‘RENAISSANCE MAN’: KEYNES, CONTEMPORARY ECONOMIC PROBLEMS AND THE ARTS

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and

The Australian Business Arts Foundation

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by

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Thank you for the opportunity to talk to you today. Given the interests of the two organizations which are hosting today's luncheon, it occurred to me that it would be appropriate to talk about two important aspects of the life and work of John Maynard Keynes.

As I am sure you are all aware, Keynes was one of, if not the, best-known, and most influential, economists of the twentieth century. His work provided the intellectual framework within which most Western governments conducted economic policy from the 1930s until the 1970s. After then, his the influence of his ideas and policy recommendations faded, in part because the application of what came to be called 'Keynesian economics' (a good deal of which bore little resemblance to what Keynes actually wrote or said) in circumstances very different from those in and for which Keynes formulated the ideas associated with him, was seen to have resulted in a number of unforeseen and undesirable consequences, in particular persistently high inflation.

However, during the course of the global financial crisis which began in mid-2007, and the ensuing sharp global economic downturn which the IMF has taken to calling 'the Great Recession' and many others 'the worst contraction since the Great Depression', many of the things which he said or wrote during the 1930s seem to have acquired renewed resonance.

He is reputed to have said, for example, that 'markets can remain irrational longer than you or I can remain solvent', a cogent warning to anyone tempted to go bargain-hunting in today's stockmarket.

During the Great Depression he was one of the foremost advocates of what we today refer to as 'fiscal policy', the proposition that governments should borrow and spend in circumstances where mass unemployment results from the unwillingness of the private sector to do so. In one of his best-remembered books he summed up this argument thus: "If the Treasury were to fill old bottles with banknotes, bury them at suitable depths in disused coalmines … and leave it to private enterprise on well-tried principles of *laissez-faire* to dig the notes up again … there need be no more unemployment … It would, indeed, be more sensible to build houses and the like; but if there are political and practical difficulties in the way of this, the above would be better than nothing"[1].

The global financial market meltdown which most accounts have beginning in mid-2007 has much in common with the one which preceded the Great Depression[2].

It was in part the result of inappropriately loose monetary policy: just as the 'bubble' which preceded the latest financial crisis was partly the result of Alan Greenspan and his counterparts at other major central banks having left interest rates too low for too long after the 'tech wreck' and ensuing (mild) recession of 2001, the 1920s bubble was in part the result of inappropriately loose monetary policy between the early 1920s and early 1928 (after which the Fed 'over-compensated' by aggressively tightening monetary policy).

[1] John Maynard Keynes, *The General Theory of Employment, Interest and Money* (London, Macmillan, 1936), p. 129.
[2] See Barry Eichengreen and Kevin O'Rourke, *A Tale of Two Depressions* (4 June 2009), http://www.voxeu.org/index.php?q=node/3421&source=cmailer, for an explanation of this theme.

And one of the reasons for the Fed's excessively loose monetary policy was a desire to prevent the US dollar from rising against the British pound, something which has a parallel with the monetary policies pursued by the People's Bank of China during the middle years of this decade in order to prevent an appreciation of the yuan against the US dollar.

The 'bubble and bust' cycle of the late 1920s and early 1930s was also, like the most recent episode, partly the result of failures of the regulatory framework – a framework which, due to a combination of ideology and incompetence, failed to keep up with the pace of innovation in the financial sector and hence to prevent the accumulation of dangerously excessive amounts of risk.

The parallel is not exact – of particular importance, from an Australian perspective, commodity prices continued rising for a year after the beginnings of the financial crisis, rather than falling for some years before the onset of financial turmoil as in the 1920s, and have not subsequently fallen by as much as they did in the 1930s.

But the course and extent of the declines in share prices and (in the United States and Europe at least) in the prices of other assets such as houses, has been eerily similar. And the transmission of financial and economic shocks from their points of origin to other parts of the globe has of course been much quicker in the current episode than in the early stages of the Great Depression.

What made the Great Depression 'great' (in terms of its depth and magnitude) was not solely the magnitude of the financial meltdown which preceded it, but also the succession of policy blunders made by central banks and governments both in its early stages and at various times during the 1930s.

