

6. Keynes, Keynesians and Critics

No analysis of the present state of the world and of the development of economic philosophy, of which it is a consequence, can avoid appropriate attention to the phenomenon of John Maynard Keynes and the shiny new spanner he threw into the creaking economic machinery of his day.

But for the fact that so many professional economists and economic journalists continue to advocate the unscientific pragmatism which goes by the name of Keynesianism in attempts to solve so-called 'economic problems' today,¹ there would be little value in subjecting it to serious examination. The disastrous consequences of the Keynesian intervention are only too plainly apparent to any thinker not seduced by Keynes' rhetoric and pseudo-mathematical abracadabra, or aware of the fundamental errors with which his major contribution to modern economic thought, *The General Theory of Employment, Interest and Money*² abounds. Fortunately, the task has been simplified for us by the work of two eminent living economists, Henry Hazlitt, in his *The Failure of the New Economics*³, and Professor W. H. Hutt: *Keynesianism – Retrospect and Prospect*⁴.

Hazlitt's work is a thoroughgoing taking-apart of *The General Theory* (which he demonstrates to be a *special* and not a general theory at all) chapter by chapter, exposing in the process the utter barrenness of Keynes' contribution, his inconsistencies and his shocking ignorance of basic principles, which in turn reflects on the quality of the thinking of all those who have fallen under the spell of his pseudo-doctrine and have misled politicians and public servants into policies which today are bearing such disastrous fruit.

In his introduction to *The Failure* — Hazlitt displays examples of the extravagant praise heaped upon Keynes by eminent economists, astonishing in the light of Hazlitt's devastating exposure of the 'Master's' fallacies. For instance, the *London Times* in its obituary said: "To find an economist of comparable influence one would have to go back to Adam Smith." Professor Alvin H. Hansen, of Harvard, wrote: "There are few who would deny, as of now, seventeen years later, that the book has had a greater impact on economic analysis and policy even in this short time than any book since Ricardo's *Political Economy*. It may be a little too early to claim that, along with Darwin's *Origin of Species* and Karl Marx's *Das Kapital*, the *General Theory* is one of the most significant books which have appeared in the last hundred years . . .". Professor Paul A. Samuelson, 1970 Nobel Prize-winner in Economics, after detailing the book's faults, describes it as

“a work of genius”. R. F. Harrod, Keynes’ biographer, said “He seems to my judgement to stand rather in the same class as Adam Smith and Ricardo.” Professor Dudley Dillard, of the University of Maryland, said: “Like Adam Smith’s *Wealth of Nations* in the 18th century and Karl Marx’s *Capital* in the 19th century, Keynes’ *General Theory* has been the centre of controversy among both professional and non-professional writers. Smith’s book is a ringing challenge to mercantilism, Marx’s book is a searching criticism of capitalism. Keynes’ book is a repudiation of the foundations of laissez faire . . .”. And, significantly, G. D. H. Cole, the well-known British Socialist economist, called the book “the most important theoretical economic writing since Marx’s *Capital*, or, if only classical economics is to be considered as comparable, since Ricardo’s *Principles* . . . What he has done, triumphantly and conclusively, is to demonstrate the falsity, even from a capitalist standpoint, of the most cherished practical ‘morals’ of the orthodox economists and to construct an alternative theory of the working of capitalist enterprise so clearly nearer to the facts that it will be impossible for it to be ignored or set aside.”⁵

Acknowledging, with B. M. Anderson, that “there has arisen a volume of theoretical literature regarding Keynes almost equal to that which has arisen around Karl Marx”, Hazlitt says “About the *General Theory* there is a strange paradox. The Keynesian literature has grown to hundreds of books and thousands of articles . . . But on the critical side there is a dearth. The non-Keynesians have contented themselves either with short articles, a few pathetic pages, or a curt dismissal on the theory that his work will crumble from its own contradictions and will soon be forgotten.” No one, he says, had up to then, undertaken a criticism in depth;⁶ a task which he does with great thoroughness in his *The Failure of the New Economics*.

The remarkable and satisfying fact about Hazlitt’s critique is that it is written with such clarity and precision that, while it is done for the benefit mainly of the professional economist, it is easily comprehensible by the intelligent layman desirous of understanding the nature of Keynes’s influence on economic thought and its effect on policies of governments throughout the Western World. In this alone he performs a great service, for undoubtedly Keynes’s own book is written in such tortuous language and riddled with so many obscurities, quite apart from its profusion of useless and merley confusing mathematical formulae, that it has given birth to the voluminous ‘interpretative’ literature described by Hazlitt, on which the layman had previously to depend for a grasp of the subject.

