

ECONOMICS OF THE FREE SOCIETY

by

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3. *The Impact of Keynesianism*

John Maynard Keynes, who died in 1946 at the age of 62, is not only the best known economist of our times but also a man who by any standards must be reckoned as one of the leading personages of the first half of the twentieth century. The history of the era which followed World War I can no more dispense with the name of this singular individual than it can with the names of Einstein, Churchill, Roosevelt, or Hitler. It is only in this broad perspective that Keynes' full importance becomes visible. How ought we to judge the influence of this man? Is he the Copernicus of economics, as so many claim, the man who banished the ghosts of economics grown rigid in the chains of tradition, who opened the door to prosperity and stability? Or did he destroy more than he created and has he summoned into being spirits that today he possibly would be gladly rid of?

It is difficult to make a simple answer to these questions. A fair judgment would have to take into account not only the manifold talents and personal charm of the man, but would require also the dissection of issues which have nourished most of the economic controversies of our time and which have given even the experts pause. We may begin by noting a characteristic trait of this animated, impulsive, and artistically sensitive man: his virtuoso-like ability to change positions on important questions, positions which he had only shortly before defended with intelligence and vigor. It is difficult to recognize in the author of *The Economic Consequences of the Peace* (1919) and of the famous series of articles on reconstruction in the *Manchester Guardian*—works which at the beginning of the '20's stood for a program of free trade and Malthusian liberalism—the same man who later announced the “end of laissez-faire,” who, using extremely weak arguments, took it upon himself to champion economic autarky and so prepared the ground intellectually for the transition to economic and monetary nationalism on the part of his own and other countries. Indeed, it was his fate—one in which, initially, he even appeared to find some visible satisfaction and which at any rate he did not explicitly disavow—to become the intellectual authority for economic policy in National Socialist Germany. A fund of nervous energy, great productivity, temperament, virtuosity in debate, a cavalier nonchalance in changing positions—these were the chief notes of Keynes' personality.

In two fundamental respects, nevertheless, Keynes was more consistent than he appeared to be. In spite of all his criticisms of "capitalism," he never became a socialist. He remained a liberal, professing devotion to democratic freedoms and convinced that in his singular way, he was promoting them. Another constant in his career was his belief, derived from his expanding researches in monetary theory, that the real defect of our economic system must be sought in the organization of its finances and its monetary institutions. To improve this organization, he made proposals ranging from the moderate ones of his *Tract on Monetary Reform* (1923) to the radical ones of his last great work, *The General Theory of Employment, Interest and Money* (1936).

This is not the place to evaluate in detail the services which Keynes, in these works, rendered to the advancement of theory. Unquestionably, they are considerable. At the same time, it is precisely because he so deeply influenced his time that it is necessary to ask whether the practical results of his theories and proposals, which were intended to improve the working of the existing economic system, did not ultimately have the effect of weakening its foundations—so that Keynes, in tragic opposition to his own intention, must be numbered among the grave-diggers of that very order of liberal democracy to which his innermost allegiance belonged.

One may believe that there are times in which vigorous measures to increase the money supply will prevent disaster; but not with impunity can a leading scientific figure like Keynes bestow the mantle of his authority on the chronic propensity of all governments to inflate. One may believe that under certain circumstances an increase in government debt is the lesser evil; but not with impunity is such a temporary measure transformed into a maxim. It can happen—as in the Great Depression of 1931-32—that all efforts to put a quick end to unemployment prove useless, so that recourse must be had to an increase of "effective demand" by the expansion of the money supply; but not with impunity can one treat, with hardly concealed contempt, the established rules and institutions upon which, in the long run, the ordered conduct of economic life depends if it is not to be held under constant inflationary pressure. One can uncover in the mechanism of saving many a problem requiring special attention, overlooked by earlier and more fortunate generations; but not with impunity can one take away from men the feeling that it is right to save, to put aside a reserve for them-

selves and their families, instead of spending everything and then calling upon the help of the state—the greatest spender of all—in time of need. Just as a storm on the high seas may require that masts be cut down and freight thrown overboard, so too in economic life there will be hurricanes which will require us temporarily to suspend the principles of free international trade; but not with impunity can one declare these principles to be “out of date” so soon as they get in the way of a policy of “full employment,” a doctrine which, following the shock of the Great Depression, has become as inflexible as any of the views ever held by the despised “old economics.” To be sure, competition, freedom of markets, wage flexibility, and a prudent fiscal policy do not necessarily guarantee prosperity and stability; indeed, there are extraordinary situations in which exceptions to these excellent principles must be made; but not with impunity can one announce to the crowd that henceforth they may in good conscience be trampled upon.