It's hard to believe now, for example, that in September 1931, the Federal Reserve imposed the biggest increase in its discount rate in its history, up to that time; or that it (and the US Government) did nothing to prevent the closure of over 9,000 banks between 1930 and 1933, taking with them the savings of millions of depositors. It's hard to believe that in 1932, the United States Congress enacted the largest tax increase in peacetime history up to that point, doubling the income tax and lifting the top rate from 24% to 63%. It's perhaps a little easier to believe (given the persistence of protectionist sentiment to this day), but nonetheless astonishing to record, that in 1930 the United States introduced the biggest tariff increases in its history, the Smoot-Hawley Tariff. It's hard to believe that as the newly-elected President of the United States, Roosevelt refused to attend the 1933 version of this year's G20 Economic Summit, thereby scuppering attempts to craft a global effort to revive international trade.

And lest it be thought that the United States was the only country to have blundered, I recall thinking, when I heard earlier this year that the Bank of England had cut its official interest rate to 0.5% and that this was the lowest rate since the founding of the Bank of England in 1693, what on earth were they doing during the Great Depression? Well, it turns out that they also lifted their official interest rate from 2.5% to 6% between June 1931 and April 1932, in an ultimately futile attempt to keep the pound on the gold standard at the over-valued parity to which Winston Churchill, as Chancellor of the Exchequer, had restored it in 1926 – a decision of which Keynes was trenchantly critical at the time. And although the Bank of England subsequently lowered the discount rate after Britain abandoned the gold standard, it never went below 2%.

The key point is that the financial market meltdown of the last 2½ years could have led to another Great Depression if governments and central banks had repeated the mistakes which they made at that time, or had failed to learn from them.

Fortunately, governments and central banks have, overwhelmingly, shown that they are capable of learning from history.

It has undoubtedly been especially helpful in that regard that the Federal Reserve has been led by Ben Bernanke, who as a result of devoting much of his academic career prior to joining the Federal Reserve Board studying the mistakes made by that institution in the 1930s probably knows more about what not to do in the circumstances he has had to confront than anybody else alive today.

The Fed's decisions to cut official interest rates to practically zero, and to expand the Fed's balance sheet by electronically 'printing money' in order, initially, to take on some of the intermediation functions that are normally the responsibility of the commercial banking system and, more recently, to aid in financing the enlarged US budget deficit, have been absolutely the right and proper courses of action. Had the Fed not done so, it is possible (given the collapse in the 'money multiplier' which measures the extent to which the commercial banking system creates credit from the 'base money' created by the central bank) that the US money supply could have contracted by more than 40%.

Instead, all the evidence is that the extraordinary monetary policy measures taken by the Fed and other central banks, and the willingness of governments to allow their budgets to go into deep deficit and to take other measures to stabilize their financial systems, are working to achieve their stated aims.

The global financial system is beginning to 'normalize', as shown by the substantial narrowing in the premia which banks pay for wholesale funds from the peaks reached immediately after the collapse of Lehman Brothers; the substantial recovery in share prices since early March; the rise in government bond yields (accompanied, it is important to emphasize, by a fall in corporate bond yields) and the unwinding of the rise in the US dollar which occurred between mid-2008 and March 2009 are all signs that the extreme risk aversion which characterized the depths of the financial crisis are now passing.

And although most major economies are still contracting, and unemployment is still rising and will probably continue rising for some time yet to come, there is also enough evidence from so-called 'leading indictors' to justify confidence that the global economy will start to record positive growth in the second half of this year.

The idea that the actions taken by the Fed and the US Government could be inflationary in circumstances where the unemployment rate is approaching 10%, and where (according to the IMF) the aggregate amount of spare capacity in the US economy will next year exceed 5½% of potential GDP, defies any understanding of the processes of inflation in a modern economy.

The most extreme extension of this proposition (which you do read and hear surprisingly often) – that what the Fed has been doing has some kind of parallel with Weimar Germany or Robert Mugabe's Zimbabwe – is, to put it politely, somewhere between laughable and ludicrous.

To be sure, the Fed will at some point need to ‘wind back’ these extraordinary measures lest they do generate inflationary pressures once the US and other economies have returned to a growth path and begun to absorb some of the ‘slack’ created by the current sharp downturn. Similarly, the Congress and Administration need to devise a credible ‘exit strategy’ to put American public finances on a sustainable footing for the medium term. But embark on either of those courses of action prematurely would be to invite a renewed slump – as indeed the premature tightening of fiscal and monetary policy in 1937 did during the Great Depression, prolonging it for another three years until it was finally ended by the great debt-financed public works program better known as World War II.