As for Hazlitt’s detailed dissection of Keynes’ book, it is unnecessary to discuss this here in other than general terms. The student not already acquainted with it should repair this lack without delay by reading it. Examination is here confined to Hazlitt’s own proposition that economic equilibrium depends on the flexibility of prices and wage rates, that inflation is created and maintained by the policy of deficit budgeting and the practice

of issuing money to counteract the rigidity of prices and wage-rates, that is to say by maintaining the inflationary (upward) spiral, and that government spending should be reduced to the minimum required to sustain such essential public services as the judiciary and the armed forces of defence. He rejects Keynes' theory of interest as being contrary to the facts, and consequently refutes the idea that interest, *per se*, is a major factor in unemployment; and he shows clearly that Keynes' whole thesis — of the need for state control of interest rates, investment and exchange rates — is simply applied socialism. (He describes the *General Theory* as The 20th Century '*Das Kapital*'.)

Before proceeding to consider Hazlitt's main contention, that equilibrium is solely dependent on the total flexibility of prices and wage-rates, it is desirable to refer to that other important critic, Professor W. H. Hutt, whose analysis of the Keynesian mythology is embodied in his scholarly work *Keynesianism – Retrospect and Prospect*, described by the author as "A critical re-statement of basic economic principles" which gives an important clue to the nature of the professor's attitude to Keynesian theory. This is set out clearly in the opening sentences of his preface to the book: "This work is put forward as a positive contribution to economics. It sets out to re-state some of the essentials of 'orthodox' or 'classical' economic teachings in a form which is intended to become appropriate for *contemporary controversies* (our italics). To do this effectively, it is necessary simultaneously to explore the erroneous foundation on which Keynesian economics has been based . . . The economic theory which has been founded on Keynes' *speculations* may be said, not unfairly, to constitute the economics which is expounded in most modern textbooks" (italics ours).⁷

Although his analysis of the *General Theory* and the system of economics which has grown up around Keynes's name by the work of his 'disciples' differs in method and style from Hazlitt's, Hutt's general conclusions are practically identical with the latter's. Like Hazlitt, he discusses the main propositions of which the *General Theory* is composed — e.g., 'The Marginal Efficiency of Capital', the 'Propensity to Consume', the 'Multiplier', 'Capital Saturation' and Keynes' preoccupation with macro-economics — the 'National Income', the 'G.N.P.', the 'Price Level', et al., — and exposes the sophistries with which the *general theory* and Keynesianism as a whole, abounds. Like Hazlitt, he devotes appropriate attention to Say's Law of the Market⁸, and shows how Keynes' attempt to disprove this succeeds only in exposing his own purblindness.

Hutt's masterly treatment of a leading postulate of Keynesian doctrine — the 'Propensity to Consume' — is well displayed in the following passage:

"If the distinction between ends and means is clearly perceived, we can think of the people expressing preferences respecting ends for which the means are scarce (by buying or refraining from buying different quantities

of different things in the market) as exercising 'consumer sovereignty'. But, in his justification of Keynesian doctrine, Dillard (a leading, enthusiastic exponent of Keynesianism) says that 'it is pure euphemism to say that consumption is the ultimate purpose of production.' It is, he says, 'the expectation of being able to convert real goods into money at a profit' which 'is the significant motivation'. Yet the entrepreneur who (i) predicts successfully the nature and scale of the demands of those who exercise consumer preference, and (ii) achieves the least-cost method of responding to those preferences, is always in the last resort an interpreter of consumer preference. And he is rewarded by profits when his interpretation is wise or lucky (just as he is penalised by losses when he is unwise or unlucky). Is it not obvious that, merely because entrepreneurial predictions and calculations are made in terms of money values, we are not forced to a monetary theory of output?" Curiously enough, he goes on, "Dillard's use of the words 'at a profit' ought to have led him to see that conversion into money has nothing to do with the matter. It is almost always possible to convert any product into money *at some price*; but the ability to do so does not mean that the type of good produced has been a profitable choice. It is profit, not the acquisition of money, which is the proof of successful prediction."⁹

But perhaps the most potent condemnation of this whole hybrid, pseudo-revolutionary thesis is, as Hutt puts it in the summary of his Chapter III, (The Consequences of the Keynesian Remedy), that "it demands the continuous deception of the public" and "It transfers power from society to the politicians." He concludes this summary as follows:

"Bronfenbrenner seems to welcome Keynesian policy because it is, he says, succeeding (through secular inflation) in achieving the ends for which Marx was striving. But this trend may be reversed through current bitter experience; and through the rise of 'defence groups' demanding (i) resistance to the pressure groups and (ii) the permanent cessation of inflation."

