

## Warts and All

G. R. Steele

There is no cure for warts. Fortunately, about 30% disappear within six months, 66% within two years and 75% after three years. This is why old remedies - involving camphor, frogs, horse hair, vinegar and the like - have been shown to work. The same principle applies to Keynesian measures in the face of an economic recession.

Whatever else is uncertain do not doubt that mountebanks will appear to claim credit whenever a recession lifts. 'After this, therefore because of this' is empty of reason; as are the exhortations to spend-or-bust that emanate from the larger part of the economics profession. State intervention through deficit spending leads inevitably to inflation and/or insolvency. Curing debt with still more debt is rightly derided by those who have read beyond the naive Keynesianism that emanates from left-wing academics.



In his own time, Maynard Keynes had been deeply troubled, both by the chronic hardship of unemployment and by its threat to western democracy. There was reasoned justification for immediate palliatives to put people into work; 'in the long run we are all dead'. Yet, it was war on a world scale that over-rode the consequences of the Great Depression. Mobilisation delivered a direct, coercive effect on employment. Thereafter, coercion took more subtle forms as Keynes's untimely death in 1946 allowed self-appointed Keynes-ians to embrace nationalisation, strong labour unions, price controls, income redistribution and wealth equalisation. Keynesians are natural socialist planners.

In harking back to the 1930s, Keynesians presented a case for sustained interventions to improve national economic performance. In so doing, they provided politicians with a basis from which to boast their capacity to achieve faster growth, fuller employment and lower inflation. In the event, they delivered low growth, more unemployment and high inflation, which was the experience of the 1970s.

The theoretical basis from which it is argued that Keynesian policies benefit the economy is riddled with the most dubious relational propositions. Its promise of sustained prosperity has proven no less fanciful than Gordon Brown's claim to have abolished boom and bust. In overriding individuals' choices and in corrupting the flow of wealth-creating investments, the effects of Keynesian measures were detailed by Keynes's great rival Friedrich Hayek.

Hayek condemned the Keynesian edifice as a 'pseudo-scientific economics of averages' which damages the myriad linkages within a liberal economic order. When the state takes responsibility for full employment, it causes business, organised labour and the public at large to rely upon a guarantee of no failure. This is a sure path to mediocrity. Hayek repudiated socialism in all of its forms, but not from passion. State schemes fail because appropriate adjustments are obtained only through the application of individuals' initiatives. In making best use of the 'particular knowledge of time and place', local entrepreneurship is vital to economic advance.

Where Keynesian economics sees investment expenditure merely as a component of demand, Hayek applied capital theory to show how the detailed structure of investments is relevant to business cycles. From that analysis, and several months ahead of the onset of the Great Depression, Hayek had predicted an impending

crisis. Although falling upon deaf ears, he warned not only that lax money had prolonged the US investment boom, but that the ventures so promoted could not be sustained.

Hayek's analysis is as relevant in 2011 as it was eighty years ago. As the bubble of every wave of unwarranted expansion bursts, easing credit to boost demand is perverse. And worse follows when sectional pressures (whether of Green or rainbow hues) incite state subsidies for high-cost low-yield investment in 'sustainable' energy. Solutions do not rest with the state. Instead, investments must be redeployed in a coherent fashion as directed by the expression of consumers' demands through the continual readjustment of market prices.

Falling exchange rates, rising commodity prices, trade union wage demands (and all other scapegoats for inflation) are symptomatic of Keynesian excesses. Inflation is caused by sustained deficit spending and it brings its own adverse consequences: price distortions, confusions and unwarranted commitments that impair coherent economic activity.

Until recently, the full paraphernalia of Keynesian monetary and fiscal instrumentation had fallen by the way as short-term interest rate adjustment became the favoured tool of Keynesian intervention. Yet, with the manipulation of interest rates, consumption and production patterns become misaligned as investments are directed to the wrong places, the wrong goods are produced and sustainable growth is compromised.

Given the complex microeconomic structure of Hayek's analysis of easy-money boom-and-bust, its detailed propositions do not lend themselves to statistical appraisal. Hayek has never been fashionable. That Keynesians continue to dismiss his theory as an irrelevant anachronism is symptomatic of the modern fashion, which 'demands that a theoretical assertion which cannot be statistically tested must not be taken seriously'.



Through until his death in 1989, Hayek sustained his criticism of Keynesian analysis as deceptive nonsense; but details change and he pointed to differences with the over-expansion of credit in the 1970s as against the 1920s. Easy credit in the US precipitated the Wall Street Crash, and its effects were predominant within capital-goods industries. In the 1970s, credit had encouraged expenditures that were much more widely dispersed; and they necessitated the harsh measures applied by Margaret Thatcher's Chancellors in the 1980s.

A quarter-century later and the details are again different. Domestic property developments were the primary feature of longer-term investments that generally become viable (but are always unsustainable) during a credit-led boom. Credit is a two-way contract; but, as feckless borrowers cried foul, bankers became scapegoats and prudent savers now pay the price. Hayek's unwelcome conclusions can be set against the deceptive simplicity of Keynesian policies. In repackaging their snake oil, the macroeconomic meddlers - and all others who disparage free-market systems - are siren voices. Whenever mistakes are made, consequences must be faced. There is no Keynesian shimmy by which the economy can duck its comeuppance. On the contrary, Keynesian interventions only impair evolving entrepreneurial readjustments by which economic prosperity is achieved. There is no easy way; but future repetitions will be avoided only if the analysis provided by Friedrich Hayek receives close attention.