in investment. Keynes speaks point-blank of negative investment, i.e. investment in reserves. On subsequent pages he notes that the remedy for recovery are not high rates of interest but low interest rates because they can ensure the sustainability of the business cycle. According to him, too high rates of interest will not provide full employment. He also speaks of the circumstances of "being active on several fronts", i.e. that with a view to maintaining a socially-targeted investment rate leading to a gradual decline in the marginal efficiency of capital, he also supports all

¹ Marginal efficiency of capital depends on the abundance or scarcity of the existing, at a given moment, capital goods, on the current cost of production, on the predictions about the future income from capital goods.

kinds of political and economic efforts aimed at increasing the propensity to consume. (Keynes, 2003, p. 294). “We can expand investment and consumption at the same time, not only to such a level which, at the existing tendency towards consumption would correspond to increased investment, but even to a higher level.” (Keynes, 2003, p. 294). Keynes believed that under conditions of the laissez-faire economy it is impossible to avoid fluctuations in employment and therefore he held that the obligation to regulate the current size of investments cannot be left in private hands. (Keynes, 2003, p. 289).

The crowning achievement of Keynes's reasoning is identification of the defects in the socioeconomic system – the inability to achieve full employment and the arbitrary, unfair distribution of wealth.

If Keynes considers the insufficient demand for consumer and investment goods as the main cause of crisis, he also proposes numerous actions to prevent it. He speaks about the need for active fiscal and monetary policy (Godłów-Legiędź, 2009), e.g. about efforts to introduce such a system of direct taxes, which would burden more high incomes and inheritances (Keynes, 2003, p. 345), about the unemployment benefit – because the fluctuations in investment will be accompanied by much smaller fluctuations in employment. (Keynes, 2003, p. 109).

And finally, perhaps the most famous passages of his book: “For a man who was unemployed for a long time, work involves more pleasure than displeasure. (...) The above considerations explain how the “unproductive” expenditure covered from loans can (...) enrich society. Building of pyramids, earthquakes, even wars may contribute to increasing wealth (...). If the State Treasury stuffed banknotes into bottles and buried them in abandoned coal-pits at a depth within easy reach and filled those coal-pits with the garbage, and then left getting out of those notes (...) to private entrepreneurs (...), unemployment would be eliminated and, as a result, both the real income of society and their physical capital would probably achieve a considerably higher level than at present. (Keynes, 2003, p. 115). Keynes used to emphasize that hiring of the unemployed to do community work is especially important in times of serious crises, not when the economy is approaching full employment. (Keynes, 2003, p. 113).

Keynes believed that the conclusions of his theory are moderately conservative. He stressed the need for a central management in an area which is mainly the domain of private initiative, but at the same time, he also argued that many areas of economic activity is to remain unchanged. He believed that the state should foster the propensity to consume – partly by the tax system, partially by a banking policy. (Keynes, 2003, p. 345).

Shortly after J.M. Keynes's death P. Samuelson attempted to assess the significance of the “General Theory”. The author deliberately does not refer here to modern interpretations, considering that they are filled with many new thoughts, completely alien to Keynes. So what did P. Samuelson write? He admitted that at first he did not

understand completely what the great economist had written, but also conjectured that Keynes himself might not have understood his own analyses. He also noted that British economists outside Cambridge, for example Harrod, Meade (Oxford), quickly took over the “new spirit”. The new trend was supported by some “new blood” from the London School – researchers such as Kaldor, Lerner, Hicks, who had abandoned the “Hayek's system” (Samuelson, 1946, p. 188).

It had been wisely said, as Paul Samuelson wrote, that only in terms of the modern theory of effective demand can we understand and defend the so-called classical theory of unemployment. Last but not least, from a long-term perspective, the Keynesian analysis began to penetrate the basic textbooks. And so, as everyone knows, once an idea germinates, however incorrect it could be, it becomes almost immortal (Samuelson, 1946, pp. 188-189).

Modern interpretations of Keynes's deliberations refer to the so-called means of stimulating of the economy. The above-mentioned tools and instruments of state influence on the economy can be divided into direct and indirect, and in such form they are usually presented in academic textbooks. Thus, what Keynes wrote or said, is presented today as direct and indirect measures aimed at fuelling the economy (anti-crisis measures) and is divided into: the unemployment benefit, controlled inflation, lowering of the interest rate on savings, progressive taxation of high income, public works, and finally State control. All these tools can be considered as ways to prevent crises.

