Smith's day forward has been laissez-faire—leaving things alone.* As we study economics further, we will be tracing the evolution of that idea—the idea of leaving the market alone—as well as investigating what has happened to the system, both when it was left alone and when it wasn't.

It is much too early to take up that controversy here. Suffice it to say that if capitalism brought a strong impetus for laissez-faire, it also brought a strong impetus for economic intervention. The very democratic liberties and political equalities that were encouraged by the rise of capitalism became powerful forces that sought to curb or change the manner in which the economic system worked. Indeed, within a few years of Adam Smith's time, the idea of leaving things alone was already breached by the English Factory Act of 1833, establishing a system of inspectors to prevent child and female labor from being abused. In our own day that same political desire to correct the unhampered workings of laissez-faire capitalism has given rise to the Social Security system, which provides a social floor beneath the market, and to the environmental legislation that limits the market's operation in certain areas.

Thus, from the beginning, capitalism has been characterized by a tension between laissez-faire and intervention—laissez-faire representing the expression of its economic drive, intervention of its democratic political orientation. That tension continues today, a deeply imbedded part of the historic character of the capitalist system.

It is said that a group of merchants called on the great Colbert, French finance minister from 1661 to 1683, who congratulated them on their contribution to the French economy and asked what he could do for them. The answer was "Laissez-nous faire"*—leave us alone. Since Colbert was a strong proponent of the complex regulations and red tape that tied up industry in France at this time, we can imagine how gladly he received this advice.*

Two

Three Great Economists

A look back over economic history has taught us something about capitalism, the social system with which economics is mainly concerned. But we have not yet gained a sense of what economics itself is about. Perhaps we can see, however, that economics is mainly "about" capitalism—that it is an effort to explain how a society knit together by the market rather than by tradition or command, powered by a restive technology rather than by inertia, could hang together, how it would work.

There is no better way of grasping this basic purpose of economics than to look at the work of the three greatest economists—Adam Smith, Karl Marx, and John Maynard Keynes. Needless to say, these three names raise blood pressures differently, depending on whether one is a conservative, a radical, or a liberal. That's a matter for a different kind of book than this one. We want to explain what Smith, Marx, and Keynes *saw* when they looked at capitalism, for their visions still define the field of economics for everyone, right and left alike.

ADAM SMITH (1723–1790)

Adam Smith is the patron saint of our discipline and a figure of towering intellectual stature. His fame resides in his masterpiece, which everyone has heard of and almost no one has read, *The Wealth of Nations*, published in 1776, the year of the Declaration of Independence. All things considered, it is not easy to say which document is of greater historic importance. The Declaration sounded a new call for a society dedicated to "Life, Liberty, and the pursuit of Happiness." The *Wealth* explained how such a society worked.

Here Smith begins by addressing a perplexing question. The actors in the market, as we know, are all driven by the desire to make money for themselves—to "better their condition," as Smith puts it. The question is obvious. How does a market society prevent

PORTRAIT OF AN ABSENTMINDED PROFESSOR

"I am a beau in nothing but my books" was the way that Adam Smith once described himself. Indeed, a famous medallion profile shows us a homely face. In addition, Smith had a curious stumbling gait that one friend called vermicular and was given to notorious fits of absentmindedness. On one occasion, absorbed in discussion, he fell into a tanning pit.

Few other adventures befell Smith in the course of his scholarly, rather retiring life. Perhaps the high point was reached at age four when he was kidnapped by a band of gypsies passing near Kirkaidy, his native hamlet in Scotland. His captors held him only a few hours; they may have sensed what a biographer later wrote: "He would have made, I fear, a poor gypsy."

Marked out early as a student of promise, at sixteen Smith won a scholarship that sent him to Oxford. But Oxford was not then the center of learning that it is today. Little or no systematic teaching took place, the students being free to educate themselves, provided they did not read dangerous books. Smith was nearly expelled for owning a copy of David Hume's *Treatise of Human Nature*, a work we now regard as one of the philosophic masterpieces of the eighteenth century.

