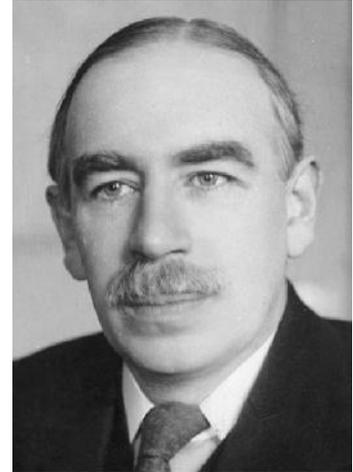


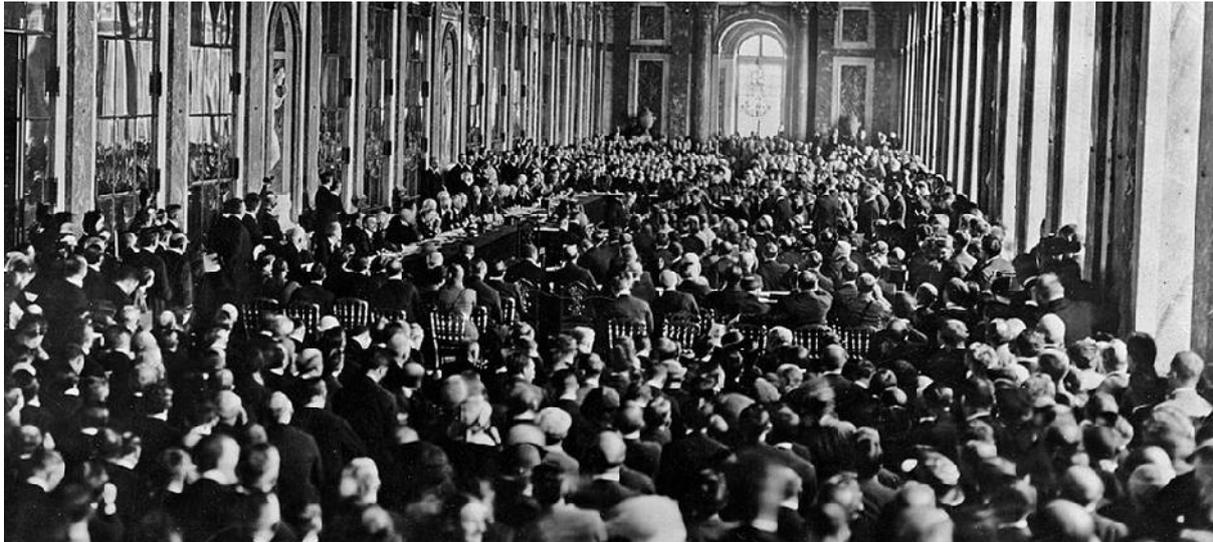
I thought I would spend this week telling you about three economists, starting with JOHN MAYNARD KEYNES (pronounced 'Kanes'). Keynes was born in Cambridge in 1883, in the last few years of the VICTORIAN AGE, when Britain was the richest and most powerful country in the world. A lot of people thought that Britain's wealth was due to its following the ideas of ADAM SMITH (who I told you about on July 22), who said that the secret to being wealthy as a country was to have FREE MARKETS, where people were free to trade goods and services with each other, and LIMITED GOVERNMENTS, which stayed out of the way of people creating wealth by trading goods and services with each other.



This meant that governments should not borrow money - which they would if they spent more money than they raised in taxes. This is because the more money a government borrows, the more it costs to borrow money - because the cost of anything goes up the more people want it (just like the cost of anything goes down the fewer people want it). The cost of borrowing money is called the INTEREST RATE - how much you have to pay by way of interest in order to borrow money from someone else, so that when you pay the money back, you also have to pay them interest as well. So the more money the government borrows, the higher interest rates go - and the harder it is for ordinary hard-working business people to borrow money to make their businesses grow and make more and better deals with other people. So if a government borrows money, it makes interest rates go up, and that CROWDS OUT ordinary people from investing in their businesses - and according to Adam Smith, that's bad, because the way a country gets rich is for ordinary business people to do as much business as possible with other people. So governments shouldn't borrow money, and they shouldn't spend that much money either - because if they are not going to borrow money, the only way for them to fund their spending is through TAXES. And those taxes have to be paid by ordinary people - and the more money that goes out of ordinary people's pockets and into the pockets of the government, the less business ordinary people can do with each other; and that, again, is bad.

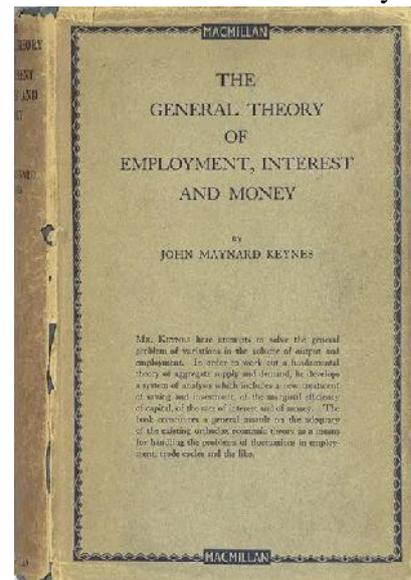
So that's what people learned from Adam Smith - governments shouldn't borrow money, and the best governments are SMALL governments, that spend very little money and therefore tax people very little. The secret of living in a wealthy country was to have free markets, low taxes, and a small government that doesn't borrow money. But John Maynard Keynes said that all of that was nonsense. After studying mathematics at Cambridge, Keynes became interested in economics and started working for the British government advising the government on economic issues.

