

The Misesian Case against Keynes*

By Hans-Hermann Hoppe

University of Nevada at Las Vegas
The Ludwig von Mises Institute

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It is my goal to reconstruct some basic truths regarding the process of economic development and the role played in it by employment, money, and interest. These truths neither originated with the Austrian school of economics nor are an integral part of only this tradition of economic thinking. In fact, most of them were part and parcel of what is now called classical economics, and it was the recognition of their validity that uniquely distinguished the economist from the crank. Yet the Austrian school, in particular Ludwig von Mises and later Murray N. Rothbard, has given the clearest and most complete presentation of these truths (Mises [1949] 1966; Rothbard [1962] 1970). Moreover, that school has presented them their most rigorous defense by showing them to be ultimately deducible from basic, incontestable propositions (such as that man acts and knows what it means to act) so as to establish them as truths whose denial would not only be factually incorrect but, much more decisively, would amount to logical contradictions and absurdities.¹

I will first systematically reconstruct this Austrian theory of economic development. Then I will turn to the "new" theory of J. M. Keynes, which belongs, as he himself proudly acknowledged, to the tradition of "underworld" economics (like mercantilism) and of economic cranks like S. Gesell (Keynes 1936). I will show that Keynes's new economics, like that "underworld" tradition, is nothing but a tissue of logical falsehoods reached by means of obscure jargon, shifting definitions, and logical inconsistencies intended to establish a statist, anti-free market economic system.

I.1 Employment

"Unemployment in the unhampered market is always voluntary" (Mises [1949] 1966: 599). Man works because he prefers the anticipated result of doing so to the disutility of labor and the psychic income to be derived from leisure. He "stops

¹ On the foundations of economics, see Mises (1978b, 1981, 1985), Rothbard (1979), and Hoppe (1983, 1988). On the competing positivist view of economics, according to which economic laws are hypotheses subject to empirical confirmation or falsification (much like the laws of physics), see Friedman (1953).

working at that point, at which he begins to value leisure, the absence of labor's disutility, more highly than the increment in satisfaction expected from working more" (ibid.: 611). Obviously, then, Robinson Crusoe, the self-sufficient producer, can only be unemployed voluntarily, that is, because he prefers to remain idle and consume present goods instead of expending additional labor in the production of future ones.

The result is similar when Friday appears and a private-property economy is established, based on mutual recognition of each person's right of exclusive ownership over those resources which he had recognized as scarce and had appropriated (homesteaded) by mixing his labor with them before anyone else had done so as well as ownership of all goods produced with their help. In this situation, not only exchange ratios-prices-for the purchase or rental of material goods become possible, but also prices (wages) for the rental of labor services. Employment will ensue whenever the offered wage is valued by the laborer more highly than the satisfactions of leisure or than the returns of self-employment. In the latter case, the laborer faces three choices. He may (1) work self-sufficiently on his own resources, or homestead previously submarginal resources, and consume his own products; (2) become a capitalist entrepreneur, engaging in barter with other self-employed entrepreneurs; or (3) become a capitalist entrepreneur in the market, selling a product for money.

Employment will increase and wages rise so long as entrepreneurs perceive existing wages as lower than the marginal value product (discounted by time preference² which a corresponding increment in the employment of labor can be expected to bring about. On the other hand, unemployment will result and increase so long as a person values the marginal value product attained through self-employment or the satisfactions of leisure more highly than a wage that reflects his labor services' marginal productivity.

In this construction there is no logical room for such a thing as "involuntary unemployment." A person is not employed, that is, not working as a hired laborer, either because he prefers leisure or because he is self-employed. In either case the person is unemployed voluntarily. But may it not be true that, on the free and unhampered market, someone is "unemployed" in the modern sense, that is, he is seeking work and cannot find a job? But such a construct raises many problems. Thus, I may be seeking a position as president of Harvard University, and this employer, for some obscure reason, may refuse to hire me for that post. We could say that I am "involuntarily unemployed," but this would distort any sensible meaning of the term. In any wage agreement, as in any exchange on the free market, *both parties* must participate willingly in the exchange, that is, both must participate voluntarily. If half of the labor force should take it into their heads that each of them should be hired as president of Harvard, and each insists on this employment and no other, then indeed half of the labor force minus one person will be permanently and "involuntarily" unemployed. But is this, as Keynes would have it, a failure of the free market, or is it a failure of the mental processes and values of those laborers? And since this problem is clearly a failure internal to the workers themselves, we must conclude that such unemployment is "voluntary" in the realistic sense that it is the consequence of the internal mental processes and choices of those workers, even though each would "voluntarily" prefer to be president of Harvard rather than to be without work.

² On time preference, see section 1.3, below.

Similarly, and coming closer to the reality of unemployment during depressions, laborers might insist on not allowing themselves to be hired at a wage below a certain rate, that is, imposing on themselves a minimum wage below which they will not be hired. Usually, this happens during business-cycle recessions, when, as Austrian business-cycle theory tells us, there is a sudden drop in employers' demand for labor, particularly in the capital-goods industries. That decline is a reflection of the sudden revelation, at the onset of a depression, that businessmen have been led by inflationary credit expansion, and the consequent drop in interest rates below the free-market level, to make unsound malinvestments. Such investments bid up wage rates and other costs too high, compared to the genuine market willingness to buy those capital goods at a profitable price. The end of, or significant slowdown in, bank credit expansion reveals these malinvestments and causes sudden business losses, leading to sharp declines in the business firms' demand for labor, land, and raw materials. Generally, the prices of land and materials are free to fall on the market, but often laborers will not accept a sudden fall in wage rates, and the result will be the same with every minimum price higher than the free-market-clearing price: an idle, unsold surplus at that overly high price. The labor market works like any market in goods and services: an artificial minimum above the market-clearing wage causes an unsold surplus—in this case, unemployment of labor. The faster that laborers allow their wage rates to fall, the sooner will unemployment disappear.

Again, we may suppose that I go to my university employer and insist that I will not be employed unless they raise my salary to \$1 million a year. They wish me Godspeed with a "have a nice rest of your life." Am I then "involuntarily" unemployed? Yes, in the sense that I would like to be employed at my present post for \$1 million and my employer refuses to make such a contract. But no, in the sense that I am stubbornly insisting on not continuing employment at less than \$1 million per year and on "voluntarily" preferring idleness to a salary below that amount. Again, although I may not enjoy idleness and would prefer my present post at \$1 million per year, I am "voluntarily" unemployed in the surely coherent sense that my unemployment is the result of my own internal mental processes.

It should be clear that the case of workers' failing to adapt quickly to a falling demand for labor is only different in degree, rather than in kind, from my own outlandish hypothetical case. Nor is such worker refusal or self-imposed minimum wage always and necessarily wrong headed. In many cases, he may be "speculatively unemployed," that is, either waiting to move to another job or region or waiting for an interval because he expects that, before too long, the demand for labor at his former post or its close equivalent will rise and he will be able to return to work at a higher pay. And those expectations are not necessarily foolish; they may in some cases be correct. But again, he would clearly be "voluntarily" unemployed, even if his expectations turn out to be in error.³ As Mises writes:

³ "The individual believes that he will find at a later date a remunerative job in his dwelling base and in an occupation which he likes better and for which he has been trained. He seeks to avoid the expenditure and other disadvantages involved in shifting from one occupation to another. There may be special conditions increasing these costs. . . . In all these cases the individual chooses temporary unemployment because he believes that this choice pays better in the long run" (Mises [1949] 1966: 598-99).