These bitter-sweet reflections come to mind as one attempts to fill in the impressive outlines of Keynes' full and immensely influential life. Because he was possessed of such an acute intelligence and such an attractive personality the damage he inflicted was all the greater, for his teachings were rendered all the more seductive thereby. Thus, he accustomed a new generation to a kind of economic logic which revolves solely about the question of how “effective demand” can be most securely maintained at the highest possible level, whereas the real problem of the postwar era was how an inflationary boom can be braked in time. Other things he did were of still graver import in their ultimate consequences. He not only demolished that which was decayed, but by his preaching of economic pragmatism and his attack on deeply rooted principles in the moral-political sphere, he became one of the principal agents in that general decay of standards, of norms, and of principles which constitutes the real core of the social crisis of our time. At bottom, his economic policy program consisted in saying: *pecca fortiter*; that is, do with a light heart what you have hitherto regarded as a sin! Whether and to what extent Keynes' accomplishments on the level of economic theory and economic technique are right, will be a subject of debate for a long time to come; but that on the higher level of social philosophy and political ethics he was very wrong, is already sufficiently clear.

That Keynes not only preached these things but preached them

apparently in good conscience, indeed with the same messianic fervor which has become so characteristic of his numerous disciples, is something which has a deeper explanation, an explanation which must be sought in the type of man and the type of philosophy which he represented. How is it that such an extraordinary man (in the best sense), whose intellect was so wide-ranging and who was just as much artist and organizer as he was scholar, could at the same time be so blind to moral-political postulates (which even in the narrower domain of economics are more important in the long run than clever monetary formulae) without which human society cannot exist?

To fully appreciate the kind of man and the kind of philosophy we are here concerned with, it is useful to compare Keynes with Adam Smith. In the depth and extent of their influence at least, the two men were strikingly similar. Moreover, both Smith and Keynes had interests which extended far beyond the confines of economics. But whereas Smith left us, in addition to his magnum opus on the *Wealth of Nations* (1776) a book on the *Theory of Moral Sentiments* (1759) which exposes the full moral-philosophical foundations of his much-misconstrued economic doctrines, Keynes has left us, in addition to his economic works, a monograph on the theory of probability (*A Treatise on Probability*, 1921). For Smith, whose book on the *Wealth of Nations* was planned as a segment of a giant opus on the cultural history of mankind, economics was viewed as an organic part of the larger whole of the intellectual, moral, and historical life of society; for Keynes, economics was part of a mathematical-mechanical universe. The one man was a representative of the humanist spirit of the 18th century; the other a representative of the geometric spirit of the 20th century; a deistic moralist was the one, an exponent of positivistic scientism the other. For the one, the cosmos of human society and the human economy was the result of the working of an "invisible hand," a living order with an immanent logic of its own which the human mind could comprehend and even destroy but could not duplicate; for the other, economy and society were the result of mechanical *quanta* subject to precise measurement and direction by an omniscient technical human intelligence. The teachings of the one were a promising beginning; those of the other the end product of a process of disintegration in which the crisis of an exclusively rationalistic society finds its ultimate expression. On the lesser level of economics, the road from Adam Smith to Keynes has doubtless been one of progress in many

respects; on the higher level of total intellectual and spiritual development, it is equally certain that the road has been one of reaction and regression.