Nor do I want to suggest that central banks and governments have made no mistakes at all.

With the benefit of hindsight, allowing Lehman Brothers to fail having previously, with the bail-out of Bear Stearns, created the impression that no systemically important institution would be allowed to fail, was a mistake.

I would also argue that the ‘quality’ of some important parts of the fiscal stimulus packages enacted in various countries, in particular in the United States, leaves a lot to be desired – although there are other examples, including China, Taiwan and Germany, where there have been some very creative and imaginative fiscal policy measures. And despite their assurances to the contrary, governments have from time to time been unable to resist the temptation to resort to protectionist trade measures.

Nonetheless the far more important point is that central banks and governments have overwhelmingly done what history shows needed to be done, and that what they have done is working.

The same is also largely true of Australia. It is now fairly clear that the economic downturn in Australia has been, and likely will continue to be, less severe than in most other comparable countries. We are thus far, as was emphasized last week following the release of the March quarter national accounts, the only Western country not to have experienced a contraction in economic activity over the past year.

That partly reflects the fact that our financial system has proven to be much more resilient than their counterparts in the United States and Europe. And that, in turn, is largely due to the fact that it has been better managed by its private sector owners and better supervised by its public sector regulators than has been the case elsewhere.

Australia’s relative good fortune also partly reflects the fact that – contrary to many well-publicized dire predictions – the Australian residential property market has held up much better than those of the United States, many European countries and a number of Asian centres such as Singapore and Hong Kong. This, in turn, stems partly from the persistent under-supply of residential housing in Australia relative to the rapidly growing underlying demand for it (in contrast to the United States where the housing bubble of earlier this decade was not only a ‘price bubble’ but a ‘quantity bubble’ as well); and partly from the fact there has not been a systemically material amount of imprudent mortgage lending in Australia, so that there is not (as there is in the United States) a massive ‘overhang’ of residential property for sale at almost any price as a result of owners being no longer able to service the mortgages they took on in order to acquire it.

A third factor in Australia's relative good fortune has been the unusual (by comparison with most Western and most Asian countries) composition of our exports. Australia's manufactured exports fell by 8.5% (in volume terms) over the year to the March quarter, a figure not markedly out of line with the decline in global manufacturing trade (though there are plenty of countries whose manufactured exports have fallen by more than that). But manufactures account for only one-fifth of our exports. Partly due to a fortuitous surge in rural exports, and partly as a result of opportunistic buying by Chinese importers, Australia's total exports rose by 3½% in volume terms over the year to the March quarter.

Australia's continued relatively rapid rate of population growth, fuelled primarily by immigration, has played a largely unrecognized role in our relative fortune. Australia's population grew by 2.0% over the year to the March quarter. Had it been growing at the 1.3% per annum rate which we recorded through the recession of the early 1990s, we would (all else being equal) already have recorded at least three consecutive quarters of negative real GDP growth, and would not now be congratulating ourselves on having avoided a recession (on that definition, at least).

But both monetary and fiscal policy have also made vital contributions to Australia's ability thus far to weather the global financial crisis better than almost all of our peers. The key to this has been that the measures which have been taken have been both *substantial* – that is, commensurately large relative to the threats at which they were directed – and *timely* – that is, implemented sufficiently early (having regard to the time-lags inherently entailed) for them to have had their impact when most needed. That has required both the Reserve Bank and the Government to make judgements as to what was *likely* to happen, on the basis of information available at the time, rather than wait for 'hard evidence' of what *had* happened, before doing anything about it. And there is always an element of risk in making those kind of judgements.

In particular, I am not especially perturbed by the magnitude of the Budget deficits which the Government envisages running over the next few years, nor by the public debt which will be accumulated in order to finance them. The Commonwealth Budget would have been in deficit by some $23bn in 2009-10, and $37bn in 2010-11, even if the Government had made absolutely none of the fiscal stimulus and other decisions which it has made since the onset of the financial crisis. To have prevented the budget from moving into deficit would have required the Government to raise taxes or cut government spending, in either case substantially – that is, to have repeated the mistakes that were made in the early years of the Great Depression. And to have done nothing at all would have been neither politically feasible nor economically responsible.

And so the Commonwealth Government will accumulate net public debt peaking, we are now told, at just over $200bn in 2013-14. As a proportion of national income this represents just under 14% - below the most recent peak in 1996, and as far as one can tell from historical data which before 1970 does not record offsetting financial assets owned by the Commonwealth, substantially below the levels prevailing after World War II up until at least the end of the 1950s. And it is of course substantially below the levels of public debt owed now, let alone in three or five years time, by the governments of most other advanced economies.