After Oxford, Smith returned to Scotland, where he obtained an appointment as professor of moral philosophy at the University of Glasgow. Moral philosophy covered a large territory in Smith's time. We have notes of his lectures in which he talked about jurisprudence, military organization, taxation, and "police"—the last word meaning the administration of domestic affairs that we would call economic policy.

In 1759 Smith published *The Theory of Moral Sentiments*, a remarkable inquiry into morality and psychology. The book attracted widespread attention and brought Smith to the notice of Lord Townshend, one day to be the Chancellor of the Exchequer, responsible for the notorious tax on American tea. Townshend engaged Smith to serve as tutor to his stepson, and Smith resigned his professorial post to set off on the grand tour with his charge. In France he met Voltaire, Rousseau, and François Quesnay, the brilliant doctor who had originated the ideas of physiocracy, a pioneering attempt to explain how the economic system functioned. Smith would have dedicated *The Wealth of Nations* to him, had Quesnay not died.

Returning to Scotland in 1766, Smith lived out the remainder of his life largely in scholarly retirement. It was during these years that the *Wealth* was slowly and carefully composed. When it was done, Smith sent a copy to David Hume, by then his dear friend. Hume wrote: "Euge!* Belle! Dear Mr. Smith: I am much pleased with your Performance. . . ." Hume knew, as did virtually everyone who read the book, that Smith had written a work that would permanently change society's understanding of itself.

self-interested, profit-hungry individuals from holding up their fellow citizens for ransom? How can a socially workable arrangement arise from such a dangerously unsocial motivation as self-betterment?

The answer introduces us to a central mechanism of a market system, the mechanism of competition. Each person out for self-betterment, with no thought of others, is faced with a host of similarly motivated persons. As a result, each market actor, in buying or selling, is forced to meet the prices offered by competitors.

In the kind of competition that Smith assumes, a manufacturer who tries to charge more than other manufacturers will not be able to find any buyers. A job seeker who asks more than the going wage will not be able to find work. And an employer who tries to pay less than competitors pay will not find workers to fill the jobs. In this way, the market mechanism imposes a discipline on its participants—buyers must bid against other buyers and therefore cannot gang up against sellers. Sellers must contend against other sellers and therefore cannot impose their will on buyers.

But the market has a second, equally important function. Smith shows that the market will arrange for the production of the goods that society wants, in the quantities society wants—without anyone ever issuing an order of any kind. Suppose that consumers want more pots and fewer pans than are being turned out. The public will buy up the existing stock of pots, and as a result their prices will rise. Contrariwise, the pan business will be dull; as pan makers try to get rid of their inventories, pan prices will fall.

Now a restorative force comes into play. As pot prices rise, so will profits in the pot business; and as pan prices fall, so will profits in that business. Once again, the drive for self-betterment

*"Well done!"

will go to work. Employers in the favored pot business will seek to expand, hiring more factors of production—more workers, more space, more capital equipment; and employers in the disfavored pan business will reduce their use of the factors of production, letting workers go, giving up leases on space, cutting down on their capital investment.

Hence the output of pots will rise and that of pans will fall. And this is what the public wanted in the first place. The pressures of the marketplace direct the selfish activities of individuals as if by an Invisible Hand (to use Smith's wonderful phrase) into socially responsible paths. Thus the workings of the competitive system transmute self-regarding behavior into socially useful outcomes. The Invisible Hand—the words that describe the overall process—keeps society on track, assuring that it produces the goods and services it needs.

Smith's demonstration of how a market performs this extraordinary feat has never ceased to be of interest. Much of economics, as we shall see in closer detail later, is concerned with scrutinizing carefully how the Invisible Hand works. Not that it always does work. There are areas of economic life where the Invisible Hand does not exert its influence at all. In every market system, for instance, tradition continues to play a role in nonmarket methods of remuneration such as tipping. So, too, command is always in evidence within businesses, for example, or in the exercise of government powers such as taxation. Further, the market system has no way of providing certain public goods—goods that cannot be privately marketed, such as national defense or public law and order. Smith knew about these and recognized that such goods would have to be supplied by the government. Then, too, the market does not always meet the ethical or aesthetic criteria of society, or it may produce goods that are profitable to make, but harmful to consume. We shall look into these problems in due course. At this juncture, however, we had better stand in considerable awe of Smith's basic insight, for he showed his generation and all succeeding ones that a market system is a reliable force for basic social provisioning.

