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Was Keynes a Liberal?

Reinhart Blohmert

But, above all, individualism, if it can be purged of its defects and its abuses, is the best safeguard of personal liberty ... and is also the best guard of the variety of life ... the loss of which is the greatest of all the losses of the homogeneous or the totalitarian state.

Half the copybook wisdom of our statesmen is based on assumptions which were at the time true, or partly true, but are now less and less true day by day. We have to invent new wisdom for a new age. And in the meantime we must, if we are to do any good, appear unorthodox, troublesome, dangerous, disobedient to them, that begat us.

In the economic field this means, first of all, that we must find new policies and new instruments to adapt and control the working of economic forces, so that they do not intolerably interfere with contemporary ideas as to what is fair and proper in the interest of social stability and social justice.¹

In some other respects the foregoing theory is moderately conservative in its implications. For whilst it indicates the vital importance of establishing certain central controls in matters which are now left in the main to individual initiative, there are wide fields of activity which are unaffected. The State will have to exercise a guiding influence on the propensity to consume partly through its scheme of taxation, partly by fixing the rate of interest, and partly, perhaps, in other ways. Furthermore, it seems unlikely that the influence of banking policy on the rate of interest will be sufficient by itself to determine an optimum rate of investment. I conceive, therefore, that a somewhat comprehensive socialisation of investment will prove the only means of securing an approximation to full employment; though this need not exclude all manner of compromises and of devices by which public authority will cooperate with private initiative. But beyond this no obvious case is made out

for a system of State Socialism which would embrace most of the economic life of the community. It is not the ownership of the instruments of production which it is important for the State to assume. If the State is able to aggregate amount of resources devoted to augmenting the instruments and the basic rate of reward to those who own them, it will have accomplished all that is necessary. Moreover, the necessary measures of socialisation can be introduced gradually and without a break in the general traditions of society.²

Keynes' father was the registrar of Cambridge University, and his mother was a mayor of that university town. He was thrown into the midst of the English elite from birth – school at Eton and then university at King's College, Cambridge. Despite his elite upbringing, he had no sympathy for the Conservative Party – his lifestyle and his liking for the modern arts were not conservative. As he himself declared:

How could I bring myself to be a conservative? ... That which is common to the atmosphere, the mentality, the view of life of – well, I will not mention names – promotes neither my self-interest nor the public good. It leads nowhere, it satisfies no ideal; it conforms to no intellectual standard; it is not even safe or calculated to preserve from spoilers that degree of civilization which we have already attained.

Keynes was no less critical of the Labour Party, based as it was on the aspirations and interests of a social class that was not his own. He was sceptical both of the party's social base and even more so of its 'autocratic inner ring' – the radical section of which Keynes designated 'the party of catastrophe'. Alienated from both the conservative and labour camps, the Liberal Party became Keynes' intellectual and political home and what he considered 'the best instrument of future progress – if only it had strong leadership and the right program'.³ He joined the party as a student and remained faithful to it thereafter.

From the beginning, however, Keynes was sceptical about nineteenth-century liberalism, which he viewed as a mixture of claims, illusions and half-truths. It inherited a conception of individualism that was founded on Locke's and Hume's doctrines of 'toleration' and the 'privatization of religion' and provided the basis for a theory of property rights which enshrined the property holder's right to 'do what he liked with himself and with his own'. Keynes described this idea as 'one of the contributions of the eighteenth century to the air we still breathe'.⁴ But he argued that it needed more than the praise of individual rights to legitimize the new doctrine of 'laissez-faire'. That was a feat of pure assertion,

by which early-nineteenth-century liberals achieved the ‘miraculous union’ of ‘conservative individualism’ derived from Locke, Hume, Johnson and Burke and the ‘socialism and democratic egalitarianism’ of Rousseau, Paley, Bentham and Godwin. Nevertheless, this ‘harmony of opposites’ would have been hard to establish had it not been for the economists, who sprang into prominence at just the right time. To the philosophical doctrine that government has no right to interfere, and the divine that it has no need to interfere, there is added a scientific proof that its interference is inexpedient. ‘The political philosopher could retire in favour of the business man – for [the] latter could attain the philosopher’s *summum bonum* by just pursuing his own private profit.’⁵

In Keynes’ view, the latter part of the nineteenth century added one more element to liberalism. Liberal thought acquired a dark side, by way of the idea of existential competition introduced by Darwin.