Unemployment is a phenomenon of a changing economy. The fact that a worker discharged on account of changes occurring in the arrangement of production processes does not instantly take advantage of every opportunity to get another job but waits for a more propitious opportunity. . . is not an automatic reaction to the changes which have occurred, independent of the will and the choices of the job-seekers concerned, but the effect of their intentional actions. It is speculative, not frictional. (Mises [1949] 1966: 600)

Of course, this does not mean that all unemployment is "voluntary," but only that in a free and unhampered market. When the market is subject to the coercion of external intervention, specifically when an external coercive institution, whether a union or a government, imposes wage rates above the market-clearing level, then there will be "involuntary" unemployment, and that unemployment will last so long as the wage rate is held above the marginal productivity of labor in that occupation. An alternative way in which the government may coerce unemployment is to *subsidize* that unemployment by paying workers to the extent that they are unemployed. This can occur either as direct government payments to the unemployed (often tax-exempt and thereby higher in after-tax terms) or as welfare payments. In either case, the net psychic return from employment over leisure is sharply reduced by such a subsidy, and the incentive to accept the proffered market wage is reduced by the same extent. Mises perceptively refers to such unemployment as "institutional" unemployment.

Thus, involuntary unemployment is only logically possible once the free-market economy is fundamentally changed and a person or institution is introduced which can successfully exercise control over resources that he or it has not homesteaded or acquired through voluntary exchange from homesteaders. Such an extramarket institution, by imposing a minimum wage higher than the marginal productivity of labor, can effectively prohibit an exchange between a supplier of labor service and a capitalist, an exchange which would be preferred by both if both had unrestricted control over their homesteaded property. The would-be laborer then becomes involuntarily unemployed, and the would-be employer is forced to dislocate complementary factors of production from more into less value-productive usages. As a matter of fact, an extramarket institution can in principle create any desired amount of involuntary unemployment. A minimum wage of, say, one million dollars per hour would, if enforced, involuntarily disemploy practically everyone and would, along this way toward forced self-employment, condemn most of today's population to death by starvation. In the absence of any institution exempt from the rules of the free market, involuntary unemployment is logically impossible and prosperity, instead of impoverishment, will result.

I.2. Money

Man participates in an exchange economy (instead of remaining in self-sufficient isolation), insofar as he is capable of recognizing the higher productivity of a system of division of labor and he prefers more goods over less. Out of his market participation arises, in turn, his desire for a medium of exchange, namely, money. Indeed, only if one were to assume the humanly impossible, that is, that man had perfect foresight regarding the future, would there be no reason for him to have money. For then, with all uncertainties

removed, in the never-never land of equilibrium, one would know precisely the terms, times, and locations of all future exchanges; everything could be prearranged accordingly and would take on the form of direct, rather than indirect, exchange (Mises [1949] 1966: 244-50).⁴ Under the inescapable human condition of uncertainty, however, when all these are not known and action must by nature be speculative, man will begin to demand goods, no longer exclusively because of their use value, but also because of their value as media of exchange. He will also consider trading whenever the goods to be acquired are more marketable than those to be surrendered, such that their possession would then facilitate the acquisition of directly serviceable goods and services at as yet unknown future dates.

Moreover, since it is the very function of a medium of exchange to facilitate future purchases of directly serviceable goods, man will naturally prefer the acquisition of a more marketable, even universally marketable, medium of exchange to that of a less or non universally marketable one. Therefore, "there would be an inevitable tendency for the less marketable of the series of goods used as media of exchange to be one by one rejected until at last only a single commodity remained, which was universally employed as a medium of exchange; in a word, money" (Mises 1971: 32-33; Menger 1981). And on the way toward this ultimate goal, by selecting monies that are increasingly more widely used, the division of labor is extended and productivity increased.

However, once a commodity has been established as a universal medium of exchange and the prices of all directly serviceable exchange goods are expressed in terms of units of this money (while the price of the money unit is its power to purchase an array of nonmoney goods), money no longer exercises any systematic influence on the division of labor, employment, and produced income. Once a money is established, any stock of money becomes compatible with any amount of employment and real income. There is never any need for more money since any amount will perform the same maximum extent of needed money work: that is, to provide a general medium of exchange and a means of economic calculation by entrepreneurs.⁵ But this means that any supply of money is optimal and, in that sense, that the supply of money is indifferent or "neutral" to the real processes of the economy. But, unfortunately, *changes* in the supply of money can have untoward and even devastating effects on the real processes of production.

Thus, suppose that the supply of money increases. Prices and wages will generally go up and the purchasing power of the money unit, down. Insofar as the money supply is greater and its purchasing power has fallen without hindrance, the new money supply will have no effect on the real economy. But, on the other hand, the supply of money is always injected into one or more specific spots in

⁴"In a system without change in which there is no uncertainty whatever about the future, nobody needs to hold cash. Every individual knows precisely what amount of money he will need at any future date. He is therefore in a position to lend all the funds he receives in such a way that the loans fall due on the date he will need them" (Mises [1949] 1966: 249; see also Rothbard [1962] 1970: 280).

⁵ See Rothbard ([1962] 1970: 669-71). "Goods are useful and scarce, and any increment in goods is a social benefit. But money is useful not directly, but only in exchanges. . . . When there is less money, the exchange-value of the monetary unit rises; when there is more money, the exchange-value of the monetary unit falls. We conclude that there is no such thing as 'too little' or 'too much' money, that, whatever the social money stock, the benefits of money are always utilized to the maximum extent" (Rothbard [1962] 1970: 670; see also Rothbard 1983).

the economy and does not increase proportionately and instantly but ripples out over time and over the market, from early receivers to later receivers. Therefore, increases of the money supply in the real world always change relative prices and alter the distribution of income and wealth. Hence, the process of change in the money supply necessarily changes relative prices and distribution, so it cannot be neutral to these real processes. Furthermore, if the increases of money occur through the expansion and monetization of bank credit, then Austrian business-cycle theory demonstrates that, inevitably, such money changes necessarily put into effect the malinvestments and the volatility of the boom-bust cycle. And such inflationary increases can wreak still more devastation on the real economy by distorting and falsifying economic calculation so that business firms will have no real idea of their costs or be able to forecast relative prices or business profits or losses.

But even though *changes* in the money supply will not be neutral to the price system or to the distribution of income or wealth, and inflation in bank credit will bring about malinvestments, failures of calculation, and a business cycle, there still need be no market unemployment. Even a sudden drop in wage rates in a depression, as we have seen, can still clear all markets every day and every step of the way. A fall in money-demand curves for goods or for resources need not create an unsold surplus if prices are free to fall downward to the market-clearing price. In the same way, a drop in the money-demand curves for labor need not cause unemployment if laborers are willing to accept falling wage rates that clear the market and ensure that everyone willing to work has a job. But if laborers are not so willing and decide to insist on a minimum wage, hoping for an early rise of their wage rates, their consequent unemployment on an unhampered market would have to be considered "voluntary." As we have seen, however, if unions or governments interfere to prop up wage rates above the market-clearing rates, then involuntary unemployment will add to the malinvestment problems of the business cycle.

Changes in the demand for money have effects similar to changes in supply, except that (a) they cannot generate a business cycle, and (b) they cannot, as in the case of government-fiat paper money of inflationary bank credit, increase without limit or, rather, increase up to the limit of a crack-up boom and runaway inflation. Thus, an increase in the demand for money, that is, a higher relative value attached to cash as compared to other goods, would certainly change relative prices and incomes, since the increase in demand would not be uniform for each person and the effects would ripple through time across the market economy. The increased demand for a given stock of money would decrease prices and wages and would raise the purchasing power of the money unit, *mutatis mutandis*. But employment and real income need not be affected.

