***Why keep repeating mistakes about Keynes?***

In a recent comment in *The Australian* of August 26 2009, Mr Tony Makin wonders why we keep repeating Keynes’s mistakes on economic policy.

A careful reading of Mr Makin’s piece reveals, however, that instead of exposing Mr Keynes’s mistakes, Mr Makin recycles errors and misconceptions about Keynes’s economics and policy that were common in the 1970s.

Recycling these solecisms about Keynes makes a mockery of the history of economic analysis.

At least three critical flaws can be identified in Makin’s comment. These claims are:

1. That Keynes’s analysis rests on the assumption of rigid money wages.

2. That this rigid wage assumption is the basis for Keynes’s theory of fiscal policy.

3. That Keynes was an exponent of central planning.

All these claims are false.

Claims 1 and 2 are embedded in Makin’s statement that a “… critical assumption of Keynes’s 1936 work [*The General Theory*] was that wages were inflexible downwards. While rigid wages were necessary to make Keynesian fiscal policy work in theory, this assumption is now less relevant in practice”.

As any Keynes scholar should know, this caricature of Keynes’s analysis is patent nonsense. It has long been conceded, at least since the 1970s, that Keynes’s analysis does not rest on the assumption of rigid wages.

To see this is so simply examine chapter 19 of *The General Theory* titled, “Changes in Money Wages” which opens with the following paragraph:

“It would have been an advantage if the effects of a change in money-wages could have been discussed in an earlier chapter. For the classical theory has been accustomed to rest the supposedly self-adjusting character of the economic system on assumed fluidity of money-wages; and when there is rigidity, to lay on this rigidity the blame for maladjustment.”

Clearly, Keynes explains in plain English that wage rigidity is the source of unemployment in classical theory. He then proceeds in chapter 19 to explain why, in terms of his general theory, flexible wages would not in general restore full employment as claimed by classical economists; they might succeed in doing so under special circumstances. Keynes concludes:

“There is, therefore, no ground for the belief that a flexible wage policy is capable of maintaining a state of continuous full employment…”

Consequently, what Makin describes as Keynes’s theory of fiscal policy is better described as the classical prescription of public works. Indeed, economists at Chicago, Harvard, Cambridge and Oxford, cognisant of the fact that flexible wages and prices were not restoring full employment, supported such policy proposals in the 1930s Depression.

To understand these issues it is necessary to understand Keynes’s general theory.

To put it simply, Keynes’s general theory explains why *laissez faire* economies can fluctuate for decades about a level of activity too low to ensure full employment and why flexibility of wages and prices cannot in general improve on that outcome.

Keynes then makes two policy proposals in the *General Theory* that follow directly from his theory.

As Mr Makin correctly notes, Keynes did indeed advocate the ‘socialization of investment’ but he also advocated the abandonment of gold and the nationalisation of the Bank of England, implemented in 1946. That is, he also recommended the ‘socialization’ of monetary policy.

Keynes’s two-pronged policy proposal was aimed at ensuring that the classical equilibrium level of economic activity occurred closer to the full employment potential.

The “socialization” of monetary policy was aimed at escaping from the clutches of that barbarous relic – gold – so the Bank of England could keep interest rates ‘low’.

The “socialization’ of investment was intended to stabilize aggregate expenditure and “crowd-in” private sector investment by reducing the level of uncertainty facing the private sector in a *laissez faire* economy.

Thus there is no substance to Makin’s claim 3 that refers to “…..Keynes’s central planning approach”.

Is Mr Makin suggesting that Australia’s ‘socialization’ of monetary policy, which began with the creation of the Reserve Bank of Australia in 1959, an element of ‘central planning’?

On the contrary, Keynes’s policy proposals were intended to restore confidence in capitalism by converting it from its *laissez faire* and unsustainable form to a form of managed capitalism that we have, more or less, experienced since WWII.

Thus, again contra Makin, Keynes’s policy proposals have been a remarkable success even though some economists, politicians and policy makers may have lost sight of his general theory.

Colin Rogers

School of Economics

University of Adelaide, 27/08/2009