15.3 - John Maynard Keynes and the ethics of finance

John Maynard Keynes (1883 - 1946) is rightly regarded as the most important economist of the 20th century. The originality of his works resides in the fact that he didn't content himself with taking economics as it was offered in his time - shaped by his mentor Alfred Marshall (1842 – 1924) - and trying to push it a little further but wished to rethink entirely the economic issue, taking the overall problem from scratch.

The uncertainty of the future

Keynes had not trained in economics but in mathematics and philosophy at Cambridge University where his own father had been a professor before becoming one of the university's main administrators.

Paradoxically Keynes' first-hand acquaintance with mathematics made him extremely suspicious of the use of mathematics in economics, judging – as the specialist in probability theory that he would become – that the uncertainty attached to the future made any deterministic forecast essentially meaningless. This ran against the spirit of the new "economics" that, within a world where information is fully available, the future is perfectly predictable (a "Laplacian" world, from the French astronomer and mathematician Pierre-Simon Laplace [1749-1827]).

Keynes' main and major contributions in economics are shaped by his conviction that we can't know anything about the future and that we are struggling to compensate – very inadequately – for that.

1. His evocation of "animal spirits" suggests that quite often we take decisions which are whimsical, rationally unjustifiable, and that there is no way we can draw a general view of human behaviour determined in such a way; this view runs against the pervasive view in economics since the end of the 19th century that man is a *homo oeconomicus* optimising the use of scarce resources to alternative ends.

2. His example of the “beauty contest” suggests that economic problems are most often intractable as we don’t know in sufficient detail by how much our own position differs from that of other people on the issue.
3. Our choices are often determined by the fact that we are “conventional”, i.e. by the fact that we have little imagination, are conformists at heart. We will thus assume that things are the way that assumed a “dead economist” or will be in the future mostly like they were in the past.

Uncertainties of the future can be transferred for a fee, like is the case in insurance. Risk can be multiplied though by people betting without any necessity on the uncertainties of the future, as in speculation.

In our societies, as the poor are too numerous for the jobs they are offered and cannot therefore be much demanding due to strife between them, the rich manage to transfer a large share of the uncertainties of the future onto the poor.

Society’s problems should be solved through politics not through economics

Keynes was convinced that the solution to economic problems did not lie in economics but in politics, i.e. in decisions made from a social standpoint. His view was that we cannot aim in human societies at a *consensus*, as individual opinions cover too wide a range; still it is possible to reduce as much as can do, frustration and resentment. Therefore if consensus is an unreachable goal, "dissensus" at least can be minimized.

The way to achieve this according to Keynes was to ensure full employment. Once this aim has been reached, other economic issues should be solved within that new framework. But there is no purely economic rationality for trying to achieve full employment: it is in essence a political goal.

Should it be that we agree with Keynes' viewpoint on this, we need to remember that within our new environment where robots are replacing us in manual tasks and software in intellectual ones, full employment may have become in our day unreachable.

Technological unemployment

In *Economic Possibilities for our Grandchildren* (1930), John Maynard Keynes warned about structural unemployment:

> "I believe that this is a wildly mistaken interpretation of what is happening to us. […]The increase of technical efficiency has been taking place faster than we can deal with the problem of labour absorption".
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> "We are being afflicted with a new disease of which some readers may not yet have heard the name, but of which they will hear a great deal in the years to come --namely, technological unemployment. This means unemployment due to our discovery of means of economising the use of labour outrunning the pace at which we can find new uses for labour."

This is now increasingly becoming the case.

Lowering wages is no solution

It is within this same framework that the question of wages should be envisioned: lowering wages is bound to generate resentment among ordinary people; it should be banned therefore as a policy.

Keynes drew the attention of his contemporaries to the fact that if lowering wages is always regarded by policy makers as an option in times of economic hardship, lowering revenues of capital such as dividends and other types of rent is regarded as heretical by them as their interests are most often aligned with those of the wealthy.

At a time in the late 1920s when lowering wages by 5% was considered as an option by the British government in order to facilitate a return to the gold standard, Keynes pretended to loudly approve the envisaged measure "IF", he said, "a 5% tax on capital is simultaneously levied". His irony was considered of very poor taste. The measure – it goes without saying – was not adopted.

Accounting rules encompass a political programme

Another issue that Keynes covered is the impact of accounting rules on the operation of our economy. Accounting rules encompass as a matter a whole philosophy of the economy.

In difficult economic circumstances, there lies an advantage in lowering the price of products: it makes them more affordable to local consumers, also, it makes them cheaper at export. Our accounting rules regard the contribution of labour as a cost, which should therefore be reduced, while the allocation of dividends to shareholders or of bonuses to executives are regarded as a sharing of benefits which is admirable as such and should remain untouched. The notion that costs related to work, i.e. wages, should be as small as possible, while costs linked to the reward of capital should be as high as possible, has nothing natural to it: it is an ideological choice written in our accounting rules. There is no objective reason why things should be so: it just reflects a power balance in favour of holders of capital and in disfavour of workers.