I.3. Interest

The holding of money is a result of the systemic uncertainty of human action. Interest rates, on the other hand, result from time preference, which is as essential to action as uncertainty. In acting, an actor not only invariably aims to substitute a more for a less satisfactory state of affairs and so demonstrates a preference for more rather than fewer goods; he must also invariably consider when in the future his goals will be reached (i.e., the time necessary to accomplish them) as well as a good's duration of serviceability; every action thus also demonstrates a universal preference for earlier over later goods and for more over less durable ones. Every

action requires some time to attain its goal; since man must consume something sometimes and cannot ever stop consuming entirely, time is always scarce. Thus, *ceteris paribus*, present or earlier goods are, and must invariably be, valued more highly than future or later ones.⁶ In fact, if man were not constrained by time preference and the only constraint operating were that of preferring more over less, he would invariably choose those production processes that would yield the largest output per input, regardless of the length of time needed for those methods to bear fruit. For instance, instead of making a fishing net first, Crusoe would immediately begin constructing a fishing trawler, as the economically most efficient method for catching fish. That no one, including Crusoe, acts in this way makes it evident that man cannot but "value fractions of time of the same length in a different way according as they are nearer or remoter from the instant of the actor's decision" (Mises [1949] 1966: 483).

Thus, constrained by time preference, man will exchange a present good against a future one only if he anticipates thereby increasing his amount of future goods. The rate of time preference, which can be different from person to person and from one point in time to the next, but which can never be anything but positive for everyone, simultaneously determines the height of the premium that present goods command over future ones as well as the amount of savings and investment. The market rate of interest is the aggregate sum of all individual time-preference rates, reflecting, so to speak, the social rate of time preference and equilibrating social savings (i.e., the supply of present goods offered for exchange against future goods) and social investment (i.e., the demand for present goods capable of yielding future returns).

No supply of loanable funds could exist without previous savings, that is, without abstention from some possible consumption of present goods (an excess of current production over current consumption). And no demand for loanable funds would exist if no one were to perceive any opportunity to employ those funds, that is, to invest them so as to produce a future output that would exceed current input. Indeed, if all present goods were consumed and none invested in time-consuming production processes, there would be no interest or time-preference rate. Or rather, the interest rate would be infinitely high, which, anywhere outside of the Garden of Eden, would be tantamount to leading a merely animal existence, that is, of eking out a primitive subsistence by facing reality with nothing but one's bare hands and only a desire for instant gratification.

A supply of and a demand for loanable funds only arises—and this is the human condition—once it is recognized that indirect, more roundabout, lengthier production processes can yield a larger or better output per input than direct and shorter ones;⁷ and it is possible, by means of savings, to accumulate the number of present goods needed to provide for all those desires whose satisfaction during the prolonged waiting time is deemed more urgent than the increment in future well-being expected from the adoption of a more time-consuming production process (Mises [1949] 1966: 490ff.).

⁶ On the time-preference theory of interest, see W. S. Jevons (1965), E. von Bohm-Bawerk (1959), R. Strigl (1934), F. A. Fetter (1977), and R. B. Garrison (1979, 1988).

⁷ To be sure, not all lengthier production processes are more productive than shorter ones; but under the assumption that man, constrained by time preference, will invariably and at all times select the shortest conceivable method of producing some given output, any increase in output then can-praxeologically-be achieved only if the production structure is lengthened.

So long as this is the case, capital formation and accumulation will set in and continue. Instead of being supported by and engaged in instantly gratifying production processes, land and labor, the originary factors of production, are supported by an excess of production over consumption and employed in the production of capital goods, that is, produced factors of production. These goods have no value except as intermediate products in the process of turning out final (consumer) goods later. Production of final products with the help of these goods is more "productive." Or, what amounts to the same thing, he who possesses, and can produce with the aid of, capital goods is nearer in time to the completion of his ultimate project than he who must do without them. The excess in value (price) of a capital good over the sum expended on the complementary originary factors required for its production is due to this time difference and to the universal fact of time preference. This excess is the price paid for buying time: for moving closer to the completion of one's ultimate goal rather than having to start at the very beginning. And for the same reason of time preference, the value of the final output must exceed the sum spent on its factors of production, that is, the price paid for the capital good and all complementary labor services.

The lower the time-preference rate, then, the earlier the process of capital formation will set in and the faster it will lengthen the roundabout structure of production. Any increase in the accumulation of capital goods and in the roundaboutness of the production structure raises, in turn, the marginal productivity of labor. This leads to increased employment and/or wage rates and, in any case (even if the labor-supply curve should become backward sloping with increased wages), to a higher wage total (see Rothbard [1962] 1970: 663ff.). Supplied with an increased number of capital goods, a better-paid population of wage earners will now produce an overall increased-future-social product, raising at last, after that of the employees, the real incomes of the owners of capital and land.

While interest (time preference) thus has a direct praxeological relationship to employment and social income, it has nothing whatsoever to do with money. To be sure, a money economy also includes a monetary expression for the social rate of time preference. Yet this does not change the fact that interest and money are systematically independent and unrelated and that interest is essentially a "real," not a monetary phenomenon. Time preference and interest, in contrast to money, cannot be conceived of as disappearing even in the state of final general equilibrium. For even in equilibrium the existing capital structure needs to be constantly maintained over time (so as to prevent it from becoming gradually consumed in the even course of an endlessly repeated pattern of productive operations). There can be no such maintenance, however, without ongoing savings and reinvestments, and there can be no such things as these without the expectation of a positive rate of interest. Indeed, if the rate of interest paid were zero, capital consumption would result and one would move out of equilibrium (see Mises [1949] 1966: 530-32; Rothbard [1962] 1970: 385-86).

Matters become more complex under conditions of uncertainty, when money is actually in use, but the praxeological independence of money and interest remains intact. Under these conditions, man invariably has three instead of two alternative ways to allocate his current income. He must decide not only how much to allocate to the purchase of present goods and how much to future goods (i.e., how much to consume and how much to invest), but also how much to keep in cash. There are no other alternatives. Yet while man must always make adjustments

concerning three margins at once, the outcome is invariably determined by two distinct and praxeologically unrelated factors. The consumption/investment proportion is determined by time preference. The source of the demand for cash, on the other hand, is the utility attached to money (i.e., its usefulness in enabling immediate purchase of directly serviceable goods at uncertain future dates). And both factors can vary independently of one another.

As with other aspects of the real economy, the level of money stock has no effect whatsoever on the rate of interest, which is determined by time preference. But *changes* in the stock of money can not only affect relative prices and incomes, but also reduce overall real incomes by causing booms and busts or by dislocating the process of economic calculation. Furthermore, since changes in the stock of money will necessarily affect the distribution of incomes, the social rate of time preference will be affected by the time preferences of the early, as compared to the later, receivers of the new money. But since there is no way of predicting whether social time preferences will rise or fall from any given change in the money supply, such changes can have no systematic effect on the rate of time preference and hence, on the rate of interest.

The same is true of changes in the demand for money and their effects on time preferences. If, for example, the Keynesian nightmare of increased hoarding becomes reality and prices generally fall while the purchasing power of money correspondingly rises, this will have no predictable systematic effects on the investment/consumption proportion in society. This proportion, and the time-preference schedule determining it, will change unpredictably, depending on the time preferences of the hoarders and nonhoarders and on how the changing demand for money ripples through the market economy.

