Keynes encouraged more spending

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Abu Dhabi/Dubai: In 1965 Time magazine's coveted year-end cover was devoted to British economist John Maynard Keynes; not to Winston Churchill or Malcolm X, both of whom had recently died.

"We are all Keynesians Now," read the headline for the magazine's cover story that would go on to rank him "with Adam Smith and Karl Marx as one of history's most significant economists."

At the time, Western economies were in the midst of what is now referred to as the golden age of capitalism. They were operating at nearly full employment and enjoying sustained real growth rates of near or above five per cent for the better parts of the 1950s and 1960s. Many credited the ideas of Keynes for the economic success story.

Keynes's fiscal principles, developed in the early 1930s, advocated the then radical idea of increased public spending, even in times of recession and even if government did not have the funds, to stimulate economic growth.

For better or worse, deficit-spending, as it is now referred to, has become the central pillar of developed and developing nations' economic policy since the onset of the global economic crisis in the last quarter of 2007.

Critics of Keynes cite the ineffectiveness of increased government spending in correcting economic stagnation and recession in the west in the 1970s and Japan in the 1990s. They also cite concern about possibly uncontrollable inflation in the coming years as central banks around the world, notably the US Federal Reserve, continue to print money feverishly to fund their governments' ballooning budget deficits.

"This is a recession that is perhaps second only in terms of scope to what happened in the 1930s not in terms of the severity but in terms of its reach," says Giyas Gökkent, National Bank of Abu Dhabi Asset Management Group chief economist. "It's a truly global recession. But because of the various policy actions that have been taken, the damage has been limited."

No doubt the policy actions Gökkent is referring to were Keynesian in every aspect including lowering interest rates, funding "stimulus packages" and stepping in to rescue large corporations.

Stimulus critics say the benefits of increased government spending will vanish once the funds run out because they do not effectively address issues of consumer and investor confidence needed for sustainable recovery.

"Even if a government stimulus were a good idea, policymakers probably wouldn't implement it the way Keynesian theory would suggest," former US Treasury Senior Adviser Ike Brannon and Chris Edwards of the Cato Institute, a Washington DC-based economic think tank, wrote in opposition to the $787 billion American stimulus package in January.

"To fix a downturn, policymakers would need to recognise the problem early and then enact a counter-cyclical strategy quickly and efficiently."

However, stimulus supporters point to France, Germany and Japan recording positive gross domestic product (GDP) growth in the second quarter, and the decline of contraction rates in the United States and United

Kingdom.

But even some Keynesian economists argue the improvement in national outputs may only be the result of temporary inventory replenishing.

Because of the economic crisis, companies all over the world have been reducing their inventories to save cash, says Mohammad Shakeel, Middle East economist at the Economist Intelligence Unit. "Once the inventories have been used up, companies have to produce more which increases output," Shakeel says.

"In order for that cycle to be sustained, you need demand. That demand at the moment is not there."

UK consumer spending fell by 0.7 per cent in the second quarter compared with 1.2 per cent in the previous quarter.

US consumer spending declined by one per cent in the second quarter compared with a 0.6 per cent gain in the first.