He also showed that it was self-regulating. The beautiful consequence of the market is that it is its own guardian. If anyone's prices, wages, or profits stray from levels that are set for everyone, the force of competition will drive them back. Thus a curious paradox exists. The market, which is the acme of economic freedom, turns out to be the strictest of economic taskmasters.

Because the market is its own regulator, Smith was opposed to government intervention that would interfere with the workings of self-interest and competition. Therefore laissez-faire became his fundamental philosophy, as it remains the fundamental philosophy of conservative-minded economists today. His commitment to the Invisible Hand did not make Smith a conventional conservative, however. He is cautious about, not dead set against, government intervention. Moreover, *The Wealth of Nations* is shot through with biting remarks about the "mean and rapacious" ways of the manufacturing class, and openly sympathetic with the lot of the workingman, hardly a popular position in Smith's day. What ultimately makes Smith a conservative—and here he *is* in accord with modern views—is his belief that the system of "perfect liberty" founded on economic freedom would ultimately benefit the general public.

Needless to say, that is a question to which we will return many times. But we are not yet done with Adam Smith. For matching his remarkable vision of an internally coherent market system was an equally new and remarkable vision of another kind. Smith saw that the system of "perfect liberty"—the market system, left to its own devices—would grow, that the wealth of such a nation would steadily increase.

What brought about this growth? As before, the motive force was the drive for self-betterment, the thirst for profits, the wish to make money. This meant that every employer was constantly seeking to accumulate more capital, to expand the wealth of the enterprise; in turn, this led each employer to seek to increase sales in the hope of gaining a larger profit.

But how to enlarge sales in a day long before advertising existed as we know it? Smith's answer was to improve productivity: Increase the output of the work force. And the road to increasing productivity was very clear: Improve the division of labor.

In Smith's conception of the growing wealth (we would say the growing production) of nations, the division of labor therefore plays a central role, as this famous description of a pin factory makes unforgettably clear:

> One man draws out the wire, another straits it, a third cuts it, a fourth points it, a fifth grinds it at the top for receiving the head; to make the head requires two or three distinct

> operations; to put it on is a peculiar business; to whiten it another; it is even a trade by itself to put them into paper. . . .
>
> I have seen a small manufactory of this kind where ten men only were employed and where some of them consequently performed two or three distinct operations. But though they were poor, and therefore but indifferently accommodated with the necessary machinery, they could when they exerted themselves make among them about twelve pounds of pins in a day. There are in a pound upwards of four thousand pins of middling size. These ten persons, therefore, could make among them upwards of forty-eight thousand pins in a day. . . . But if they had all wrought separately and independently . . . they could certainly not each of them make twenty, perhaps not one pin in a day.*

How is the division of labor to be enhanced? Smith places principal importance on the manner already announced in his description of the process of making pins: Machinery is the key. The division of labor—and therefore the productivity of labor—is increased when the tasks of production can be taken over, or aided and assisted, by the capacities of machinery. In this way each firm seeking to expand is naturally led to introduce more machinery as a way of improving the productivity of its workers. *Thereby the market system becomes an immense force for the accumulation of capital, mainly in the form of machinery and equipment.*

Moreover, Smith showed something remarkable about the self-regulating properties of the market system as a growth-producing institution. We recall that growth occurred because employers installed machinery that improved the division of labor. But as they thereupon added to their work force, would it not follow that wages would rise as all employers competed to hire labor? And would that not squeeze profits and dry up the funds with which machinery could be bought?