In an unhampered economy, the interest rate is solely determined by the social rate of time preference (to which is added a premium, depending on the extent of risk involved in the particular loan). Since the real interest rate will tend to equal this social rate of time preference, expected price inflation will tend to be added by the market to the money interest rate, so as to keep the real rate equal to time preferences. The rate of interest on money loans will tend to be equal to the rate of return on investments, with this rate itself determined by the time-preference rate plus the inflation premium. But if the banks inflate credit, the increased supply of loans will temporarily drive down the loan-interest rate below the free-market rate, thereby generating the inflationary boom-bust cycle.

I.4. The Capitalist Process

With the division of labor established and extended via development of a universal medium of exchange, the process of economic development is essentially determined by time preference. To be sure, there are other important factors: the quality and quantity of the population, the endowment with nature-given resources, and the state of technology. Yet of these, the quality of a group of people is largely beyond anyone's control and must be taken as a given; the size of a population may not advance economic development, depending on whether the population is below or above its optimum size for a given-sized territory; and nature-given resources or technological know-how can have an economic impact only if discovered and utilized. In order to do this, though, there must be prior savings and investment. It is not the availability of resources and

technical or scientific knowledge that imposes limits on economic advancement; rather, it is time preference that imposes limits on the exploitation of actually available resources as well as on the utilization of existing knowledge (and also on scientific progress, for that matter, insofar as research activities too must be supported by saved-up funds).

Thus, the only viable path toward economic growth is through savings and investment, governed as they are by time preference. Ultimately, there is no way to prosperity except through an increase in the per-capita quota of invested capital. This is the only way to increase the marginal productivity of labor, and only if this is done can future income rise in turn. With real incomes rising, the effective rate of time preference falls (without, however, reaching zero or becoming negative), adding still further increased doses of investment and setting in motion an upward-spiraling process of economic development.

There is no reason to suppose that this process will come to a halt short of reaching the Garden of Eden, where all scarcity has disappeared—unless people deliberately choose otherwise and begin to value additional leisure more highly than any further increase in real incomes. Nor is there any reason to suppose that the process of capitalist development will be anything but smooth, that is, that the economy will flexibly adjust not only to all monetary changes but to all changes in the social rate of time preference as well. Of course, as long as the future is uncertain, there will be entrepreneurial errors, losses, and bankruptcies. But no systematic reason exists for this to cause more than temporary disruptions or for these disruptions to exceed, or drastically fluctuate around, a "natural rate" of business failures (see Rothbard 1983a: 12-17).

Matters become different only if an extramarket institution such as government is introduced. It not only makes involuntary unemployment possible, as explained above, but the very existence of an agent that can effectively claim ownership over resources which it has neither homesteaded, produced, nor contractually acquired also raises the social rate of time preference for homesteaders, producers, and contractors, hence creating involuntary impoverishment, stagnation, or even regression. It is only through government that mankind can be stopped on its natural course toward a gradual emancipation from scarcity long before ever reaching the point of voluntarily chosen zero growth.⁸ And it is only in the presence of a government that the capitalist process can possibly take on a cyclical (rather than a smooth) pattern, with busts following booms. Exempt from the rules of private-property acquisition and transfer, government naturally desires a monopoly over money and banking and wants nothing more than to engage in fractional reserve banking, that is--in nontechnical terms, monopolistic counterfeiting--so as to enrich itself at the expense of others through the much less conspicuous means of fraud rather than through outright confiscation (see Rothbard 1983a; Hoppe 1989a). Boom-and-bust cycles are the outcome of fraudulent fractional reserve banking. If, and insofar as, the newly created counterfeit money enters the economy as additional supplies on the credit market, the rate of interest will have to fall below what it would otherwise have been: credit must become cheaper: Yet at a lower price more credit is taken and more resources then are invested in the production of future goods (instead of being used for present consumption) than would otherwise have been. The roundaboutness of the entire production structure is lengthened. In order to complete all investment projects now under way, more time is needed than that

⁸ On the role of government as destructive of wealth formation, see Rothbard (1977) and Hoppe (1989d).

required to complete those projects begun before the credit expansion. All the goods that would have been created without credit expansion must still be produced-plus those that are newly added. However, for this to be possible more capital is required. The larger number of future goods can be successfully produced only if additional savings provide a means of sustenance sufficiently large to bridge, and carry workers through, the longer waiting time. But, by assumption, no such increase in savings has taken place. The lower interest rate is not the result of a larger supply of capital goods. The social rate of time preference has not changed at all. It is solely the result of counterfeit money entering the economy through the credit market. It follows logically that it must be impossible to complete all investment projects under way after a credit expansion, due to a systematic lack of real capital. Projects will have to be liquidated so as to shorten the overall production structure and readjust it to an unchanged rate of social time preference and the corresponding real investment/consumption proportion.⁹

These cyclical movements cannot be avoided by anticipation (contrary to the motto "a cycle anticipated is a cycle avoided"): they are the praxeologically necessary consequences of additional counterfeit credit being successfully placed. Once this has occurred, a boom-bust cycle is inevitable, regardless of what the actors correctly or incorrectly believe or expect. The cycle is induced by a monetary change, but it takes effect in the realm of "real" phenomena and will be a "real" cycle no matter what beliefs people happen to hold.¹⁰

Nor can it be realistically expected that the inevitable cyclical movements resulting from an expansion of credit will ever come to a halt. As long as an extramarket institution like government is in control of money, a permanent series of cyclical movements will mark the process of economic development; for through the creation of fraudulent credit, a government can engender an inconspicuous income and wealth redistribution in its own favor. There is no reason (short of idealistic assumptions) to suppose that a government would ever deliberately stop using this magic wand merely because credit expansion entails the "unfortunate" side effect of business cycles.

II

After this reconstruction of the classical, and especially the Austrian theory of employment, money, interest, and the capitalist process, I will now turn to Keynes and his "new" theory. Against the backdrop of our explanation of the old theory, it should be easy to recognize Keynes's "new" *General Theory of Employment*,

⁹ On the theory of the business cycle, see Mises's original contribution (Mises 1971); his first elaborate version is in Mises (1928 1978a). See also Hayek (1939b, [1935] 1967c). Hayek's works were first published in 1929, resp. 1931; it is interesting to note that Hayek, who received the Nobel Prize in 1974, the year after Mises's death, for his contributions to the Mises/Hayek theory of the business cycle, obviously misrepresents Mises's achievements as regards the development of this theory. In his *Prices and Production* of 1931, the first presentation of the Austrian business-cycle theory to appear in English, Hayek acknowledges Mises's prior claim to fame. Yet even though he cites Mises's 1928 work (cited above), he falsely claims that Mises's contributions to the theory were essentially confined to a few remarks in his original work of 1912; See Strigl (1934), Robbins (1971), Rothbard (1983a), Mises, Haberler, Rothbard, and Hayek (1983), Hoppe (1983), Garrison (1986, 1988).

¹⁰ See also R. Garrison 1988b. See also the critique of psychological (as opposed to praxeological) business-cycle theories, below.

Interest, and Money as fundamentally flawed and the Keynesian revolution as one of this century's foremost intellectual scandals.¹¹

II.1. Employment

Keynes sets out a false theory of employment. Contrary to the classical view, he claims that there can be involuntary unemployment on the free market and, further, that a market can reach a stable equilibrium with persistent involuntary unemployment. Finally, in claiming such market failures to be possible, he professes to have uncovered the ultimate economic rationale for interference in the operations of markets by extramarket forces. Since the free market is defined in terms of homesteaded or produced private property and the voluntary nature of all interactions between private property owners, it should be clear that what Keynes claims to show is roughly equivalent to a squaring of the circle.

