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Keynes and the Assault on Savings, Part 1 **by Gregory Bresiger**

In the long, run we are all dead.

— John Maynard Keynes, *A Tract on Monetary Reform*

There are men regarded today as brilliant economists, who deprecate saving and recommend squandering on a national scale as the way of economic salvation; and when anyone points to what the consequences of these policies will be in the long run, they reply flippantly, as might the prodigal son of a warning father: “In the long run, we are all dead”....

— Henry Hazlitt, *Economics in One Lesson*

Americans finally must heave the Keynesian myth that savings hurts the economy and that too much savings contributes to slumps. These myths threaten economic liberty and health.

Keynesian advocates of this mistaken view blame the Great Depression on oversaving and underconsumption. Misers, sitting on their dollars, engaging in what one economist calls the “liquidity preference,” caused problems in the 1930s. Instead, they said, individuals and especially the government should have spent generously so that the economy would grow.

The liquidity preference and the emphasis on consumption are among the basic beliefs of John Maynard Keynes, probably the most influential economist of the 20th century. Generations after his death, he continues to exert his influence on the welfare states of the West.

Keynes was also famous for justifying his short-term big-spending policies by saying that “in the long run we are all dead.” This sentiment is consciously or unconsciously endorsed by mainstream media and most government leaders.

Indeed, policymakers, laboring under these Keynesian fallacies for decades, have successfully implored Americans to consume, not to save. Entertainment culture often presents savers as narrow-minded and mean-spirited. Tax policy for generations has generally encouraged

consumption while discouraging savings. Examples of the former are the progressive income tax, payroll taxes, and corporate-profits taxes, all of which hurt capital formation.

Millions of average Americans and their elected officials, whether they acknowledge it or not, have subscribed to Keynesian notions. The result has been record levels of public and private debt. This has happened as the personal savings rate has declined dramatically.

Tax policies and culture have led to signal changes in the American attitude toward savings. Since 1994, America's annual personal savings rate as a percentage of personal disposable income always has been in the low single digits, according to the U.S. Commerce Department. (The highest rate was in 1994, when it was recorded as only 4.8 percent, one of the lower rates of the major industrial economies). However, between 1947 and 1994, the personal savings rate averaged 12.9 percent.

Indeed, the personal savings rate in 1944, the last full year of World War II, peaked at 26.1 percent. Yet over the next 60 years or so savings became something Americans did less and less.

"Savings rates have never been lower," economist Ben Stein told *Forbes Magazine* in May of 2005. Since that time the rate has dropped some more. In 2008, the rate declined to 1.7 percent. And in some recent quarters it has actually been in negative territory. "This is the greatest crisis facing the country that people can do something about," Stein added.

But trust in the government to do all or most of the saving would be likely to be misplaced. Even the grandest social-insurance programs usually assume that the retiree has significant private savings. And here culture and tax policy again are hurting the country, potentially setting up the economy and tens of millions of Americans for a continued drop in the standard of living.

Political success

But even if one accepts the philosophy that programs such as Social Security can replace a significant part of most retirement savings, can one depend on these programs? Can one depend on government to protect the long-term assets of social-insurance trust funds? For decades, those trust funds have been spent by the government on things not authorized by the payroll taxes. And does the average American want to rely on the promises of social-insurance bureaucracies and leaders, both of whom are often motivated by political pressures?

This is a dangerous dependence, warned one of the great friends of liberty, Alexis de Tocqueville. In *Democracy in America*, he said such bureaucracies would keep citizens depending on them in "perpetual childhood."

Tocqueville was thinking of the experience of his country under Louis XIV. That was a time when the French bureaucracy tried to manage every minute aspect of the economy and the citizen's life. The result? By the end of Sun King's reign, France was bankrupt. Americans appear headed for the same problem.

Declining savings rates combined with huge public-debt levels have dire consequences for the economy. A shortage of savings means there is not enough capital to go around. Government eats up more and more capital to pay for deficits and various entitlement and military programs.

So startup firms and those older ones desperately needing capital find it harder to obtain cash. And those firms lucky enough to find capital must pay a higher rate of interest than if savings rates were healthy. The economy stops growing. More people lose jobs. Such is the United States today.

Again, we must consider that these things are happening at a time when the U.S. economy is in a tailspin not seen since the 1930s, with its problems expected to continue for months or possibly years. And the 1930s, the era of the Great Depression, was also a time of very low savings rates.

In 1932, personal savings rates were minus 0.9 percent. By 1938, they weren't much better, just 2 percent, according to the Commerce Department. The economy was in the midst of a brutal recession, despite Franklin Roosevelt's years of repeated big spending and countercyclical policies combined with tax-the-rich policies designed to redistribute income.

Given this sorry economic record of little savings, high debt, and a hobbled economy, it is logical that most elected officials, Republican and Democrat, rarely mention the importance of savings. Very few members of Congress have identified with the issue for one reason: It's not good politics. Citizens who take responsibility for their own personal welfare and savings have little need for politicians, whose success in a welfare state is contingent on the helplessness of constituents.