There is little consolation in the fact that Keynes at the close of his life worriedly endeavored to dampen the overzealousness of his followers. And it is tiresome, after a while, to have to listen to the repeated affirmation that Keynes himself, had he lived, would have contributed the necessary correction of "Keynesianism." This may well have been the case. On the other hand, the real tragedy of the Keynesian legacy is that what Keynes regarded as intellectual "working capital," i.e., ideas easily shifted from the service of one ideal to that of another, became for his less flexible disciples intellectual "fixed capital," the profits of which were protected by every means available, including that of monopolistic exclusion. Keynes cannot be spared the reproach of having failed to take this fateful result of his writings and teachings into account.

A fact of the postwar era, which is as singular as it is compromising for Keynesianism, is that the more determinedly the Keynesians have sought to enthrone the teachings of the master as the only legitimate economics, the more decisively have actual economic events moved away from the Keynesian postulates. Most governments, if not most economists, have become painfully aware of the inadequacy of Keynes' teachings in dealing with the chronic inflation of the postwar years; nor was this teaching able to shed any light on the fact that it was precisely the noninflationary economies of this period, least influenced by Keynesianism, which achieved the most remarkable rates of growth, employment, and stability, whereas it was the inflationary (in particular, the Anglo-American) economies which, by comparison, stagnated. Indeed, so compromising for Keynesianism were these postwar developments that the efforts to transform the ideology into a mere logical apparatus, capable of being shifted with cool detachment from the fight against deflation to the fight against inflation, are quite understandable. Of course, when this is done with the claim that it is still the pure light of Keynesian teaching which informs the new approach, we scientific legitimists will be excused for showing some astonishment at so much flexibility. After having for years pointed out to the representatives of the "new economics" the threat (inflation) which finally became reality, we find it difficult to accustom ourselves to seeing our analysis and prescriptions tricked out in the language of this same "new economics." This being

the case, it may at least be permitted to make a few comments thereon.

To begin with, we will readily concede that the use of Keynesianism as a logical apparatus, as a simple technique in the struggle against inflation in the full employment countries is (and was) thoroughly legitimate in one respect at least. Non-Keynesians themselves make use of the apparatus when they say that such countries were "living beyond their means," i.e., that their aggregate expenditures for consumption and investment generated more purchasing power for the output of the economy than could be supplied at current prices, with the consequent emergence of inflationary gaps and balance of payments deficits. Such insights could have been derived from the "old economics" as well, although it is conceded that macroeconomic concepts have been improved and refined by the "new economics."

But having made these concessions and with them a step toward conciliation, it would be reasonable to expect that the representatives of the "new economics," in turn, would frankly admit: first, that their passionately-held ideology has turned out to be, in truth, a mere logical technique; and secondly, that if in the postwar period it became necessary to apply the technique to a situation diametrically opposed to the one Keynes had in mind, this in itself was largely due to the ideological influence of Keynesianism with its emphasis on fear of deflation, full employment at any cost, and unrestrained government spending.

It is the latter circumstance which points to the great difficulty of applying the logical apparatus of the "new economics," in admirable nonpartisanship, to either inflation or deflation, depending on the situation. Keynesianism, even in the most favorable case, tends to be latent inflationism. This inflationism becomes virulent so soon as disturbances occur, especially those accompanied by unemployment and business contraction, which appear to constitute "deflation." In fact, the disturbances may be due not to disproportions between the gross magnitudes of the economy (as the "new economics" would have it) but (in terms of the "old economics") to false values—prices or wages—and to a false allocation of the factors of production. What then? What of the case in which wage increases cause unemployment? Above all: how is it planned to cope with the fact that the reduction of inflationary over-employment is usually accompanied by pseudo-deflationary phenomena?

We see that even where the new economics is reduced to a mere

neutral logical technique, and even where it happens to find itself in agreement with the prescriptions of the "old economics," the desired synthesis is considerably more difficult to achieve than at first appears. Such a synthesis will at all events not take place unless the representatives of the "new economics" determine to give up their claims that their theories and methods are the only valid ones, and until they abandon still more positions than they have already done.