Keynes begins with the false statement that the classical theory assumed "that there is no such thing as involuntary unemployment in the strict sense" (Keynes 1936: 21, 6, 15). In fact, it assumed no such thing. Classical theory assumed that involuntary unemployment is logically/praxeologically impossible as long as a free market is in operation. That involuntary unemployment, indeed any degree of it, can exist in the presence of an extramarket institution such as minimum-wage laws, has never been seriously doubted.

After stating this falsehood, Keynes then proceeds to give his definition of involuntary unemployment: "Men are involuntarily unemployed if, in the event of a small rise in the price of wage-goods [i.e., consumer goods] relative to the money wage, both the aggregate supply of labor willing to work for the current money-wage and the aggregate demand for it at that wage would be greater than the existing volume of employment" (ibid.: 15)¹² Translated into plain English, what Keynes is saying is that men are involuntarily unemployed if an increase in prices relative to wage rates leads to more employment (see Hazlitt [1959] 1973: 30). Yet such a change in relative prices is logically equivalent to a fall in real wage rates; and a fall in real wages can be brought about on the unhampered market by wage earners at any time they so desire simply by accepting lower nominal wage rates, with commodity prices remaining where they are. If laborers decide not to do this, there is nothing involuntary in their remaining unemployed. Given their reservation demand for labor, they choose to supply that amount of labor which is actually supplied. Nor would the classification of this situation as voluntary change a bit if, at another time, lower wage rates increased the amount of employment. By virtue of logic, such an outcome can be brought about only if, in the meantime, laborers have increased their relative evaluation of a given wage rate versus their labor reservation demand (otherwise, if no such change has occurred, employment will decrease instead of increasing). The fact, however, that one can change one's mind over time hardly implies that one's earlier choice was involuntary, as Keynes would have it. Of course, one can define one's terms anyway one wishes, and, in true Orwellian fashion, one may even choose to call voluntary "involuntary" and involuntary "voluntary." Yet, through this method,

¹¹ For pro-Keynesian literature, see S. Harris (1948a), A. Hansen (1953); for anti-Keynesian literature, see H. Hazlitt ([1959] 1973, 1984).

¹² At this point Keynes promises an alternative definition to be given on page 26; revealingly, no such definition appears there or anywhere else in the book!

anything under the sun can be "proven," while in fact nothing of substance whatsoever is shown. Keynes's alleged proof leaves entirely unaffected the fact that no such thing as involuntary employment, in the usual sense of this term, can ever exist on the unhampered market.

And as if this were not enough, Keynes tops it off by claiming that involuntary unemployment is conceivable even in equilibrium. Indeed, he criticizes his earlier *Treatise on Money* by saying, "I had not then understood that, in certain conditions, the system could be in equilibrium with less than full employment" (Keynes 1936: 242-43, 28). Yet equilibrium is *defined* as a situation where changes in values, technology, and resources no longer occur; where all actions are completely adjusted to a final constellation of data; and where all factors of production, including labor, are employed to the fullest extent possible (given these unchanging data) and are repeatedly and endlessly employed in the same constant production pattern. Hence, as H. Hazlitt has remarked, the discovery of an unemployment equilibrium by Keynes, in his *General Theory*, is like the discovery of a triangular circle—a contradiction in terms (Hazlitt [1959] 1973: 52).

II.2. Money

Having failed in his treatment of employment and unemployment, Keynes, in his discussion of money, then discards economic reasoning by advancing the claim that money and monetary changes (can) have a systematic and even positive effect on employment, income, and interest. Given the fact that "money" appears in the full title of *The General Theory*, Keynes's positive theory of money is amazingly brief and undeveloped. Brevity, of course, can be a virtue. In the case of Keynes, it offers the opportunity to pinpoint rather easily his elementary mistakes. For Keynes, "*the importance of money essentially flows from its being a link between the present and the future*" (Keynes 1936: 293). "Money in its significant attributes is, above all, a subtle device for linking the present and the future" (ibid.: 294). That this is false follows from the fact that in equilibrium no money would exist,¹³ yet even under equilibrium conditions there would still be a present and a future, and both would still be linked. Rather than functioning as a link to the future, money serves as a medium of exchange; a role that is inextricably tied to the *uncertainty* of the future.¹⁴ *Action*, which invariably

¹³ Mises explains: "Let us assume that there is only gold money and only one central bank. With the successive progress toward the state of an evenly rotating economy all individuals and firms restrict step by step their holding of cash and the quantities of gold thus released flow into nonmonetary-industrial-employment. When the equilibrium of the evenly rotating economy is finally reached, there are no more cash holdings; no more gold is used for monetary purposes. The individuals and firms own claims against the central bank, the maturity of each part of which precisely corresponds to the amount they will need on the respective dates for the settlement of their obligations. The central bank does not need any reserves as the total sum of the daily payments of its customers exactly equals the total sum of withdrawals. All transactions can in fact be effected through transfer in the bank's books without any recourse to cash. Thus the 'money' of this system is not a medium of exchange; it is not money at all; it is merely a *numeraire*, an ethereal and undetermined unit of accounting of that vague and indefinable character which the fancy of some economists and the errors of many laymen mistakenly have attributed to money" (Mises [1949] 1966: 249).

¹⁴ Keynes recognizes that money also has something to do with uncertainty. The fundamental mistake in his theory of money pointed out here, however, surfaces again when he relates money not to uncertainty as such but, more specifically, to uncertainty of interest rates. "The necessary condition [for the existence of money]," he writes, "is the existence of uncertainty as to the future rate of interest" (Keynes 1936: 168-69). See also the

begins in the present and is aimed at some future goal, more or less distant in time from the action's beginning, constitutes the real link between the present and the future. And it is time preference as a universal category of action that gives this link between present and future its specific shape. Money, in contrast to interest, no more relates the present to the future than do other economic phenomena, such as nonmonetary goods. Their present value, too, reflects anticipations regarding the future, no more and no less than does money.

From this first misconception regarding the nature of money, all other misconceptions flow automatically. Being defined as a subtle link between present and future, the demand for money (its supply being given), which Keynes, in line with his general inclination to misinterpret logical/praxeological categories as psychological ones, terms "liquidity preference" or "propensity to hoard" (*ibid.*: 174), is said to be functionally related to the rate of interest (and vice versa).¹⁵ "Interest," writes Keynes, "is the reward of not-hoarding" (*ibid.*), "the reward for parting with liquidity" (*ibid.*: 167), which makes liquidity preference in turn the unwillingness to invest in interest-bearing assets. That this is false becomes obvious as soon as one asks the question, "What, then, about prices?" The quantity of beer, for instance, that can be bought for a definite sum of money is obviously no less a reward for parting with liquidity than is the interest rate, thus making the demand for money an unwillingness to buy beer as much as an unwillingness to lend or invest (see Hazlitt [1959] 1973: 188ff.). Or, formulated in general terms, the demand for money is the unwillingness to buy or rent nonmoney, including interest-bearing assets (i.e., land, labor, and/or capital goods, or future goods) *and* noninterest-bearing assets (i.e., consumer or present goods). Yet to recognize this is to recognize that the demand for money has nothing to do with either investment or consumption, nor with the ratio of investment-to-consumption expenditures, nor with the spread between input and output prices, that is, the discount of higher-order, or future, goods versus lower-order, or present goods. Increases or decreases in the demand for money, other things being equal, lower or raise the overall level of money prices, but real consumption and investment as well as the real consumption/investment proportion remain unaffected; and, such being the case, employment and social income remain unchanged as well. The demand for money determines the spending/cash balance proportion. The investment/consumption proportion, pace Keynes, is an entirely different and unrelated matter. It is solely determined by time preference (see Rothbard 1983a: 40-41; Mises [1949] 1966: 256).