Once again, however, the market was its own regulator. For Smith showed that the increased demand for labor would be matched by an increased supply of labor, so that wages would not rise or would rise only moderately. The reason was plausible. In

*Adam Smith, The Wealth of Nations (New York: Modern Library, 1937), pp. 4, 5.

Smith's day, infant and child mortality rates were horrendous: "It is not uncommon," wrote Smith, ". . . in the Highlands of Scotland for a mother who has borne twenty children not to have two alive." As wages rose and better food was provided for the household, infant and child mortality would decline. Soon there would be a larger work force available for hire: ten was the working age in Smith's day. The larger work force would hold back the rise in wages—and so the accumulation of capital could go on. Just as the system assured its short-term viability by self-regulating the output of pots and pans, so it assured its long-term viability by self-regulating its steady growth.

Of course, Smith wrote about a world that is long since vanished—a world in which a factory of ten people, although small, was still significant enough to mention; in which remnants of mercantilist, and even feudal, restrictions determined how many apprentices an employer could hire in many trades; in which labor unions were largely illegal; in which almost no social legislation existed; and above all, where the great majority of people were very poor.

Yet Smith saw two essential attributes in the economic system that was not yet fully born at that time: first, that a society of competitive, profit-seeking individuals can assure its orderly material provisioning through the self-regulating market mechanism; and second, that such a society tends to accumulate capital, and in so doing, to enhance its productivity and wealth. These insights are not the last word. We have already mentioned that the market mechanism does not always work successfully, and our next two economists will demonstrate that the growth process is not without serious defects. But the insights themselves are still germane. What is surprising after two centuries is not how mistaken Smith was, but how deeply he saw. In a real sense, as economists we are still his pupils.

KARL MARX (1818–1883)

To most Americans, Karl Marx's name conjures up revolutionary images. To a certain extent, that is perfectly correct (see box). But for our purposes Marx is much more than a political activist. He was a profoundly penetrative economic thinker, perhaps the most remarkable analyst of capitalism's dynamics who ever lived. So we will spend no time at all defending or assailing his political philos-

PROFILE OF A REVOLUTIONARY

A great, bearded, dark-skinned man, Karl Marx was the picture of a revolutionary. And he was one—engaged, mind and heart, in the effort to overthrow the system of capitalism that he spent his whole life studying. As a political revolutionary, Marx was not very successful, although with his lifelong friend Friedrich Engels, he formed an international working class "movement" that frightened a good many conservative governments. But as an intellectual revolutionary Marx was probably the most successful disturber of thought who ever lived. The only persons who rival his influence are the great religious leaders, Christ, Mohammed, and Buddha.

Marx led as turbulent and active a life as Smith's was secluded and academic. Born to middle-class parents in Trier, Germany, Marx was early marked as a student of prodigious abilities, but not temperamentally cut out to be a professor. Soon after getting his doctoral degree (in philosophy) Marx became editor of a crusading, but not communist, newspaper, which rapidly earned the distrust of the reactionary Prussian government. It closed down the paper. Typically, Marx printed the last edition in red. With his wife, Jenny (and Jenny's family maid, Lenchen, who remained with them, unpaid, all her life), Marx thereupon began life as a political exile in Paris, Brussels, and finally in London. There, in 1848, together with Engels, he published the pamphlet that was to become his best known, but certainly not most important work: *The Communist Manifesto.*

The remainder of Marx's life was lived in London. Terribly poor, largely as a consequence of his hopeless inability to manage his own finances, Marx's life was spent in the reading room of the British Museum, laboriously composing the great, never-finished opus, *Capital.* No economist has ever read so widely or so deeply as Marx. Before even beginning *Capital,* he wrote a profound three-volume commentary on all the existing economists, eventually published as *Theories of Surplus Value,* and filled thirty-seven notebooks on subjects that would be included in *Capital*—these notes, published as the *Grundrisse* (Foundations) did not appear in print until 1953. *Capital* itself was written backwards, first Volumes II and III, in very rough draft form, then Volume I, the only part of the great opus that appeared in Marx's lifetime, in 1867.

