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RAHN: Incorrigible Keynesians

Theory’s founder would denounce policies associated with his name

By Richard W. Rahn
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Imagine that you have a serious drinking problem, which has caused your job performance to decline. If your doctor said to you, "Don't stop drinking now, because going sober may cause you discomfort and may not immediately improve your job performance" - while failing to tell you that if you keep drinking, you will become totally dysfunctional and may die - what would you think of your doctor?

The U.S. government has a serious overspending problem. If the spending and the resulting deficits are not soon stopped, the U.S. economy will become dysfunctional, and our prosperity and freedoms will disappear. Despite the overwhelming evidence that the government is headed for a debt crisis, there are still a few economists who are saying: "Spend more." Last week, one of the "spend more" crowd, Mark Zandi ofMoody's, made the absurd claim that the attempt by the Republicans to cut the budget by approximately $60 billion (or less than 2 percent of total federal spending) would result in 700,000 lost jobs. The Democrats and their media allies, of course, jumped on the opportunity Mr. Zandigave them as their latest excuse not to reduce spending. Instead, they have proposed cutting the budget by one quarter of 1 percent.

Economists like Mr. Zandi, and the notoriously irresponsible Paul Krugman of the New York Times, who demand massive new government spending, are unreconstructed Keynesians who cling to totally discredited ideas, which, time and time again, have been shown not to work. When I was a doctoral student at Columbia University, I, too, was taught the Keynesian orthodoxy of the time. But when the great stagflation of the 1970s set in, it was obvious that what was in the textbooks did not fit the real world in which I was living. Up to that time, I had little knowledge of the Austrian (led by F.A. Hayek) and Chicago (led by Milton Friedman) schools of economics. But I soon realized thatHayek, Friedman and their colleagues had a much better understanding and explanation of the real world. The Keynesian ideas work in theory, but not in practice; but the Austrians and Chicagoans have ideas that both work in theory and practice - as demonstrated by Ronald Reagan, Margaret Thatcher and many others around the globe.

The Keynesians' basic argument is that if the government increases spending during a downturn, it can employ people who are not working and the additional spending will have a "multiplier" effect throughout the economy. This can be true only if the new spending does not replace more productive private-sector spending and even more productive government spending, and uses the personal and business savings more productively than private parties would. But in the real world, most government spending is far less productive than private spending. For example, the Government Accountability Office (GAO) has just released a report showing hundreds of redundant and duplicative government spending programs - hence, the forecasted multiplier effects never occur. Because the multipliers are not there, the Keynesians never reach their promised land of full employment so they are reduced to crying for more and more government spending without end.

The Keynesians have a consistent track record of failure. During the 1930s, government spending was greatly increased, yet the economy stayed in depression and the private economy revived only after the end of World War II when government spending was radically reduced. The Keynesians said this would renew the Depression - but they were wrong. They were wrong again in the 1970s when they said stagflation could not occur and the early 1980s when they said the Reagan supply-side program could not work. Mr. Zandi, Mr. Krugman and the rest were wrong when they said the Obama stimulus program would keep the unemployment rate below 8 percent. The only reason they are now trotted out is they give the big-government people an excuse to spend other people's money. How sad.

John B. Taylor of Stanford University, a most-respected and responsible economist and former undersecretary of the Treasury and member of the President's Council of Economic Advisers, correctly noted that "[n]othing could be more contrary to basic economics and experience and facts" than the claim by Mr. Zandi and the others that reducing federal spending will reduce economic growth.

In the real world, any increase in government spending is going to further worsen the debt/gross domestic product ratio, meaning debt service will become more and more costly, eventually reaching a point when it is unsustainable - which is what happened to Greece. Government bondholders are going to demand higher and higher interest rates at some point because of the increased risk of default and/or inflation. Governments normally default on their debts (i.e., cheat the bondholders) by inflating the currency by printing money or not paying all the interest due and extending the date of payback. The United States is fast reaching the point of unsustainability - hence there is no real choice but to greatly reduce government spending.

Although he got many things wrong, John Maynard Keynes understood the problem of too much debt, which is why he advocated balancing the budget over the business cycle.If

Keynes were alive today, would he associate himself with the modern day Keynesians? Not likely.

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