It is no wonder that policy-makers and their loyal media sycophants, in the midst of what may develop into another Great Depression, call for more of the same policies as a way to restore the economy. A failed stimulus package under the Bush administration is followed by a much bigger one under the Obama administration.

But while the failure of successive stimulus plans may be a reality, the political power that accrues to political elites by the implementation even of failed policies is a political success story from their point of view. This thesis is brilliantly explained in Robert Higgs's *Crisis and Leviathan*. The bottom line is always the same: Failure is success in the public sector. The individual loses liberty as state failure guarantees more state power.

If this latest stimulus package fails, candid Obama supporters — like realistic Roosevelt supporters reviewing his sorry economic record decades after the fact — will claim that it failed, not because of the philosophy behind it, but because it wasn't big enough. But what is the growth philosophy that the United States now depends on instead of the once-traditional pro-saving approach? Supporters of more of the same Keynesianism — although it is depicted as “change” — constantly cite some form of the “paradox of thrift.”

Attacks on saving

This paradox is a very old concept. It was famously advocated by Keynes in the 1920s and 1930s. However, he actually filched the idea from inflationists such as the 18th-century philosopher Bernard Mandeville and the Edwardian journalist J.A. Hobson.

Still, this “spend-now, anti-savings” idea seemed very new when Keynes revived it in the 1930s. He approvingly quoted Hobson’s *Physiology of Industry* in his own famous book, *The General Theory of Employment, Interest and Money*. According to Keynes,

[Saving,] while it increases the existing aggregate of capital, simultaneously reduces the quantity of utilities and conveniences consumed; any undue exercise of this habit must, therefore, cause an accumulation of capital in excess of that which is required for use, and this excess will exist in the form of general over-production.

Keynes contended that saving prolongs a recession while spending reverses it and produces a boom. The boom can go on as long as the government keeps spending and inflating. Keynes made these arguments in *The General Theory*, which was published in 1936.

Oversaving caused and prolonged the Great Depression, according to Keynes and his followers, because it hurt mass buying power. Economic inequality was also a problem in the 1920s, he believed. This is one reason that Keynesian Obama in 2009 seems as determined to redistribute wealth as he is to restore prosperity. He embraces the Keynesian argument that economic inequality, aggravated by too much savings, causes depressions or recessions. Ergo, today’s deep recession can be corrected only by government action.

Too much saving can also block recovery, Keynes warned in *The General Theory*. “The more virtuous we are, the more determinedly thrifty, the more obstinately orthodox in our national and personal finance, the more our incomes will have to fall.”

No one should be surprised that Keynes questioned thrift on economic grounds. His definition of it, in a work of his a decade before *The General Theory*, claimed it was “negative.”

“Saving,” he wrote in his *Treatise on Money*, “is the act of the individual consumer and consists in the negative act of refraining from spending the whole of his current income on consumption.”

“Negative act”?

The savings issue for Keynes was also cultural. Before he wrote *The General Theory* and before the Great Depression, he was arguing that oversaving hurt society in countless big and small ways.

For example, in *The Economic Consequences of the Peace*, a scathing critique of the Treaty of Versailles after World War I, Keynes compared the building of the railroads in the 19th century to the building of the pyramids in Egypt by slave labor.

The passion to accumulate savings, to make one's property bigger — and, using Keynes's analogy, to bake a bigger cake without ever eating it — became a fetish in the 19th century. It hurt the standard of living in myriad ways, he argued.

“The duty of saving became nine-tenths of virtue and the growth of the cake the object of true religion,” he wrote. “There grew round the non-consumption of the cake all those instincts of Puritanism which in other ages had withdrawn itself from the world and neglected the arts of production as well as enjoyment.”

Public policymakers from the administrations of Roosevelt to the current Obama administration and throughout the Western world have accepted Keynes's ideas as economic and social policy. Even Republicans, who previously opposed them in the 1930s, learned to accept Keynes's ideas. Indeed, a Republican president, Richard Nixon, famously announced his conversion to Keynes in the 1970s.

This is ironic, since it was Keynes who said that we are often the slaves of long forgotten philosophers and thinkers whom we know little about. Indeed, many lawmakers who believe in Keynes's philosophy have never read his works. Fewer still can even understand Keynes because of his turgid and incoherent language. Economist Jacob Viner said *The General Theory* was “difficult to read, understand and judge.” Indeed, some critics believe Keynes was confusing by design.

Still, politicians have passed along this rarely examined system to mainstream journalists, who usually just accept it. They often parrot it with little understanding that the debate over whether Keynes was right is still open. Yet for politicians the debate is settled: Keynes's ideas are right for our economy, they claim.

But they are not. Without sufficient savings, our standard of living will continue to decline. Why is saving critical and why do so many people fail to understand that? More on that in part two.

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