Marx was assuredly a genius, a man who altered every

aspect of thinking about society—historical and sociological as well as economic—as decisively as Plato altered the cast of philosophic thought, or Freud that of psychology. Very few economists today work their way through the immense body of Marx's work; but in one way or another his influence affects most of us, even if we are unaware of it. We owe to Marx the basic idea that capitalism is an *evolving* system, deriving from a specific historic past and moving slowly and irregularly toward a dimly discernible, different form of society. That is an idea accepted by many social scientists who may or may not approve of socialism, and who are on the whole vehemently "anti-Marxist."

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phy. What interests us is what he saw in capitalism that was different from Smith.

Adam Smith was the architect of capitalism's orderliness and progress; Marx was the diagnostician of its disorders and eventual demise. Their differences are rooted in the fundamentally opposite way that each saw history. In Smith's view, history was a succession of stages through which humankind traveled, climbing from the "early and rude" society of hunters and fisherfolk to the final stage of commercial society. Marx saw history as a continuing struggle among social classes, ruling classes contending with ruled classes in every era.

Moreover, Smith believed that commercial society would bring about a harmonious, mutually acceptable solution to the problem of individual interest in a social setting that would go on forever—or at least for a very long time. Marx saw tension and antagonism as the outcome of the class struggle, and the setting of capitalist society as anything but permanent. Indeed, the class struggle itself, expressed as the contest over wages and profits, would be the main force for changing capitalism and eventually undoing it.

A great deal of interest in Marx's work focuses on that revolutionary perspective and purpose. But Marx the economist interests us for a different reason: Marx also saw the market as a powerful force in the accumulation of capital and wealth. From his conflict-laden point of view, however, he traces out the process—mainly in Volume II of *Capital*—quite differently than Smith does. As we have seen, Smith's conception of the growth process stressed its self-regulatory nature, its steady, hitch-free path. Marx's concep-

tion is just the opposite. To him, growth is a process full of pitfalls, a process in which crisis or malfunction lurks at every turn.

Marx starts with a view of the accumulation process that is much like that of a businessman. The problem is how to make a given sum of capital—money sitting in a bank or invested in a firm—yield a profit. As Marx puts it, how does M (a sum of money) become M′, a *larger* sum?

Marx's answer begins with capitalists using their money to buy commodities and labor power. Thereby they make ready the process of production, obtaining needed raw or semifinished materials, and hiring the working capabilities of a labor force. Here the possibility for crisis lies in the difficulty that capitalists may have in getting their materials or their labor force at the right price. If that should happen—if labor is too expensive, for instance—M stays put and the accumulation process never gets started at all.

But suppose the first stage of accumulation takes place smoothly. Now money capital has been transformed into a hired work force and a stock of physical goods. These have next to be combined in the labor process; that is, actual work must be expended on the materials, and the raw or semifinished goods transformed into their next stage of production.

It is here, on the factory floor, that Marx sees the genesis of profit. In his view, profit lies in the ability of capitalists to pay less for labor power—for the working abilities of their work force—than the actual value workers will impart to the commodities they help to produce. This theory of *surplus value* as the source of profit is very important in Marx's analysis of capitalism, but it is not central to our purpose here. Instead, we stop only to note that the labor process is another place where accumulation can be disrupted. If there is a strike, or if production encounters snags, the money capital (M) that is invested in goods and labor power will not move along toward its objective, a larger sum of money capital (M′).

But once again suppose that all goes well and workers transform steel sheets, rubber casings, and bolts of cloth into automobiles. The automobiles are not yet money. They have to be sold—and here, of course, lie the familiar problems of the marketplace: bad guesses as to the public's taste; mismatches between supply and demand; recessions that diminish the spending power of society.

If all goes well, the commodities *will* be sold—and sold for M′, which is bigger than M. In that case, the circuit of accumulation

is complete, and the capitalists will have a new sum M′, which they will want to send on another round, hoping to win M″. But unlike Adam Smith's smooth-growth model, we can see that Marx's conception of accumulation is riddled with pitfalls and dangers. Crisis is possible at every stage. Indeed, in the complex theory that Marx unfolds in *Capital,* the inherent tendency of the system is to generate crisis, not to avoid it.