Nothing could seem more opposed than the old doctrine and the new – the doctrine which looked on the world as the work of the divine watchmaker and the doctrine which seemed to draw all things out of Chance, Chaos, and Old Father Time. But at this one point the new ideas bolstered up the old. The economists were teaching that wealth, commerce, and machinery were the children of free competition. ... But the Darwinians could go one better than that – free competition had built man ... the company of the economists were there to prove that the least deviation into impiety involved financial ruin.⁶

When liberals’ individualistic view on the world was combined with these Darwinian ingredients, it fit the needs of the business world perfectly. As Alfred Marshall, Keynes’ teacher and the greatest economist of his time wrote, ‘Our hopes of progress were centered’ on the achievements of business heroes.⁷

Keynes’ studies with Marshall equipped him with the dominant microeconomic view of classic liberal economics. But he began to see that this would not be enough to defend liberal society in the coming age. Keynes fitted liberalism with new insights and with new programmes that left behind the old Darwinistic view and the pure laissez-faire attitudes that no longer functioned and had begun to lose their legitimacy. The rest of this chapter will concentrate on his political shift, and sketch the new frame for economic liberalism that Keynes created. It shows how he came to promote a liberal rationale for strengthening the influence of the state on investment.

As a member of the UK Treasury during the First World War, Keynes had seen gold going to the United States and the value of the dollar increase. The United States, as the main purveyor of arms for the Allied armies, grew into

a new economic world power, and American money dominated the markets after the war. Most of the world's gold bullion was (physically) in the United States, and the dollar, not gold any more, was the world currency. When Britain under Churchill tried to bind the pound to gold again in 1925, she was obviously dreaming of days that had gone with the war: Britain was no longer in possession of enough gold to cover all her currency obligations. It was impossible to retain the gold standard in the short term. The British elites did not see that fact, and the 'Consequences of Mr. Churchill', as Keynes called this adventurous step, were that exports of British goods – mainly coal – fell. To raise the value of the pound meant also making export goods expensive. The coal industry suffered heavily under this Treasury dictate, and tried to make coal cheaper by slashing the miners' wages. This led to the longest strike in English history, and prompted Keynes to ask:

Why should the miners, the weakest economic link, who make their living from their wages in the coal industry, accept that dictate? Why should we allow the financial elite to insist on its wishes? The idea of the old-world party that you can, for example, alter the value of money and then leave the consequential adjustments to be brought about by forces of supply and demand, belongs to the days of fifty or a hundred years ago when trade unions were powerless, and when the economic juggernaut was allowed to crash along the highway of progress without obstruction and even with applause.⁸

Keynes argued that the contemporary elite's response to the post-war crisis rested on assumptions that no longer applied. He called for 'new wisdom for a new age' to replace them, recognizing that this enterprise would be criticized as a dangerous departure from the certainties of orthodox classical economics. This new wisdom, however, would enable economic policy-makers to ensure that economic forces were directed in ways that were consistent with prevailing ideas about society and social justice, rather than frustrating them.

With these arguments, Keynes showed a feeling for the democratic value of fairness and a lot more moral respect for the most vulnerable classes than British elites had shown before. In so doing, he confronted the challenges of the new democratic era of the twentieth century. Not surprisingly, this approach brought Keynes into conflict with some members of the Liberal Party, but he presented it as a way of conserving important features of a liberal society that were threatened by the emergence of powerful and extreme socialist tendencies in modern national and international politics. For example, Keynes saw that the British miners were not only more vulnerable than the bankers of the

city but that they also tended to move further to the left as the strike went on. This tendency was risky in the new times of democracy that had come about after the war. During that time, the Soviet experiment blossomed, and a lot of intellectuals moved to the political left. Keynes, who was married to a Russian ballet dancer and knew Russia from his travels and his experiences with Russian negotiators at conferences (like Genoa and Rapallo), remained sceptical and was more inclined to make capitalism friendlier than to run the risk of a revolution during which all the cultural capital of the West might be swept away.