There is no principle of economics or of public finance which says that the optimal level of debt for a government is zero, any more than there is one which says that a household or a business which has anything other than zero or negative net debt is imprudent or irresponsible. It ultimately depends on what the debt is used for, and how readily it can be serviced.

I am not wholly convinced that the Government will be able to maintain the spending discipline required to return the budget to surplus by 2015-16, or to 'pay off' its net debt by some time in the early 2020s, as foreshadowed in the recent Budget. Achieving those goals will, I think, require 'harder' decisions, and more of them, than were contained in this year's Budget. But if that timetable were to slip by two or three years, I for one would not be losing much if any sleep over it.

Let me conclude this first part of my remarks today by noting that the spirit of Keynes the economist has been very much alive during the past year, and that we are all much the better for it.

I want to turn now to another, albeit perhaps less well-known, aspect of Maynard Keynes' life and work. The arts, and artists, played a major role in Keynes' life. The two great loves of his life were the painter Duncan Grant and the ballerina Lydia Lopokova, whom he married in 1925. According to his biographer Robert Skidelsky, Keynes regarded both as 'delicate work[s] of art, to be worshipped and protected against breakage'[3]. Keynes was Chairman of the Council for the Encouragement of Music and the Arts from 1941, which in 1945 became the Arts Council of Great Britain. Keynes was Chairman of this Council until his death in April 1946.

Keynes' active involvement in and support for the arts goes back at least to 1921, when he wrote in the foreword to a catalogue for an exhibition by the London Group of artists (which included his friends Roger Fry and Duncan Grant):

> "Civilized ages have always recognized that a patron of the arts performs for the society he lives in a distinguished and magnanimous function. Without patrons art cannot easily flourish"[4].

Keynes was very much aware, in 1930, of one of the problems that artists and arts organizations continue to face today:

> "It is impossible, in my experience, to go on continually getting financial support for something which is perpetually losing money and presents itself as a bottomless sink to the friends and supporters who come in enthusiastically at the start"[5].

There is a contemporary relevance to his observation (in the same article) that:

> "When one sees how much money is spent in a year on useless and hideous objects, it seems monstrous that it should be a serious struggle to provide some of the most promising artists in the country ... with £150 a year. Why does the general public find it so extraordinarily difficult to get over its reserves and hesitations towards contemporary art?"[6]

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[3] Robert Skidelsky, *John Maynard Keynes: Hopes Betrayed 1883-1920* (London, Macmillan, 1983), p. 104.
[4] JM Keynes, Catalogue for the London Group Exhibition, Mansard Gallery, October 1921; reprinted in *The Collected Writings of John Maynard Keynes*, Volume 28 (London, Macmillan, 1982), Chapter 3, p. 297.
[5] JM Keynes, 'The London Artists' Association: Its Origin and Aims', *Studio,* June 1930; reprinted in *Collected Writings,* op. cit., p. 299.
[6] *Ibid*. p. 307.

Keynes worried that the economic egalitarianism which he for the most part favoured would eventually destroy private patronage of the arts, making government support the only way of saving the arts from extinction[7]. In this regard, as in a number of others, Keynes turns out to have been wrong.

But the arguments he used to advocate government support for the arts nonetheless resonate today no less than in the 1930s when he made them:

> "We have persuaded ourselves that it is positively wicked for the state to spend a halfpenny on non-economic purposes. Even education and public health only creep in under an economic alias on the ground that they 'pay' … One form alone of uncalculated expenditure survives from the heroic age – war. And even that must sometimes pretend to be economic"[8].

A decade later, in 1945, he observed that " … the civilizing arts … in fact use up an infinitesimal quantity of materials in relation to their importance in the national life and the comfort they can give to the individual spirit"[9].

Keynes thought that 'state spending, in times of depression or boom, should be oriented to the beautiful as well as the useful'[10]. And his advocacy was not confined to 'permanent monuments of dignity and beauty', but:

> "Even more important … are the ephemeral ceremonies, shows and entertainments in which the common man (*sic*) can take his delight and recreation after his work is done, and which can make him feel, as nothing else can, that he is one with, and part of, a community finer, more gifted, more splendid, more care-free than he can be by himself"[11].