To sum up, his theory provided several arguments in favour of state intervention in the economy. Another problem is the question whether he was right? Do contemporary economists agree with Keynes?

4. FOR AND AGAINST KEYNES – POSITION OF DAVID COLANDER

To fully assess Keynes's work, it is worth referring to the discourse which includes an article by D. Colander, 1999 on the rightness of teaching the Keynesian theory (Colander, 1999, pp. 364-370). So what are the arguments in favour of abandoning the idea of teaching Keynes's thoughts? Colander arranges them as follows:

- Keynesian model is wrong if you treat it as a guide to economic policy. On its basis students are taught that a budget deficit contributes to economic growth and a budget surplus causes it to shrink. Colander gave the example of the 90s concerning the U.S. economy which grew despite the budget deficit. He suggested, therefore, that Keynes's model should be abandoned and long-term relationship between deficit, interest rates and economic growth be examined. We need to highlight that the budget deficit has little influence on economic growth.
- The multiplier effect is empirically not too large, hence the Keynesian multiplier model is almost useless.

- In the long run, the economy oscillates by itself around natural equilibrium growth rate and is not unstable, as is suggested by the Keynesian model.

After presenting the negative arguments there appear to be positive comments in favour of preserving Keynes' thoughts:

- Keynesian model is wrong if you treat it as a guide to policy but interpreting this model, you will discover that Keynes did not state at all that government spending (deficit) always contributes to economic growth. In the general theory there is nowhere to be found that a deficit is necessary to keep the economy moving. Keynes defied deficits. He believed that a deficit may only occasionally be useful.
- The interpretation model of Keynes can be considered as a model which simply suggests the directions and effects of adopted policy; it is more like intellectual exercise, not the economic model.
- Economists do not know what the natural rate of unemployment, inflation, etc. is.

In later sections of his study Colander stated that he was in favour of preserving Keynesian economics but, of course, after subjecting it to a critical analysis. He summarized his deliberations by drawing a conclusion that students should have the knowledge that leaving everything to the market is a historical, not a theoretical argument. It is based on the importance of government failures, not the absence of market imperfections.

However, in the summary he quoted Keynes's statement that economic theory is a method rather than doctrine, it is the mental apparatus, a technique of thinking which helps its owners to draw the right conclusions.

Keynes was a virtuoso of the economy. Despite many critics, even from the mainstream of the Austrian school of economics (with outstanding representatives – F. von Hayekiem and L. von Mises, and Murray Rothbard (Hultberg, Hoppe, Rothbard, Salerno, 2004)), from the monetaristic trend with M. Friedman and others, it seems that he is still present in the minds of politicians and economists who influence the fate of the economies in which they live, create and govern.

In 1946, P. Samuelson wrote: *“Here lies the secret of the General Theory. The book is poorly written, poorly constructed, (...) arrogant, grunted, polemic (...), there are plenty of worthless and confusable discoveries in it. Keynesian system looks very vaguely here (...). Sparkles of deep thinking and intuition are accompanied by tedious algebra. After the unfortunate definition suddenly there is an unforgettable brilliant development. When we finally reach the end of this book, we find that the analysis contained in it is obvious, yet innovative. In short, this is a work of genius.”* (Samuleson, 1946, p. 190, Blaug, 2000). Let this quotation be used for assessing the talent and contributions of this great thinker in the development of economic theory and economic policy.

J.M. Keynes is to be regarded as a great economist who had filled a gap in the classical theory. He was able to extend the traditional functions of government. He believed that the state is the only measure that makes it possible to avoid destruction of capitalist forms of the economy and a *sine qua non* for successful operation of private initiative. (Keynes, 2003, p. 348).

In conclusion, it is worth adding that the crisis of the modern economy (the first decade of the 21st century) shows that there is no move away from Keynes. However, what is important is not to develop a real sphere but a regulative sphere of a government, namely optimal scale of taxation, effective interest rates, a system of constitutional and legal order, so as to be able to inhibit the animal instincts of human nature, pushing to make harmful and too risky decisions (Shiller, 2009, p. 6).

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