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An Autopsy for the Keynesians

We were warned that the 2013 sequester meant a recession. Instead, unemployment came down faster than expected.

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This year the tide changed in the economy. Growth seems finally to be returning. The tide also changed in economic ideas. The brief resurgence of traditional Keynesian ideas is washing away from the world of economic policy.

No government is remotely likely to spend trillions of dollars or euros in the name of “stimulus,” financed by blowout borrowing. The euro is intact: Even the Greeks and Italians, after six years of advice that their problems can be solved with one more devaluation and inflation, are sticking with the euro and addressing—however slowly—structural “supply” problems instead.

U.K. Chancellor of the Exchequer George Osborne [wrote](#) in these pages Dec. 14 that Keynesians wanting more spending and more borrowing “were wrong in the recovery, and they are wrong now.” The land of John Maynard Keynes and Adam Smith is going with Smith.

Why? In part, because even in economics, you can’t be wrong too many times in a row.

Keynesians told us that once interest rates got stuck at or near zero, economies would fall into a deflationary spiral. Deflation would lower demand, causing more deflation, and so on.

It never happened. Zero interest rates and low inflation turn out to be quite a stable state, even in Japan. Yes, Japan is growing more slowly than one might wish, but with 3.5% unemployment and no deflationary spiral, it’s hard to blame slow growth on lack of “demand.”

Our first big stimulus fell flat, leaving Keynesians to argue that the recession would have been worse otherwise. George Washington’s doctors probably argued that if they hadn’t bled him, he would have died faster.

With the 2013 sequester, Keynesians warned that reduced spending and the end of 99-week unemployment benefits would drive the economy back to recession. Instead, unemployment came down faster than expected, and growth returned, albeit modestly. The story is similar in the U.K.

These are only the latest failures. Keynesians forecast depression with the end of World War II spending. The U.S. got a boom. The Phillips curve failed to understand inflation in the 1970s and its quick end in the 1980s, and disappeared in our recession as unemployment soared with steady inflation.

Still, facts and experience are seldom decisive in economics. Maybe Washington's doctors are right. There are always confounding influences. Logic matters too. And illogic hurts. Keynesian ideas are also ebbing from policy as sensible people understand how much topsy-turvy magical thinking they require.

Hurricanes are good, rising oil prices are good, and ATMs are bad, we were advised: Destroying capital, lower productivity and costly oil will raise inflation and occasion government spending, which will stimulate output. Though Japan's tsunami and oil shock gave it neither inflation nor stimulus, worriers are warning that the current oil price decline, a boon in the past, will kick off the dreaded deflationary spiral this time.

I suspect policy makers heard this, and said to themselves "That's how you think the world works? Really?" And stopped listening to such policy advice.

Keynesians tell us not to worry about huge debts, or to default or inflate them away (but please, call it "restructuring" or "repairing balance sheets"). Even the Obama administration has ignored that advice, promising long-run solutions to the debt problem from day one. Europeans have centuries of memories of what happens to governments that don't pay debts, or who need to borrow for a new emergency but have stiffed their creditors once too often. More debt? Nein danke!

In Keynesian models, government spending stimulates even if totally wasted. Pay people to dig ditches and fill them up again. By Keynesian logic, fraud is good; thieves have notoriously high marginal propensities to consume. That's a hard sell, so stimulus is routinely dressed in "infrastructure" clothes. Clever. How can anyone who hit a pothole complain about infrastructure spending?

But people feel they've been had when they discover that the economics is about wasted spending, and infrastructure was a veneer to get the bill passed. And they smell a rat when they hear economic arguments shaded for partisan politics.

Stimulus advocates: Can you bring yourselves to say that the Keystone XL pipeline, LNG export terminals, nuclear power plants and dams are infrastructure? Can you bring yourselves to mention that the Environmental Protection Agency makes it nearly impossible to build anything in the U.S.? How can you assure us that infrastructure does not mean "crony boondoggle," or high-speed trains to nowhere?

Now you like roads and bridges. Where were you during decades of opposition to every new road on grounds that they only encouraged suburban "sprawl"? If you repeat in your textbooks how defense spending saved the economy in World War II, why do you support defense

cutbacks today? Why is “infrastructure” spending abstract or anecdotal, not a plan for actual, valuable, concrete projects that someone might object to?

Keynesians tell us that “sticky wages” are the big underlying economic problem. But why do they just repeat this story to justify inflation and stimulus? Why do they not advocate policies to undo minimum wages, labor laws, occupational licenses and other regulations that make wages stickier?

Inequality was fashionable this year. But no government in the foreseeable future is going to enact punitive wealth taxes. Europe’s first stab at “austerity” tried big taxes on the wealthy, meaning on those likely to invest, start businesses or hire people. Burned once, Europe is moving in the opposite direction. Magical thinking—that, contrary to centuries of experience, massive taxation and government control of incomes will lead to growth, prosperity and social peace—is moving back to the salons.

Yes, there is plenty wrong and plenty to worry about. Growth is too slow, and not enough people are working. Even supporters acknowledge that Dodd-Frank and ObamaCare are a mess. Too many people on the bottom are stuck in terrible education, jobless poverty, and a dysfunctional criminal justice system. But the policy world has abandoned the notion that we can solve our problems with blowout borrowing, wasted spending, inflation, default and high taxes. The policy world is facing the tough tradeoffs that centuries of experience have taught us, not wishing them away.

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