We will not trace Marx's theory of capitalism further except to note that at its core lies a complicated analysis of the manner in which surplus value (the unpaid labor that is the source of profit) is squeezed out through mechanization. Someone who wants to learn about Marx's analysis must turn to other books, of which there are many.*

Our interest lies in Marx as the first theorist to stress the instability of capitalism. Adam Smith originated the idea that growth is an inherent characteristic of capitalism; but to Marx we owe the idea that that growth is wavering and uncertain, far from the cybernetic, assured process Smith described. Marx makes it clear that capital accumulation must overcome the uncertainty inherent in the market system and the tension of the opposing demands of labor and capital. The accumulation of wealth, although always the objective of business, may not always be within its power to achieve.

In *Capital,* Marx sees instability increasing until finally the system comes tumbling down. His reasoning involves two further, very important prognoses for the system. The first is that *the size of business firms will steadily increase as the consequence of the recurrent crises that wrack the economy.* With each crisis, small firms go bankrupt and their assets are bought up by surviving firms. A trend toward big business is therefore an integral part of capitalism.

Second, *Marx expects an intensification of the class struggle as the result of the "proletarianization" of the labor force.* More and more small business people and independent artisans will be squeezed out in the crisis-ridden process of growth. Thus the social structure will be reduced to two classes—a small group of capitalist magnates and a large mass of proletarianized, embittered workers.

**At the risk of appearing self-serving, a useful introduction is R. L. Heilbroner,* Marxism: For and Against *(New York: Norton, 1980).*

In the end, this situation proves impossible to maintain. In Marx's words:

> Along with the constant decrease in the number of capitalist magnates, who usurp and monopolize all the advantages of this process of transformation, the mass of misery, oppression, slavery, degradation and exploitation grows; but with this there also grows the revolt of the working class, a class constantly increasing in numbers, and trained, united and organized by the very mechanism of the capitalist process of production. The monopoly of capital becomes a fetter upon the mode of production which has flourished alongside and under it. The centralization of the means of production and the socialization of labour reach a point at which they become incompatible with their capitalist integument. This integument is burst asunder. The knell of capitalist private property sounds. The expropriators are expropriated.*

Much of the economic controversy that Marx generated has been focused on the questions: Will capitalism ultimately undo itself? Will its internal tensions, its "contradictions," as Marx calls them, finally become too much for its market mechanism to handle?

There are no simple answers to these questions. Critics of Marx vehemently insist that capitalism has *not* collapsed, that the working class has *not* become more and more miserable, and that a number of predictions Marx made, such as that the rate of profit would tend to decline, have not been verified.

Supporters of Marx argue the opposite case. They stress that capitalism almost did collapse in the 1930s. They note that more and more people have been reduced to a "proletarian" status, working for a capitalist firm rather than for themselves; in 1800, for example, 80 percent of Americans were self-employed; today the figure is 10 percent. They stress that the size of businesses has constantly grown, and that Marx did correctly foresee that the capitalist system itself would expand, pushing into noncapitalist Asia, South America, and Africa.

It is doubtful that Marx's contribution as a social analyst will ultimately be determined by this kind of score card. Certainly he made many remarkably penetrating statements; equally certainly,

Karl Marx, Capital, *Vol. I (New York: Vintage, 1977), p. 929.*

he said things about the prospects for capitalism that seem to have been wrong. Many economists do not accept Marx's diagnosis of class struggle as the great motor of change in capitalist and precapitalist societies or his prognosis of the inevitable arrival of socialism. But what Marx's reputation ultimately rests on is something else. It rests on his vision of capitalism as a system under tension, and in a process of continuous evolution as a consequence of that tension. Few would deny the validity of that vision.