He ended up attending the VERSAILLES (pronounced 'Ver - sigh') CONFERENCE at the end of WORLD WAR I, which would determine how much Germany should pay for invading France and forcing Britain and France into a four year long war, with a huge loss of life. The British and French wanted the Germans to pay huge sums in REPARATIONS for what it did, but Keynes argued that this was a terrible idea that would bankrupt Germany and ensure that Germany would try to take revenge on Britain and France at some point in the future. A lot of people thought that Keynes' prophecy came true with the series of events that I talked about on August 11, where Germany suffered terrible inflation from printing the money they needed to pay their reparations, and then suffered terrible unemployment, which led to the rise of ADOLF HITLER, and WORLD WAR II.



Keynes was so disgusted at the way that Germany had been treated at the Versailles Conference that he left the British government. In 1921, he became the BURSAR of KING'S COLLEGE, CAMBRIDGE, which meant he was in charge of all the money and property that King's College owned, and had the job of making King's College even richer than it was. This was something he was very skilful at, by doing what Adam Smith advised, and making loads and loads of trades with other people. Sometimes these trades went wrong. There was a time when Keynes bought a whole load of wheat, which he planned to sell on at a profit, but he forgot to sell the wheat. It ended up being delivered to King's College, and had to be stored in the Chapel while Keynes tried to find someone to take it away. But more often than not, the trades went really well, and King's College became very rich.

And this was at a time when the rest of the world was getting poorer, because of a GREAT DEPRESSION, which started with the WALL STREET CRASH in America in 1929, and led to loads of people losing their jobs in countries like America, and Britain, and Germany. The British government thought that the solution was to do what Adam Smith advised - the only way Britain could get richer was for the government to get out of the way of people trading with each other, so Britain's government cut the amount of money it spent, so that it borrowed and taxed people less. But in 1936, Keynes published a book called THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY which argued that this was exactly the wrong thing to do. When no one has any money, the only way for the country to get richer is for the government to borrow a huge amount of money, and spend it like crazy, to put that money into the pockets of ordinary people who would then spend it themselves, and put that money in the pockets of other people, and those other people would spend that money, putting it in the pockets of yet more people, who would then spend it - and as the money goes whizzing round and round and round, people get back into work and the economy comes back to life.



So that was Keynes' recipe for a healthy economy. When times are bad, the government should spend a lot more than it raises in taxes and spark a lot of economic activity by

spending that money. And when times are good and people are going a bit crazy spending loads of money that they may not be able to afford, the government should take some money out of the economy and cool things down by spending less than it raises in taxes. In this way, Keynes argued, a government could fine-tune things to ensure that the economy kept on getting bigger every year.

Keynes' ideas were accepted very quickly in America, where the new President FRANKLIN DELANO ROOSEVELT (pronounced 'Delay - no Rooze - ah - velt') had been elected in 1932, having promised to bring the Great Depression to an end. The idea that you could do this by the government borrowing a huge amount of money and spending it was very tempting. A government that spends a lot of money without raising taxes is always going to be very popular - whoever gets the money spent by the government will love the government forever, and no one will be unhappy with the government because they have to pay more in taxes to cover the government's spending. And Roosevelt followed Keynes' advice, and as a result became very popular, getting re-elected in



1936, 1940, and 1944. And governments round the world gradually came round to Keynes' way of thinking, with the British government after 1945 (when the country was completely bankrupt) borrowing large amounts of money to cover huge increases in public spending on things like the newly created NATIONAL HEALTH SERVICE.

And for many years, it seemed that Keynes had discovered the best way of running an economy - from 1945 to 1970, countries in the West got richer and richer, but without swinging madly between periods of mass unemployment and periods of crazy inflation, which people had gone through in the 1930s. Everything was smooth - countries got richer by about 3% a year: not too much, not too little, always the same. And the temperature of the economies of countries in the West was always kept at roughly the same level - when things got a bit cool, the government would warm things up by running a DEFICIT, spending more than it got in through taxes and borrowing to make up the difference, and when things got a bit too hot, the government would cool things down by running a SURPLUS, spending less than it got in through taxes, and saving the difference in order to pay back the debts it had run up in the years it ran a deficit.

Keynes never got to see any of this - he died relatively young at the age of 63, in 1946, shortly after the end of WORLD WAR II, and after attending another post-War conference - the BRETTON WOODS CONFERENCE - that was intended to determine how the world economy would be run after the end of World War II. And even if he had lived long enough to see



his ideas adopted across the world, he probably would not have lived long enough to live through the 1970s, when the economies of Western countries got into real trouble, and people started to wonder whether Adam Smith was right all along, and that Keynes had not actually discovered the secret of running a successful economy. One economist, in particular, became world-famous in the 1970s for arguing that Keynes' ideas were a disaster and should be rejected. His name was MILTON FRIEDMAN (pronounced 'Freed - mun'), and I will tell you about him on Wednesday.