The same conclusion is reached if changes in the supply of money (liquidity preference being given) are considered. Keynes claims that an increase in the supply of money, other things being equal, can have a positive effect on employment. He writes, "So long as there is unemployment, employment will change in the same proportion as the quantity of money" (Keynes 1936: 296). Yet this is a highly curious pronouncement because it *assumes* the existence of unemployed resources instead of *explaining* why such a thing should possibly occur; for, obviously, a resource can be unemployed only because it is either not recognized as scarce at all and thus has no value whatsoever or because its owner

following discussion.

¹⁵ On the absurd implications of the assumption of functional-rather than causal- relations, see the discussion in section n.3, below.

voluntarily prices it out of the market and its unemployment then is no problem needing a solution (see Hutt [1939] 1977).

Even if one were to waive this criticism, Keynes's statement would still be fallacious. For if other things were indeed equal, then the additional supply of money would simply lead to increased overall prices and to simultaneously and proportionally increased wage rates, and nothing else would change at all. If, contrary to this, employment should increase, it could only do so if wage rates did not rise along with, and to the same extent as, other prices. However, other things then could no longer be said to be equal because real wage rates would be lowered, and employment can only rise while real wages fall if the relative evaluation of employment versus self-employment (i.e., unemployment) is assumed to have changed. Yet if this were assumed to have changed, no increase in the money supply would have been required. The same result, namely, increased employment, could also have been brought about by laborers' accepting lower nominal wage rates.

II.3. Interest

In his discussion of the interest phenomenon, Keynes abandons reason and common sense entirely. According to Keynes, since money has a systematic impact on employment, income, and interest, then interest itself—quite consistently, for that matter—must be conceived of as a purely monetary phenomenon (Keynes 1936: 173).¹⁶ I need not explain the elementary fallacy of this view.

Suffice it to say here again that money would disappear in equilibrium, but interest would not, which suggests that interest must be considered a real, not a monetary, phenomenon.

Moreover, Keynes, in talking about "functional relationships" and "mutual determination" of variables instead of causal, unidirectional relations, becomes entangled in inescapable contradictions as regards his theory of interest (see Rothbard [1962] 1970: 687-89). As has been explained above, on the one hand, Keynes thinks of liquidity preference (and the supply of money) as *determining* the interest rate, such that an increased demand for money, for instance, will raise the interest rate (and an increased supply of money, lower it) and that this then will reduce investment, "whilst a decline in the rate of interest may be expected, ceteris paribus, to increase the volume of investment" (Keynes 1936: 173). On the other hand, characterizing the interest rate as "the reward for parting with liquidity," he contends that the demand for money is *determined* by the interest rate. A fall in the interest rate, for instance, would increase one's demand for cash (and also, it should be added, one's propensity to consume) and hence lead to *reduced* investment. Obviously, however, a lower interest rate can hardly do both, increasing and decreasing investment at the same time. Something must be wrong here.

Since interest, according to Keynes, is a purely monetary phenomenon, it is only natural to assume that it can be manipulated at will through monetary policy (provided, of course, that one is not restricted in this policy by the existence of

¹⁶ See also Keynes's laudatory remarks on mercantilist economics, and in particular, S. Gesell, as precursors of this view (Keynes 1936: 341, 355).

100% reserve commodity money standard, such as the gold standard). "There is," writes Keynes, "no special virtue in the pre-existing rate of interest" (ibid.: 328). In fact, if the supply of money is sufficiently increased, the interest rate supposedly can be brought down to zero. Keynes recognizes that this would imply a superabundance of capital goods, and one would think that this realization should have given him cause to reconsider. Not so! On the contrary, in all seriousness he tells us "that a properly run community equipped with modern technical resources, of which the population is not increasing rapidly, ought to be able to bring down the marginal efficiency of capital in equilibrium approximately to zero within a single generation" (ibid.: 220). It is "comparatively easy to make capital goods so abundant that the marginal efficiency of capital is zero (and) this may be the most sensible way of gradually getting rid of many of the objectional features of capitalism" (ibid.: 221). "There are no intrinsic reasons for the scarcity of capital" (ibid.: 376). Rather, it is "possible for communal saving through the agency of the State to be maintained at a level where it ceases to be scarce" (ibid.).

Never mind that this would imply no need for maintenance or replacement of capital any longer (for, if this were the case, capital goods would still be scarce and hence command a price) and that capital goods would instead have to be "free goods" in the same sense in which air is usually "free." Never mind that if capital goods were no longer scarce, then neither would consumer goods be scarce (for, if they were, the means employed to produce them would have to

be scarce too). And never mind that in this Garden of Eden, which Keynes promises to establish within one generation, there would no longer be any use for money. For, as he informs us, "I am myself impressed by the great social advantages of increasing the stock of capital until it ceases to be scarce" (ibid.: 325). Who would dare disagree with this?¹⁷

Yet more is to come—because, as Keynes sees it, there are some obstacles on the path toward paradise. For one thing, the gold standard gets in the way because it makes the expansion of credit impossible (or difficult, at least, in that a credit expansion would lead to an outflow of gold and a subsequent economic contraction). Hence Keynes's repeated polemics against this institution.¹⁸ Further, there is the just explained problem of his own making: that is, a lower interest rate supposedly increases and decreases investment simultaneously. And it is to get out of this logical mess that Keynes comes up with a conspiracy theory: for, while

¹⁷ See also Hazlitt ([1959] 1973: 231-35). What about the seemingly obvious objection that the expansion of monetary credit, through which Keynes wants to bring about, the reduction of the interest rate to zero, is nothing but an expansion of paper and that the problem of scarcity is a matter of "real" goods which can only be overcome through "genuine savings"? To this he gives the following funny answer: "The notion that the creation of credit by the banking system allows investment to take place to which 'no genuine saving' corresponds" (Keynes 1936: 82), that is, "the idea that saving and investment. . . can differ from one another, is to be explained, I think, by an optical illusion" (ibid.: 81). "The savings which result from this decision are just as genuine as any other savings. No one can be compelled to own the additional money corresponding to the new bank-credit unless he deliberately prefers to hold more money rather than some other form of wealth" (ibid.: 83). "The new money is not 'forced' on anyone" (ibid.: 328). As Henry Hazlitt remarks, "On the same reasoning we can create any amount of new 'savings' we wish overnight, simply by printing that amount of new paper money, because somebody will necessarily hold that new paper money" (Hazlitt [1959] 1973: 227).

¹⁸ See Keynes (1936: 129ff., 336ff., 348ff.). On Keynes's role in the actual destruction of the gold standard, see Hazlitt (1984).

the interest rate must be reduced to zero in order to eliminate scarcity, as we were just told, the lower the interest rate, the lower also the reward for parting with liquidity. The lower the interest rate, that is to say, the lower the incentive for capitalists to invest because their profits will be reduced accordingly. Thus, they will try to undermine, and conspire against, any attempt to resurrect the Garden of Eden.