Which is a pretty accurate prediction of the state of affairs confronting Western economies at the present time, of which the state of war between the miners' union and the government in Great Britain at the beginning of 1974 was a terrifying example.

Tempting as it is to extract similar passages from both of these important works in exposing the fundamental errors of Keynesianism, and of the damaging consequences of their perpetration during the past forty years,¹⁰ it is essential, in pursuance of the central theme of this present book, to consider now an important omission from the arguments of both these authors which indicates either a remarkable lack in themselves of basic economic principles or a deliberate act of exclusion under a compulsion to support an existing institution. This omission is the failure to discuss in any way the other vital factor in the distribution of wealth — rent, the 'return to

land';¹¹ indeed, the term does not even appear in the index of either of the books. Even the term land, which appears once¹² in a brief and question-begging way in Hazlitt's work is ignored by Hutt.

To say the least, it is a remarkable omission from any discussion of the factors essential to the achieving of economic equilibrium. Indeed, as the main purpose of this present work is to demonstrate, economic equilibrium is *impossible* as long as the existing system continues, in which the *economic rent* is considered to be a legitimate return to the individual or corporate owner of a site instead of to the whole society.

Apart from the fundamental error in his assumption that land is capital¹³ — an error he shares with a distinguished group of modern writers in economics, too numerous to mention¹⁴ which invalidates much of his argument with Keynes over the nature of interest, Hazlitt confines his concept of inflation to that of arbitrary control by governments of the supply of money, ignoring (except in his condemnation of much current government expenditure) the role of taxation. He proceeds from this incomplete analysis to define the cause of the inflationary spiral as the inflexibility of prices and wage-rates with the weight of his argument on the rigidity (downward) of the latter, so that the villain in his drama is the labour union leader.¹⁵ It can only be assumed that, to achieve the desired economic equilibrium, he would favour attempts to break the vicious circle by expedients already tried and proved futile by the governments of the United States, Great Britain, Australia and New Zealand to control both prices and incomes.

Turning to Professor Hutt, his attitude on the responsibility of the union for the continuance of the 'wage-price spiral' is exemplified in the following passage of his book:

“. . .the operation of the so-called 'money illusion' as a factor determining the behaviour of the trade-unions has been rapidly changing. Both the rank and file and their leaders are today only too aware that the maintenance of money wage-rates does not mean the maintenance of standards. The tendency is, rather, more and more to attempt to push up money wage-rates *in advance* of the continuing rise in the prices of final products. . . . Union leaders are encouraged to claim credit and even compete against one another in securing sensational increases. They soon emerge as the most powerful vested interest against any policy which might aim at bringing inflation to an end. And is it surprising that eventually they come to insist upon wage contracts being concluded in terms of escalator clauses?¹⁶

This contention is supported by the report of an interview conducted by the Australian *National Times* with John Halfpenny, Victorian State Secretary of the Amalgamated Metal Workers Union, who, in answer to the question "In the present inflationary situation will your union continue to press for large wage gains? . . ." said: "Of course we will

because it is the only weapon that workers have to offset the disastrous effect that inflation has upon their standard of living . . .” And to the question: “Would your attitude to wage claims alter if prices were strictly controlled?” He said: “Our attitude to wage claims or wage increases wouldn’t alter because to suggest that if wages (?) were controlled or stabilised or that they ought to be stabilised or controlled to a greater extent suggests again that the present distribution of wealth is fair and reasonable, and of course it isn’t . . . There are all sorts of other reasons for wage demands which are not directly related to prices.”¹⁷

It is natural that those members of the public who suffer from the immediate consequences of such policies as these should bitterly resent the fact that they are held to ransom by the ‘selfish’ unions. Thus the divisions already existing in society tend to deepen and widen until the frustrations become unbearable and a state resembling civil war emerges.

As a cure for this anarchic situation both Hazlitt and Hutt offer the specific of cessation of currency inflation and enforced price and wage-rate flexibility. The contention of this present work is that, desirable, even essential, as these steps are in restoring a true balance to the economy — and supposing they could be brought about, which is doubtful without inducing a state of *actual* civil war, *they are not in themselves sufficient*: that, in fact, the ‘most radical change’ which Hutt says will be necessary¹⁸ will have to be more radical and more profound before the desired equilibrium is achieved. For the consuming public are at present held to ransom not merely by the striking union deliberately choosing a time and situation most likely to create the greatest public inconvenience, even damage, to secure its immediate goal; but by a fundamental condition of the system itself which guarantees a permanent imbalance of which the phenomenon of continuing poverty in the midst of plenty — in a state of alleged, but chimerical, affluence — is the inevitable sign and consequence.