Keynes was well aware of the weakening condition of English industry in the face of an ongoing loss of markets. In the second half of the 1920s he designed an economic programme for the construction of houses for the working classes as part of Liberal Party leader Lloyd George's promotion of employment. This programme was already a break with one of the old liberal dogmas, that states must abstain from economic activities. But aside from this political pragmatism, Keynes did not at this time depart from the theoretical framework of liberal economic dogma: free markets, free trade and free treaties. He thus favoured a practical political programme before he got the theoretical frame for it. He had seen the need before he saw the way out of a theoretical dead end. It was not until the 1930s that Keynes began to radically reconstruct the liberal picture of economics. The Great Depression, which broke out in October 1929 in New York, lasted years and opened his eyes to the role of money as store of value, and the role of effective demand in the economic fabric of capitalism. He saw that the labour market had no tendency to self-rebalancing and that unemployment could last longer than was good for the unemployed and for the political system.

This observation was for him obvious proof that free markets do not deliver full employment automatically, as the Classical School had claimed. Members of this school had taught that if workers were willing to lower their wages, the market would balance again. In the Depression, however, wages had sunk to the bottom, employment did not rise and the economy did not get back into motion. Keynes knew that capital is attracted only by profits, and that entrepreneurs invest only if they expect rising demand. The war had accelerated some changes in industrial production, and the new productivity that resulted led to new markets for mass consumption from upper middle class and wealthy customers to the market for mass products. But demand in the main mass-production markets sank as workers lost their jobs and wages. People had to spend what little money they had on the most urgent necessities of food and drink. Discretionary consumption remained constrained. Demand was low, and the whole economy went from stagnation to decline.

In the classical liberal view, crisis was the moment when industries that were not competitive in the market die, and new, more competitive industries come to the fore. So the liberal view was Darwinian, and liberals saw, in crisis, a cleansing effect, like a process of natural selection. But this sort of sanitation, which might be part of economic development in normal times, wastes a lot of talent and skill in times of depression, when millions of people lose their jobs. It also deprives savers of their money when capital values go to rack and ruin. The loss of cultural norms and human suffering are the consequence; when people are thrown out of their careers and life plans, birth rates go down and the social fabric begins to rot. People begin to look for political leaders who will propagate a new social order or revolutionary programmes, and the capitalist system is on the brink of destruction.

As the crisis of the Great Depression went on, there was no light on the horizon and the position of the classical liberal economists became difficult to maintain. There seemed to be a problem with Say's law stipulating that all products would find customers at the end of the day. Obviously, to Keynes, the classical liberal economic creed had proved to be built on sand. Waiting for the moment when the labour market would rebalance itself turned out to be like waiting for Godot – illusory and also dangerous. 'In the long run,' said Keynes, 'we are all dead.'⁹

But all the private actors who might affect the situation were under severe economic constraints. It was capital's greed for profits that fuelled the markets, and capital went therefore into branches of the economy where expectations for purchase were rising: supply grows only when demand is expected. Credit could be as cheap as possible, but factory owners would not want to produce anything as long as they did not expect demand for their products. So there could not be an end to unemployment in the face of this dilemma. On the one side, each dismissed worker would reduce the salary balance sheet of the entrepreneur, but on the other side, each jobless worker would also reduce the aggregate purchasing power of the economy. A microeconomic view could not solve this dilemma; only a politically armed macroeconomic perspective could integrate these seeming paradoxes. There was only one actor who could help find a way out of the dilemma: the state. Only the state was exempt from the economic constraints which applied, necessarily, to capital. At this particular historical moment, the state could help fuel the economy as long as necessary to reduce unemployment.

