Keynes and the Myth of Permanent Deficit Spending

The issue of ongoing and growing governmental deficits has arisen once again, as it does from time to time in U.S politics, but those who are raising the issue most critically now are liberal Democrats, many of whom have spent most of their time until this moment advocating programs and public spending which made federal debt greater and greater.

John Maynard Keynes was a British economist in the last century who, after the worldwide economic depression began in the 1930s, advocated deficit policy and government intervention as good and effective tools to meet that crisis.

President Franklin Roosevelt and his is administration adopted Lord Keynes' theories as a basis for its New Deal programs and strategies for economic recovery. Keynesian economics subsequently has been given credit for "saving" the U.S. economy—although some commentators now argue that World War II and the natural business cycle might deserve more credit.

Lord Keynes, however, has partly had a bad rap as an advocate for permanent deficits. In fact, he opposed them in principle.

Created a hereditary baron late in life (he sat in the House of Lords as a member of the Liberal Party), Keynes first made his mark before World War I. At the notorious Versailles Peace Conference after the war, he represented Great Britain, but was shut out of the decision-making because he was one of the few economists and statesmen who strongly opposed retaliatory reparation demands on Germany—prophesying they would create economic and political instability in the defeated nation.

Keynes actually advocated high inflation in Germany in the 1920s as a way to offset the punitive cost of the reparations. (Unfortunately, this inflation had unintended consequences.)

When the worldwide depression occurred in the 1930s, he advocated government intervention by deficit spending to boost employment and revive the economy. Keynes' economic strategies were thus opportunistic and primarily short-term.

American economist Milton Friedman argued for lower taxes to promote growth, and attacked the notion that permanent deficits and entitlement spending were healthy and helpful strategies for a free market economy.

His and others' ideas, including cutting taxes, were adopted by President Ronald Reagan in the 1980s to end the earlier "stagflation" (and later high inflation), high interest rates, and high unemployment that dogged President Jimmy Carter and his administration in the late 1970s.

While most liberal politicians continued to advocate and promote Keynesian ideas of high taxes, deficits and lots of government spending programs, their conservative opponents often have only insisted on lowering taxes while compromising with liberals on government programs.

Recent Republican presidents have cut taxes, but often failed to rein in government spending, thus ultimately dooming economic recoveries. "Supply-side" earned a reputation among liberals as a "trickle-down" theory and a failure, but when properly applied, it works.

President Trump could fall into the same economic trap as his GOP predecessors as he combines the Republican much-needed tax reform with substantial new government spending not only on new infrastructure (his idea) but with liberal entitlement spending as part of his dealing with the Democrats. (The problem, to be fair, is that rebuilding public infrastructure is overdue, and entitlements are almost politically impossible to reduce.)

Former Speaker of the House Newt Gingrich argues that a balanced budget is not only a good thing, but is possible.

Republicans, when he was the U.S. house leader, initiated the last balanced budgets in the 1990s. A centrist Democratic president, Bill Clinton, embraced the idea, and the two sides compromised and made it a bipartisan effort. (Many economists now point out, however, that this brief period of budget surpluses was inherently compromised by the Clinton-inspired incipient Fannie Mae and Freddie Mac bubbles that later were disastrous to the U.S. economy.)

Is there a Democrat leader today willing to make a true balanced budget possible?

Some Democrats today are acting as short-sided as the politicians did at Versailles a hundred years ago, arguing for more confiscatory taxation against “the rich”—as well as for more and more entitlement programs.

This strategy, applied almost everywhere in post-World War II Europe had some short-term success in that continent’s recovery from devastation, but its long-term efficacy was a failure, even in the much-touted Scandinavian nations where public policies are now increasingly adopting more free market solutions.

While “purist economic” conservative congressional figures and groups have often recently stood in the way of needed legislation—and were persuaded finally to support the key tax reform bill — their critique of subsequent “aggravations” of new deficit spending should not be summarily dismissed or ignored.