The idea that by a continuous manipulation of macroeconomic variables it is possible to offset now a deflationary, now an inflationary tendency is extremely attractive. The "new economics," however, has by no means an exclusive patent on it; from the beginning it has been the signpost of a reasonable economic policy. But it will remain a misleading and a dangerous idea so long as it is not purged, far more completely than hitherto, of all traces of "Keynesianism." For inevitably the Keynesians will be found looking at inflation through the wrong end of the telescope and deflation through a magnifying glass. Hence, this otherwise useful idea—so long as it remains in the grip of the "new economics," with its exclusive concern with macroeconomics—will be the captive of an intellectual outlook which distorts the nature of both deflation and inflation. The very circumstance that in the postwar period so much time and argument and so much inflation were required before even the more observant of the representatives of the "new economics" were persuaded to change course from anti-deflation to anti-inflation, shows the inner tendency of this whole school of thought. In the logical machine so cleverly devised by Keynes and his followers we find, to be sure, an inflation brake. But the machine is so constructed that the brake is depressed only when a breakneck rate of speed has been attained; and the brake has the further fatal tendency of being released as soon as the braking action is the least bit effective.

In summary, we find in the teachings of Keynes the social philosophy of a man who, proud of his alleged modernity and progressiveness, believes himself capable of "making over" society and the economy. We find a man who has forgotten those mysterious powers of the human soul and of human society which cannot be expressed in mathematical equations, nor confined within an assemblage of statistics or the rubrics of economic planning. It is in no small degree this character of Keynesian teachings which explain their large success in those countries and with those political parties in

which a preference for social planning and active suspicion of individual freedom is especially marked. The greater the extent to which a person's milieu, habits, way of life, and social environment prevent him from seeing that the real evil of our civilization lies in the profoundly unnatural character of our lives, our society, and our way of thinking—not in any still imperfect ability to increase government budget deficits, keep interest rates down, pump up “effective demand,” make rates of exchange flexible, and manipulate balances of payments—the greater is the likelihood of his susceptibility to the doctrines which Keynes made fashionable. Conversely, the success of these doctrines shows us how many people there are who find them appealing, and how sick is an age which could spawn them in such numbers. For all these reasons, we may expect to be able to measure the progress of the recovery of society (the first signs of which we believe to be already visible), in part, by the number of men who succeed in freeing themselves from the spell of Keynesianism and in recognizing not only its economic weaknesses, but the errors of its social philosophy as well.⁷ Then it will be possible to evaluate, objectively and unemotionally, the real contributions of Keynes, infused as they are with the elements of both grandeur and tragedy. On this note we may proceed to the last chapter of this book.

NOTES

1. (p. 208) *Economic Fluctuations*

The reader is referred to the following additional publications of the author: W. Röpke, *Crises and Cycles* (London, 1936); W. Röpke, *Civitas Humana* (London, 1948). See also: G. Haberler, *Prosperity and Depression* (3rd ed.; Geneva, 1941); Hans Gestrinch, *Kredit und Sparen* (2nd ed.; Godesberg, 1948); J. Schumpeter, *Business Cycles* (New York, 1939); League of Nations (report), *Economic Stability in the Post-War World* (Geneva, 1945); G. Haberler (ed.), *Readings in Business Cycle Theory* (Philadelphia, 1944); W.A. Jöhr, *Die Konjunkturschwankungen* (Tübingen-Zürich, 1952); G. Schmölders, "Konjunktoren und Krisen," *Rowohlts Deutsche Enzyklopädie*, Vol. 3.

2. (p. 217) *Inadequate Investment—A Matter of Fate?*

Under the influence of Keynes (*The General Theory of Employment, Interest and Money* [London, 1936]) and of the American economist Alvin H. Hansen (*Full Recovery or Stagnation?* [New York, 1938]), widespread currency was given to the notion that the rich industrial countries have entered the phase of relative investment saturation ("mature economy") and that consequently a permanent tendency for savings to outstrip investment will develop unless appropriate measures are taken to forestall this. This theory of latent chronic stagnation must, however, be abandoned as unproven. See W. Röpke, *Civitas Humana* (*op. cit.*, pp. 218-220); Howard S. Ellis, "Monetary Policy and Investment," *American Economic Review*, Supplement, March 1940; Henry C. Simons, "Hansen on Fiscal Policy" in *Economy Policy for a Free Society* (Chicago, 1948); Willford I. King, "Are We Suffering from Economic Maturity?" *Journal of Political Economy*, October 1939; George Terborgh, *The Bogey of Economic Maturity* (Chicago, 1945). The above-mentioned League of Nations report also rejects the mature economy thesis; in the interim it has long since been disproved by events, and its place taken by the concern as to how rapid rates of growth can be achieved without inflation.