Driven by "animal spirits" (ibid.: 161) and "gambling instincts" (ibid.: 157), and "addicted to the money-making passion" (ibid.: 374), they will conspire to ensure "that capital has to be kept scarce enough" (ibid.: 217). "The acuteness and peculiarity of our contemporary problem arises, therefore," writes Keynes, "out of the possibility that the average rate of interest which will allow a reasonable average level of employment [and of social income] is one so unacceptable to wealth owners that it cannot be readily established merely by manipulating the quantity of money" (ibid.: 308-9). In fact, "the most stable, and least easily shifted, element in our contemporary economy has been hitherto, and may prove to be in the future, the minimum rate of interest acceptable to the generality of wealth owners" (ibid.: 309).¹⁹ Fortunately, we are informed, there is a way out of this predicament: through 'the euthanasia of the rentier, and, consequently, the euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity-value of capital' (ibid.: 376, 221). Surely, they deserve such a fate. For "the business world" is ruled by an "uncontrollable and disobedient psychology" (ibid.: 317), and private investment markets are "under the influence of purchasers largely ignorant of what they are buying and of speculators who are more concerned with forecasting the next shift of market sentiment than with a reasonable estimate of the future yield of capital assets" (ibid.: 316). As a matter of fact, don't we all know that "there is no clear evidence from experience that the investment policy which is socially advantageous coincides with that which is most profitable" (ibid.: 157); indeed, that the decisions of private investors depend largely on "the nerves and hysteria and even the digestions and reactions to the weather" (ibid.: 162), rather than on rational calculation? Thus, concludes Keynes, "the duty of ordering the current volume of investment cannot safely be left in private hands" (ibid.: 320). Instead, to turn the present misery into a land of milk and honey, "a somewhat comprehensive socialization of investment will prove the only means" (ibid.: 378). "The State, which is in a position to calculate the marginal efficiency of capital-goods on long views and on the basis of the general social advantage [must take] an ever greater responsibility for directly organizing investment" (ibid.: 164).

I trust that none of this requires further comment. It is all too obvious that these are the outpourings of someone who deserves to be called anything except an economist.

II.4. The Capitalist Process

Such a verdict finds still more support when Keynes's theory of the capitalist process is finally considered. That Keynes was no friend of capitalism or

¹⁹ He adds, in a footnote, "the nineteenth-century saying, quoted by Bagehot, that 'John Bull' can stand many things, but he cannot stand 2 per cent." On Keynes's conspiracy theory, see Hazlin ([1959] 1973: 316-18).

capitalists should be obvious from the quotations above. In fact, by advocating "a socialization of investment he comes out openly as a socialist."²⁰ For Keynes, capitalism *meant* crisis.

He gave essentially two reasons for this. The first one, to which Keynes attributed the cyclical nature of the capitalist process, has already been touched upon. Surely, as long as the course of the economy is largely determined by capitalists who, we have been told, "are largely ignorant of what they are purchasing," and who conspire "to keep things scarce," that course cannot be a smooth, even one. Depending mostly on people who base their decisions on their "digestion and the weather," the capitalist process must be erratic. Moved by the "waxing and waning" of entrepreneurial optimism and pessimism, which in turn are determined by the "uncontrollable and disobedient psychology of the business world," booms and busts are inevitable. Business cycles—so goes the central message of chapter 22 of *The General Theory*, "Notes on the Trade Cycle"—are *psychologically* determined phenomena. Yet this is surely incorrect. A psychological explanation of the business cycle is, strictly speaking, impossible, and to think of it as an explanation involves a category mistake: Business cycles are obviously real events experienced by individuals, but experienced by them as occurring outside of themselves in the world of real goods and real wealth. Beliefs, sentiments, expectations, optimism, and pessimism, on the other hand, are *psychological* phenomena. One can think of any psychological phenomenon as affecting or influencing any other one. But it is impossible to conceive of a psychological phenomenon or feeling state as having any direct impact on outcomes in the external world of real things and goods. Only through *actions* can the course of real events be influenced, and any explanation of the business cycle must then necessarily be a *praxeological* (as opposed to a psychological) one. Keynes's psychological business-cycle theory, in fact, *cannot explain why anything real happens at all*.

However, in the real world, people must act and must continually allocate and reallocate scarce resources to valued goals. One cannot *act* arbitrarily, though, as Keynes would have it, because in acting one is invariably constrained by a real scarcity which cannot be affected by our psychology at all. Nor does Keynes's theory explain why entrepreneurial mood swings would result in any *particular* pattern of business fluctuations—such as the boom-bust cycle that he supposedly wants to explain—instead of any other conceivable pattern of fluctuations. The second reason for the instability of capitalism, and for the desirability of a Socialist solution, according to Keynes, is capitalism's inherent stagnationist tendencies. His stagnation theory centers on the notion, which he takes from Hobson and Mummery and endorses, "that in the normal state of modern industrial Communities, consumption limits production and not production consumption" (Keynes 1936: 368).²¹ With this as one of his axioms, only nonsense can follow.

²⁰ Keynes's socialism, however, was not the egalitarian-proletarian version espoused by the Bolsheviks. For this, Keynes had nothing but contempt. His socialism was of the Fascist or Nazi variety. In the preface to the German edition of his *General Theory* (which appeared in late 1936) he wrote: "Nevertheless the theory of output as a whole, which is what the following book purports to provide, is much more easily adapted to the conditions of a totalitarian state, than is the theory of production and distribution of a given output produced under conditions of free competition and a large measure of laissez-faire."

²¹ On the Keynesian theory of stagnation, see Hansen (1941); for a critique, see G. Terborgh (1945) and Rothbard (1987).

Stagnation is due to a lack of consumption. "Up to the point where full employment prevails," Keynes writes, "the growth of capital depends not at all on a low propensity to consume but is, on the contrary, held back by it" (ibid.: 372-73). Combined with this underconsumptionist thesis is a "fundamental psychological law, upon which we are entitled to depend with great confidence both *a priori* from our knowledge of human nature and from the detailed facts of experience, is that men are disposed, as a rule and on the average, to increase their consumption as their income rises, but not by as much as the increase in their income" (ibid.: 96). "As a rule, . . . a greater proportion of income [will be] saved as real income increases" (ibid.: 97, 27ff.).

On its own, this second law, which is accepted as plausible here for the sake of argument (except for adding that consumption can, of course, never fall to zero), would not seem to indicate any trouble. So what? If savings overproportionally increase with increasing incomes, so much the better for the social product.²² But Keynes, characteristically, joins this law to the thesis that production is limited by consumption, and he then has no difficulty proving whatever he wishes.

If consumption limits production, and if nonconsumption rises with rising incomes, then it does indeed seem to follow that increasing incomes imply their own undoing by increasing nonconsumption, which in turn limits production, and so on. And if this is so, it also seems to follow that wealthier societies, which non-consume more, should be particularly plagued by this "stagnitis" and that, in any given society, it should be the rich, who non-consume more, who contribute most to economic stagnation (except for the "minor" problem that one cannot explain, according to this theory, how individuals or societies could be wealthier than others in the first place!). In any case, Keynes accepts these conclusions as true.²³ Then, accordingly, he presents his recommendations for how to get out of stagnation. In addition to a "comprehensive socialization of investment," Keynes suggests measures to stimulate consumption, in particular an income redistribution from the rich (people with a low propensity to consume) to the poor (those with a high propensity to consume):

Whilst aiming at a socially controlled rate of investment with the view to a progressive decline in the marginal efficiency of capital, I should support at the same time all sorts of policies for increasing the propensity to consume. For it is unlikely that

²² In fact, Keynes informs us that *savings is by definition identical to investment* (Keynes 1936: 63), "that the excess of income over consumption, which we call saving, cannot differ from the addition to capital equipment which we call investment" (ibid.: 64). Then, however, a reduced proportion of consumption expenditures must by definition go hand in hand with increased investments, and this would lead to a higher future income, to still more absolute consumption and still more absolute and relative saving and investment. Where, indeed, is the problem here?