There is much more to Marx than the few economic ideas sketched here. Indeed, Marx should not be thought of primarily as an economist, but as a pioneer in a new kind of critical social thought: It is significant that the subtitle of *Capital* is *A Critique of Political Economy.*

In the gallery of the world's great thinkers, where Marx unquestionably belongs, his proper place is with historians rather than economists. Most appropriately, his statue would be centrally placed, overlooking many corridors of thought—sociological analysis, philosophic inquiry, and of course, economics.

For Marx's lasting contribution was a penetration of the *appearances* of our social system and of the ways in which we think about that system, in an effort to arrive at buried essences deep below the surface. That most searching aspect of Marx's work is not one we will pursue here, but bear it in mind, because it accounts for the persisting interest of Marx's thought.

Finally, what about the relation of Marx to present-day communism? That is a subject for a book about the politics, not the economics, of Marxism. Marx himself was a fervent democrat—but a very intolerant man. More important, his system of ideas has also been intolerant, and may thereby have encouraged intolerance in revolutionary parties that have based their ideas on his thought. Marx himself died long before present-day communism came into being. We cannot know what he would have made of it—probably he would have been horrified at its excesses but still hopeful for its future.

JOHN MAYNARD KEYNES (1883–1946)

Marx was the intellectual prophet of capitalism as a self-destructive system; John Maynard Keynes was the engineer of

capitalism repaired.* Today, that is not an uncontested statement. To some people, Keynes's doctrines are as dangerous and subversive as those of Marx—a curious irony, since Keynes himself was totally opposed to Marxist thought and wholly in favor of sustaining and improving the capitalist system.

The reason for the continuing distrust of Keynes is that more than any other economist, he is the father of the idea of a "mixed economy" in which the government plays a crucial role. To many people these days, all government activities are suspicious at best and downright injurious at worst. Thus, in some quarters Keynes's name is under a cloud. Nonetheless, he remains one of the great innovators of our discipline, a mind to be ranked with Smith and Marx as one of the most influential our profession has brought forth. As Nobelist Milton Friedman, an avowed conservative, has declared: "We are all Keynesians now."

The great economists were all products of their times: Smith, the voice of optimistic, nascent capitalism; Marx, the spokesman for the victims of its bleakest industrial period; Keynes, the product of a still later time, the Great Depression.

The Depression hit America like a typhoon. One half the value of all production simply disappeared. One quarter of the working force lost its jobs. Over a million urban families found their mortgages foreclosed, their houses lost to them. Nine million savings accounts went down the drain when banks closed, many for good.

Against this terrible reality of joblessness and loss of income, the economics profession, like the business world or government advisers, had nothing to offer. Fundamentally, economists were as perplexed at the behavior of the economy as were the American people themselves. In many ways the situation reminds us of the uncertainty that the public and the economics profession share in the face of inflation today.

It was against this setting of dismay and near-panic that Keynes's great book appeared: *The General Theory of Employment, Interest and Money*. A complicated book—much more technical than *The Wealth of Nations* or *Capital*—the *General Theory* nevertheless had a central message that was simple enough to grasp. The overall level of economic activity in a capitalist system, said Keynes (and Marx

This is probably the most mispronounced name in economics. It should be pronounced "canes," not "keens."

and Adam Smith would have agreed with him) was determined by the willingness of its entrepreneurs to make capital investments. From time to time this willingness was blocked by considerations that made capital accumulation difficult or impossible: In Smith's model we saw the possibility of wages rising too fast, and Marx's theory pointed out difficulties at every stage of the process.

But all the previous economists—even Marx, to a certain extent—believed that a failure to accumulate capital would be a temporary, self-curing setback. In Smith's scheme, the rising supply of young workers would keep wages in check. In Marx's conception, each crisis (up to the last) would present the surviving entrepreneurs with fresh opportunities to resume their quest for profits. For Keynes, however, the diagnosis was more severe. He showed that a market system could reach a position of "under-employment equilibrium"—a kind of steady, stagnant state—despite the presence of unemployed workers and unused industrial equipment. *The revolutionary import of Keynes's theory was that there was no self-correcting property in the market system to keep capitalism growing.*

We will understand the nature of Keynes's diagnosis better after we have studied a little more economics, but we can easily see the conclusion to which his diagnosis drove him. If there was nothing that would automatically provide for capital accumulation, a badly depressed economy could remain in the doldrums unless some substitute were found for business capital spending. And there was only one such possible source of stimulation. This was the government. The crux of Keynes's message was therefore that government spending might be an essential economic policy for a depressed capitalism trying to recover its vitality.