Keynes brought this 'new' old perspective, which had disappeared from sight since Ricardo and his followers, into the mainstream of economic thought. With it, he erased the dark, Darwinian side of liberal economics. The message was that liberal politics has to guard a measure of fairness in a society, and to

bring about a social cushion against brutal hardship. This was the song of a new liberalism, which was no longer based on Darwinian laws of natural selection, but on human culture. A liberalism which had been substantially devoted to limiting state intervention had now, with some caution, to equip the state to intervene at critical moments in order to preserve both a liberal society and a liberal economy from potential threats from the extremes of left and right.

Keynes' 'revolution' was very successful. Keynes was already a famous and influential economist, with links not only inside the economics community but also to politics and even journalism. He had a huge number of followers, not only in Britain but also inside the American Roosevelt administration. From its publication in 1936, his *General Theory* would remain the most influential theory for almost three generations. One of his students was Paul Samuelson, whose basic economics textbook was in print for half a century. Keynes' idea of liberalism is still fundamental to the American meaning of 'liberal' today.¹⁰

It was not until the 1980s that a counter-revolution took place and the old myth of the automatic balancing of the economy through free markets came to the fore again. Amid the turbulence of the time, Milton Friedman argued for the stability of private markets and had a deep distrust of the state. And the idea of an enlightened politics was given up, and supply-side economics, together with the so-called 'new classical macroeconomics' and public choice theory, once again enlarged the distance between economic theory and real economy: as before Keynes, economics would again be a normative-ideological art that had nothing to say about reality, as the Enron scandal and the world financial crises have demonstrated.

This thinking in alternatives – state or markets – was not what Keynes stood for: his ideals were semi-autonomous institutions, which were, in his view, the best mediator between the welfare of the whole society and individual interests – like the Bank of England.¹¹ Its aim was to feed the British economy with money and hold the currency stable – but not to make a profit. Keynes even believed that joint stock companies, 'where the owners of capital, i.e. the shareholders, are almost dissociated from the management', might evolve in a direction where 'the direct personal interest of the (management) in the making of profit becomes quite secondary'.¹² And indeed, until the end of the 1970s, the idea of joint stock company leaders had been to satisfy not only shareholders but also stakeholders like communities and workers.¹³ A change came with Jensen and Meckling and their 'principal-agent-theory', emphasizing shareholders as proprietors, not only as creditors.¹⁴ Keynes saw managers as professionals, not as agents of the proprietors. His trust was on professionals and professional agencies that

stood above the constraint of profit-making. But the world for professionals has become smaller and smaller since the sudden deregulation of financial markets in the UK in 1986 ('big bang') marked the entry of the profit-making principle into the realm of the mediators. With the vanishing of professionals from the stock exchanges and the growing influence of finance on the real economy, the dangers of crisis grew, once again bringing the whole deregulated capitalist system to the brink of the abyss.

Chapter 16

- 1 John Maynard Keynes, *Collected Writings* (Cambridge: Cambridge University Press, 2012), vol. IX, 305–6. Henceforth cited as *CW* followed by volume and page numbers.
- 2 Keynes, ‘The General Theory of Employment, Interest and Money,’ *CW* VII, 380, 377–8.
- 3 *CW* IX, 296–7.
- 4 ‘The End of Laissez-Faire’ *CW* IX, 272.
- 5 *Ibid.*, 274–5.
- 6 *Ibid.*, 276–7.
- 7 *CW* IX, 286.
- 8 *Ibid.*, 305.
- 9 Keynes, ‘Tract on Monetary Reform’ [1923], *CW* IV, 65.
- 10 What in Germany is called ‘social democratic’ politics is closest to this, but the term has a different history.
- 11 *CW* IX, 289
- 12 *Ibid.*, 289
- 13 See, for example, Clarence S. Walton, *Corporate Social Responsibilities* (Belmont, CA: Wadsworth Publishing Company, 1967).
- 14 Michael C. Jensen and William H. Meckling, ‘The Nature of Man,’ *Journal of Applied Corporate Finance* 7, no. 2 (Summer 1994), 4–19.