At the height of the Great Depression, Keynes looked forward to a time when:

> "the *economic problem* may be solved, or be at least within sight of solution, within a hundred years … that for the first time since his creation man (*sic*) will be faced with his real, his permanent problem – how to use his freedom from pressing economic cares, how to occupy the leisure which science and compound interest will have won for him, to live wisely and agreeably and well"[12].

In anticipation of that time, Keynes thought: "there will be no harm in making mild preparations for our destiny, in encouraging and experimenting in, the arts of life as well as the activities of purpose"[13].

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[7] Roy Harrod, *The Life of John Maynard Keynes* (London, Macmillan, 1951), p. 518; Robert Skidelsky, *John Maynard Keynes: Fighting for Britain* (London, Macmillan, 2000, p. 288).
[8] JM Keynes, 'Art and the State', originally published in *The Listener*, 26 August 1936; *Collected Writings*, op. cit., p. 342. He characterized this as 'the Treasury view'.
[9] JM Keynes, Foreword to the catalogue for An Exhibition of French Book Illustration, 1895-1945; *Collected Writings*, op. cit., p. 365-66.
[10] Skidelsky, op. cit. (2000), p. 288.
[11] JM Keynes, 'Art and the State', p. 344.
[12] JM Keynes, 'Economic Possibilities for Our Grandchildren', originally published in *Nation and Athenaeum*, 11 and 18 October 1930, and subsequently in *Essays in Persuasion* (London, Macmillan, 1931), pp. 326 and 328.
[13] Ibid., p. 332.

Although one might say that there are still another twenty-three years in which Keynes' prediction could come true, it's more likely that this will be another thing about which he was wrong.

Alternatively, it could be seen as an illustration of the contemporary economist's maxim that when forecasting, one should give numbers, or dates, but not both!

Keynes' vision of the role of the arts in our society, and the role of the State and of the private sector in financing it, remains as valid today as it was when he was spelling it out.

The Australia Council, and the various State Arts bodies such as the one which I currently have the privilege of chairing, were modelled on the organization of which Keynes was the founding chair.

In one of those odd parallels with which history is replete, the founding Chair of the Australia Council, Herbert Cole ('Nugget') Coombs, was also an economist.

During his nineteen years as its Governor, the Commonwealth - subsequently the Reserve – Bank acted 'to some degree as a patron of the Arts, particularly those related to painting, sculpture, architecture and associated crafts', acquiring a 'variety of works by contemporary Australian artists who have become recognized as the most distinguished of our time'[14].

Coombs' views on funding of the arts were similar to Keynes':

> "The Arts have always needed patrons, and it has seemed to me that those on whom 'the arrangements of society' confer control of great resources have an obligation to society to perform this function. The natural successors of the noble families of the Middle Ages are today the great corporations, public and private"[15].

The role which economists, or people with training in economics, have played in promoting support for the arts in Britain and Australia thus belies their widespread perception as people who 'know the price of everything and the value of nothing'.

Of course it continues to be important to make the case for government, corporate and individual support for the arts.

That is especially so in the present circumstances where government budgets are under pressure from falling revenues, businesses are seeking to curb 'non-essential' spending, and individual and family fortunes have been decimated (in some cases literally) by plunging share and property prices.

And yet in these circumstances the arts have so much to offer, not only as a diversion from the pressures associated with tough times, but also in some cases as a way of holding a light up to and making us think differently about what we are experiencing.

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[14] HC Coombs, *Trial Balance* (Macmillan, Melbourne, 1981), p. 224-5.
[15] Ibid., p. 226.

I believe that, increasingly, the arts embody and require skills and attitudes that are called for in contemporary business contexts:

- critical thinking;
- the ability to challenge conventional wisdom, to – in the clichés so loved of business leaders and consultants – 'push the envelope' and (gulp) 'think outside the square';
- the capacity to look at familiar objects or themes from new angles and perspectives;
- the ability to innovate with new media, new forms, and new technology; and
- the ability to borrow and adapt from things that appear to work in other settings.

In times such as these the work of the Australian Business Arts Foundation in building partnerships between business and arts organizations and individual artists is more important than ever, not only in allowing arts organizations to survive and flourish, but also to provide opportunities for arts organizations and individual artists to help businesses, their employees and their clients and customers to survive and thrive.

If economists such as Maynard Keynes and 'Nugget Coombs have been able to see these connections, surely it's not too much to expect that others can too.