> “The nineteenth century carried to extravagant lengths the criterion of what one can call for short "the financial results," as a test of the advisability of any course of action sponsored by private or by collective action. The whole conduct of life was made into a sort of parody of an accountant's nightmare. Instead of using their vastly increased material and technical resources to build a wonder city, the men of the nineteenth century built slums; and they thought it right and advisable to build slums because slums, on the test of private enterprise, "paid," whereas the wonder city would, they thought, have been an act of foolish extravagance, which would, in the imbecile idiom of the financial fashion, have "mortgaged the future"-- though how the construction to-day of great and glorious works can impoverish the future, no man can see until his mind is beset by false analogies from an irrelevant accountancy.[…]
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> But once we allow ourselves to be disobedient to the test of an accountant's profit, we have begun to change our civilization. And we need to do so very warily, cautiously, and self-consciously. For there is a wide field of human activity where we shall be wise to retain the usual pecuniary tests. It is the state, rather than the individual, which needs to change its criterion. It is the conception of the Secretary of the Treasury as the chairman of a sort of joint stock company which has to be discarded.”

Keynes and speculation

Keynes was a speculator. He incurred considerable losses through it but also considerable gains which ended up making him rich.

Very often his economic models were shaped by the reasoning that a speculator would make. This led him to explanations where only one party of a transaction where two parties are involved would determine price formation: the seller according to him in a sale, the lender in a loan, ignoring the power balance between the two parties.

Speculation however according to Keynes should be kept moderate so it shouldn't disrupt the operation of the overall economic system:

> "… when he purchases an investment, the American is attaching his hopes, not so much to its prospective yield, as to a favourable change in the conventional basis of valuation, i.e. that he is, in the above sense, a speculator. Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done." (in *The general theory of employment, interest and money* – 1936).

Two types of needs: absolute and relative

Soviet communism was becoming very popular among Keynes' friends in the 1920s. Keynes had first-hand experience of the Soviet Union: in 1925 he was invited to Moscow as a representative of Cambridge University. A month before he had married Lydia Lopokova, a Russian ballet-dancer, and had the opportunity of visiting her family, her father had a very modest job: he was a cinema usher.

This trip led Keynes to reflect about the notion of an ideal society. There were two issues to solve Keynes explained: one is to satisfy people's objective essential needs, the second is to satisfy people's subjective desire to be envied by others. The first type of needs is of an absolute type and can be satisfied with the economic means at our disposal, the second issue is of a relative type and is unsolvable as long as some of us wish to be better at any costs than everyone else: the fact is of course that only one person at a time can have a better lot than everyone else!

“Now it is true that the needs of human beings may seem to be insatiable. But they fall into two classes – those needs which are absolute in the sense that we feel them whatever the situation of our fellow human beings may be, and those which are relative in the sense that we feel them only if their satisfaction lifts us above, makes us feel superior to, our fellows.”

How can this second issue be solved? By making sure to remove people's wish to be envied by others. People who have had money in their family for several generations, so-called "old money" hold no such needs says Keynes. The solution then is to ensure that everyone is "old money". This can be achieved over a number of generations. Then capital stops being scarce, interest rates become very low and rentiers, people who earn money by lending their money get starved out, the "euthanasia of the rentiers" is then achieved, to use Keynes' phrase.

The end of laissez-faire (1926)

There was a clash in the 1930s between people such as Friedrich von Hayek (1899-1992) who held that the economy works best with little regulation, as self-regulation makes the economic engine tick to perfection, and people such as Keynes who held the view that we need to use our rationality to make appropriate decisions to push the economy in the right direction where it will not go on its own.

“Let us clear from the ground the metaphysical or general principles upon which, from time to time, *laissez-faire* has been founded. It is *not* true that individuals possess a prescriptive 'natural liberty' in their economic activities. There is *no* 'compact' conferring perpetual rights on those who Have or on those who Acquire. The world is *not* so governed from above that private and social interest always coincide. It is *not* so managed here below that in practice they coincide. It is *not* a correct deduction from the principles of economics that enlightened self-interest always operates in the public interest. Nor is it true that self-interest generally *is* enlightened; more often individuals acting separately to promote their own ends are too ignorant or too weak to attain even these. Experience does *not* show that individuals, when they make up a social unit, are always less clear-sighted than when they act separately.”

Ethics are therefore fundamental to lead our behavior, in the economy and finance just as elsewhere. Taking an analogy with animals and in an example he uses of giraffes competing for high-up leaves through their long neck:

> "If we have the welfare of the giraffes at heart, we must not overlook the sufferings of the shorter necks who are starved out, or the sweet leaves which fall to the ground and are trampled underfoot in the struggle, or the overfeeding of the long-necked ones, or the evil look of anxiety or struggling greediness which overcasts the mild faces of the herd."

About the supporters of capitalism, he had to say the following:

> "… they have begun by assuming a state of affairs where the ideal distribution of productive resources can be brought about through individuals acting independently by the method of trial and error in such a way that those individuals who move in the right direction will destroy by competition those who move in the wrong direction. This implies that there must be no mercy or protection for those who embark their capital or their labour in the wrong direction. It is a method of bringing the most successful profit-makers to the top by a ruthless struggle for survival, which selects the most efficient by the bankruptcy of the less efficient. It does not count the cost of the struggle, but looks only to the benefits of the final result which are assumed to be permanent."

This amounts to regarding a very anti-social drive: the love of money, as the engine for making the social machinery work:

> "Thus one of the most powerful of human motives, namely the love of money, is harnessed to the task of distributing economic resources in the way best calculated to increase wealth."