3. (p. 217) *Secondary Depression*

See W. Röpke, *Crises and Cycles*, *op. cit.*; W. Röpke, "Die sekundäre Krise und ihre Ueberwindung," *Economic Essays in Honour of Gustav Cassel* (London, 1933).

4. (p. 218) "Full Employment"

For criticism of the "full employment" school see: G. Haberler, *op. cit.*; Howard S. Ellis, *op. cit.*; Hans Gestrinch, *op. cit.*; W. Röpke, *The Social Crisis of Our Time* (Chicago, 1950); W. Röpke, *Civitas Humana*, *op. cit.*; Allan G.B. Fisher, *Economic Progress and Social Security* (London, 1945); Henry C. Simons, *op. cit.*, especially Chapter XIII, "The Beveridge Program: An Unsympathetic Interpretation"; L.A. Hahn, *The Economics of Illusion* (New York, 1949); W. Röpke, "'Vollbeschäftigung'—eine trügerische Lösung," *Zeitschrift für das gesamte Kreditwesen*, 1950, No. 6 (discussion on the same in No. 11). For the practical application of these thoughts to the case of German economic policy since 1948 see W. Röpke, *Ist die deutsche Wirtschaftspolitik richtig?* (Stuttgart, 1950), a monograph prepared at the behest of the German government, the

essentials of which have been reprinted in Wilhelm Röpke, *Gegen die Brandung* (Erlenbach-Zurich, 1959). An extreme example of the "full employment" ideology and one in which its principal errors may be particularly well studied is the United Nations report by five economic experts entitled *National and International Measures for Full Employment* (Lake Success, New York, 1949). For criticism of this document see: Jacob Viner, "Full Employment at Whatever Cost," *The Quarterly Journal of Economics*, August, 1950; W. Röpke, *The Economics of Full Employment* (New York, 1952).

5. (p. 218) *Cyclical Policy*

In addition to the above-mentioned League of Nations study, *Economic Stability in the Post-War World*, see my own book *Crises and Cycles* and also: Charles La Roche, *Beschäftigungspolitik in der Demokratie* (Zurich, 1947); B. Ohlin, *The Problem of Employment Stabilisation* (London, 1950); Paul Binder, *Die Stabilisierung der Wirtschaftskonjunktur* (1956).

6. (p. 219) *Flexibility of the Economic System*

This extremely important theme has been the subject of investigation by: H.L. Keus, *De ondernemer en zijn social-economische problemen* (Haarlem, 1942); Allan G.B. Fisher, *op. cit.*; League of Nations, *Economic Stability in the Post-War World*, *op. cit.*; Madeleine Jaccard, *La mobilité de la main d'oeuvre et les problèmes du chômage et de la pénurie de travailleurs* (Lausanne, 1945); W.H. Hutt, *Plan for Reconstruction* (London, 1943). For discussion of current problems in this area see also my book *A Humane Economy*, *op. cit.*

7. (p. 228) "Keynesianism"

The theories of Keynes ("Keynesianism") which long dominated economic debate and policy with respect to economic fluctuations, and which produced many uncritical analyses of the problem of "full employment," have been subjected to increasingly sharp, even devastating criticism. See L.A. Hahn, *Common Sense Economics* (New York, 1956); L.A. Hahn, *Geld und Kredit* (Frankfurt am Main, 1960); Henry Hazlitt, *The Failure of the "New Economics," An Analysis of the Keynesian Fallacies* (New York, 1959); Henry Hazlitt (ed.), *The Critics of Keynesian Economics* (New York, 1960); W. Röpke, *A Humane Economy* (Chicago, 1960); W. Röpke, "Was lehrt Keynes?" in *Gegen die Brandung*, *op. cit.*; David McCord Wright, *The Keynesian System* (New York, 1962).