Whether or not Keynes's remedy works and what consequences government spending may have for a market system have become major topics for contemporary economics—topics we will deal with later at length. But we can see the significance of Keynes's work in changing the very conception of the economic system in which we live. Adam Smith's view of the market system led to the philosophy of laissez-faire, allowing the system to generate its own natural propensity for growth and internal order. Marx stressed a very different view, in which instability and crisis lurked at every stage, but of course Marx was not interested in policies to maintain capitalism. Keynes propounded a philosophy as far removed from Marx as from Smith. For if Keynes was right, laissez-faire was not the appropriate policy for capitalism—certainly not for capitalism in depression. And if Keynes was right about his remedy, the gloomy

PORTRAIT OF A MANY-SIDED ENGLISHMAN

Keynes was certainly a man of many talents. Unlike Smith or Marx, he was at home in the world of business affairs, a shrewd dealer and financier. Every morning, abed, he would scan the newspaper and make his commitments for the day on the most treacherous of all markets, foreign exchange. An hour or so a day sufficed to make him a very rich man; only the great English economist David Ricardo (1772–1823) could match him in financial acumen. Like Ricardo, Keynes was a speculator by temperament. During World War I, when he was at the Treasury office running England's foreign currency operations, he reported with glee to his chief that he had got together a fair amount of Spanish pesetas. The chief was relieved that England had a supply of *that* currency for a while. "Oh no," said Keynes. "I've sold them all. I'm going to break the market." And he did. Later during the war, when the Germans were shelling Paris, he went to France to negotiate for the English government; on the side, he bought some marvelous French masterpieces at much reduced prices for the National Gallery—along with a Cézanne for himself.

More than an economist and speculator, he was a brilliant mathematician; a businessman who very successfully ran a great investment trust; a ballet lover who married a famous ballerina; a superb stylist and an editor of consummate skill; a man of huge kindness when he wanted to exert it, and of ferocious wit when (more often) he chose to exert that. On one occasion, banker Sir Harry Goshen criticized Keynes for not "letting things take their natural course." "Is it more appropriate to smile or rage at these artless sentiments?" wrote Keynes. "Best, perhaps, to let Sir Harry take *his* natural course."

Keynes's greatest fame lay in his economic inventiveness. He came by this talent naturally enough as the son of a distinguished economist, John Neville Keynes. As an undergraduate, Keynes had already attracted the attention of Alfred Marshall, the commanding figure at Cambridge University for three decades. After graduation, Keynes soon won notice with a brilliant little book on Indian finance; he then became an adviser to the English government in the negotiations at the end of World War I. Dismayed and disheartened by the vengeful terms of the Versailles Treaty, Keynes wrote a brilliant polemic, *The Economic Consequences of the Peace*, which won him international renown.

Almost thirty years later, Keynes would himself be a chief negotiator for the English government, first in securing the necessary loans during World War II, then as one of the architects of the Bretton Woods agreement that opened a new system of international currency relations after that war. On his return from one trip to Washington, reporters crowded around to ask if England had been sold out and would soon be another American state. Keynes's reply was succinct: "No such luck."

prognostications of Marx were also incorrect—or at least could be rendered incorrect.

But was Keynes right? Was Smith right? Was Marx right? To a very large degree these questions frame the subject matter of economics today. That is why, even if their theories are part of our history, the "worldly philosophers" are also contemporary. A young writer once remarked impatiently to T. S. Eliot that it seemed so pointless to study of the thinkers of the past, because we know so much more than they. "Yes," replied Eliot. "They are what we know."