²³ Keynes writes, "If in a potentially wealthy community the inducement to invest is weak, then, in spite of its potential wealth, the working of the principle of effective demand will compel it to reduce its actual output, until, in spite of its potential wealth, it has become so poor that its surplus over its consumption is sufficiently diminished to correspond to the weakness of the inducement to invest" (Keynes 1936: 31). Or: "The greater, moreover, the consumption for which we have provided in advance, the more difficult it is to find something further to provide for in advance, and the greater, unfortunately, is the margin between our incomes and our consumption. So, failing some novel expedient, there is, as we shall see, no answer to the riddle, except that there must be sufficient unemployment to keep us so poor that our consumption falls short of our income by no more than the equivalent of the physical provision for future consumption which it pays to produce to-day" (ibid.: 105).

full employment can be maintained, whatever we may do about investment, with the existing propensity to consume. There is room, therefore, for both policies to operate together: -to promote investment and, at the same time, to promote consumption, not merely to the level which with the existing propensity to consume would correspond to the increased investment, but to a higher level still. (Ibid.: 325)²⁴

But how is such a thing as simultaneously promoting investment and consumption in order to increase income conceivably possible? In fact, Keynes gives us his own formal definitions of the terms involved: "Income = consumption + investment; saving = income - consumption; therefore, saving = investment" (ibid.: 63).²⁵ Under these definitions, a simultaneous increase in consumption and investment out of a given income is conceptually impossible!

Keynes, however, is not much disturbed over "details" such as these. In order to get what he wants, he simply shifts, completely unnoted, the meanings of his terms. He drops the formal definitions quoted above, since these would render such a result impossible, and he adopts a new meaning for the term "saving." Instead of unconsumed income, "saving" quietly comes to mean "hoarding," that is, the act of not spending money on *either* consumer *or* capital goods (see Hazlitt [1959] 1973: 120-33). The results can thereby be easily made to come out right. For now savings are no longer equal to investment; and saving, being defined as the act of *not* spending, automatically acquires a negative connotation, while investment and consumption take on positive ones. Moreover, now one must almost naturally be worried about savings exceeding investment, or so it seems, for this would appear to imply that something is leaking out of the economy and that income (defined as investment + consumption) will be somehow reduced. Keynes certainly worries about this possibility. He calls it "a chronic tendency throughout human history for the propensity to save to be stronger than the inducement to invest" (Keynes 1936: 367). And this chronic tendency must surely be particularly pronounced if incomes are high, for then, as we have been told, savings reach a particularly high proportion of income. But do not despair: where something can leak out, something also can leak in. If savings are viewed as unspent money, then savings can be brought into existence, simply enough, by means of governmental money creation to compensate for the outward leakage which tends to increase with increasing incomes. There is the danger, of course, that these compensatory "community savings" will immediately leak out again by being added to the private sector's cash hoardings (because, according to Keynes, the newly created savings would lower the interest rate, and this in turn would increase the capitalists' liquidity preference so as to counteract such a tendency and artificially to "keep capital scarce"). But this can be taken care of by the "socialization of investment," as we know, and by some Gesellian stamped-money schemes: "the idea behind stamped money is sound" (ibid.: 357). And once saving and investing are done publicly-through the agency of the state, as Keynes would say-and all money is spent, with no keep-things-scarce motive in the way any more, there is indeed no longer any problem with increasing consumption and investment simultaneously. Since savings have become unspent

²⁴ Or, "the remedy would lie in various measures designed to increase the propensity to consume by the redistribution of incomes or otherwise" (Keynes 1936: 324).

²⁵ It is typical of Keynes's philosophy of abundance that he gets things upside down here as well. For the correct definitions are: product produced = income; income - consumption = saving; saving = investment. Where does Keynes's income come from?

money, and newly created money and credit are just as "genuine" as any other because these are not "forced" on anyone, savings can be created by the stroke of a pen.²⁶ And since the state, contrary to the scarcity-exploiting capitalists, can make sure that these additional genuine savings are indeed being spent (instead of wandering into hoards), any increase in the supply of money and credit through governmental counterfeiting increases consumption and investment simultaneously and so promotes income twice. Permanent inflation is Keynes's cure-all. It helps overcome stagnation; and more of it overcomes the more severe stagnation crises of the more advanced societies. Finally, once stagnation is defeated, still more inflation will abolish scarcity within one generation.²⁷

Yet the wonders do not cease. What is this leakage, this surplus of savings over investment, that constitutes all such dangers? Something must leak from somewhere to somewhere else, and it must play some role both here and there. Keynes tries to deflect such thoughts by asking us once again not to apply logic to economics. "Contemporary thought," he writes, "is still deeply steeped in the notion that if people do not spend their money in one way they will spend it in another" (ibid.: 20). It seems hard to imagine how this contemporary thought could possibly be wrong, but Keynes believed it false. For him there exists a third alternative. Something, an economic good, one would think, simply drops out of existence, and this means trouble.

An act of individual saving means—so to speak—a decision not to have dinner today. But it does *not* necessitate a decision to have dinner or buy a pair of boots a week hence or a year hence or to consume any specified thing at any specified date. Thus it depresses the business of preparing to-day's dinner without stimulating the business of making ready for some future act of consumption. It is not a substitution of future consumption—demand for present consumption—demand—it is a net *diminution* of such demand. (Ibid.: 210)

Still, the strictures of a two-valued logic do not quite crumble yet. How can there be any net diminution of something? What is not spent on consumer goods or capital goods must still be spent on something else—namely, on cash. *This exhausts all possibilities.* Income and wealth can and must be allocated to consumption, investment, or cash. Keynes's diminution, the leakage, the excess of savings over investment, is income spent on, or added to, cash hoardings. But such an increase in the demand for cash has no effect on real income, consumption, or investment, as has already been explained. With the social money stock being given, a general increase in the demand for cash can only bid down the money prices of nonmoney goods. But so what?²⁸ Nominal income, that is, income in terms of money, will fall; but real income and the real consumption/investment proportion will be unchanged. And people, along the way, get what they want, that is, an increase in the real value of their cash

²⁶ On this, see note 17.

²⁷ On Keynes's program of permanent inflation, see also this remark on the trade cycle: ". The right remedy for the trade cycle is not to be found in abolishing booms and keeping us permanently in a semi-slump; but in abolishing slumps and thus keeping us permanently in a quasi-boom" (Keynes 1936: 322). The answer to credit expansion, that is, is still more credit expansion.

²⁸ Contrary to Keynes's fanciful fears, the demand for money can never be infinite because everyone must obviously consume sometimes (and cannot delay consumption further), and at such points liquidity preference is definitely finite.

balances and in the purchasing power of the money unit. There is nothing stagnating here, or draining, or leaking, and Keynes has offered *no theory of stagnation at all* (and with this, of course, no theory of how to get out of stagnation either). He has merely given a perfectly normal phenomenon, such as falling prices (caused by an increased demand for money or by an expanding productive economy), a bad name in calling it "stagnation," or "depression," or the result of a lack of effective demand, so as to find another excuse for his own inflationary schemes.²⁹

Here we have Keynes, then: the twentieth century's most famous "economist." Out of false theories of employment, money, and interest, he has distilled a fantastically wrong theory of capitalism and of a socialist paradise erected out of paper money.

²⁹ The second element of Keynes's stagnation theory is equally false. It may be true that savings equaling investment increase overproportionally with increasing incomes- although it can never reach 100 percent. Yet this situation should certainly give no one concern regarding the social income produced. It is, however, *not* true that savings, in the sense of hoarding, increase with increasing incomes and that the greatest leakage then occurs among the rich and in wealthy societies. The opposite is true. If real income increases because the economy, supported by additional savings, is expanding, then the purchasing power of money increases (the money stock being given). But at a higher purchasing power of the money unit, the amount of cash demanded actually falls (the demand-for-money schedule being given). Thus, if anything, the leak/stagnation non-problem should actually diminish, rather than increase, with increasing wealth.