As Henry George demonstrated in his *The Science of Political Economy*¹⁹ — the universal ignoring of which by professional economists can only be seen as evidence of a conspiracy to suppress it — the existing economic system inevitably maintains the return to labour at around the level of subsistence, relative improvements in wage-rates achieved by industrial blackmail notwithstanding. This is so because of the diversion of the *economic rent* into the channels of private income instead of public revenue, necessitating the institution of taxation of private income and wealth as a poor and inequitable substitute, with its permanent ill-effects on production costs and its increasing tendency to spread the growth of bureaucracy and of political power.

Later stages of this book will be devoted to the detailed exposition of this proposition. Before reaching this point, however, it is necessary to take a stage further the examination of modern economic teaching and practice in

order to test the validity of its dicta in the light of contemporary events and of the basic principles of political economy.

NOTES ON CHAPTER 6

1. As an indication of the pathetic state of confusion into which modern economics has fallen, nothing could better serve than an article by a contemporary economics journalist, Christopher Jay, which appeared in the *Australian Financial Review* of 7.12.73 entitled: "Come Back John Maynard Keynes — 33 Economists Need You!" The article begins: "Dear J.M.K. — with the publication of the *General Theory* in 1936 you led the world out of the wilderness of the Great Depression and into the promised land to stop the milk and honey slopping all over the place and setting off endemic inflation." Jay then lists the names of the 33 economists "split down the middle" as he puts it, on the question of whether or not to support the Australian Federal Government's referendum on power to control prices and wages. The article concludes with the words: "Whichever side one is on, it is obvious that consensus on inflation is eluding the economics profession."
2. J. M. KEYNES: *The General Theory of Employment, Interest and Money*; Macmillan & Co. Ltd., London, 1936. (innumerable reprints).
3. HENRY HAZLITT: *The Failure of the New Economics*; D. Van Nordstrand & Company Inc., Princeton, N.J. 1959.
4. W. H. HUTT: *Keynesianism — Retrospect and Prospect*; Henry Regnery Company, Chicago, 1963.
5. References for all the foregoing quotations are given by Hazlitt in his Introduction to the 1959 edition of *The Failure*.
6. Professor Hutt's book appeared shortly after Hazlitt's own.
7. See *Economics*, Samuelson, Hancock and Wallace (Australian edition), 1970, discussed in chapter 7 of this present work.
8. As Hutt expresses it: "The supply of wanted things is the source of demand for wanted things."
9. *Keynesianism — Retrospect and Prospect*, chap. II 'The Nature of the Keynesian Thesis' (10) P 31.
10. See *Keynesianism* —: the passage beginning (9) "The harm wrought to mankind. . ." chap. XIII, p 404.
11. RENT — properly so-named by economists to distinguish it from those rewards which are derived in the market by productive investors of labour and capital — may be more accurately described as the avenue through which non-producing 'investors' in land are enabled to acquire an increasing share of the national product.
12. *The Failure* —: chap. XVII, p 247: "The next thing to notice, in the passage I have quoted from p 242 (of the *General Theory*) is that, after greatly underestimating the existing amount of world capital accumulation, Keynes speaks of the 'high liquidity premiums formerly attaching to the ownership of land.' Now, no doubt in the pre-capitalistic period land-ownership represented usually the chief form of wealth-ownership. But how Keynes figures that land ever bore a 'liquidity premium' is a mystery. Land is proverbially, and has nearly always been, probably the most *illiquid* possession that a man could hold. It was usually much more *illiquid* in the past than it is today when its liquidity is for all practical purposes greatly increased by numerous real estate agents, by newspaper advertising, and by an organised mortgage market. It has become less illiquid with the development of capitalism; for in the pre-capitalist period land was usually inherited and commonly entailed."
13. Ibid.
14. e.g. *Economics* (Aust ed): Samuelson, Hancock and Wallace; references to 'capital'.
15. GALBRAITH'S VERSION IS: "In the inflation drama it remains only to introduce Hamlet. That, by common consent, is the union. It is the instigator presumptive of that most familiar of economic phenomena, the wage-price spiral." (*The Affluent Society*, Pelican ed: p 182.)
16. *Keynesianism — Retrospect and Prospect*: p 415.
17. *National Times* (Sydney): Nov. 26/Dec. 1, 1973.
18. *Keynesianism*: p 416.
19. Henry George: *The Science of Political Economy*, Schalkenbach edtn. 1962.