Keynes’ forecast – he got growth right and everything else wrong

Most economists do not usually make forecasts (because they are typically shown to be spectacularly wrong!), but in the dark days of the Great Depression in 1930, one of the greatest economists of the twentieth century, John Maynard Keynes, stuck his neck out to forecast the future a hundred years hence. In the essay, *Economic Possibilities for our Grandchildren*, he urged the public to look beyond the then troubled economic times to the time of their grandchildren, when human ingenuity and steady growth would have lifted incomes significantly. He estimated incomes in the developed world would rise by four to eight times in the span of a century. Consequently, he declared, in the early decades of the twenty first century, mankind would be on the verge of solving the economic problem – that is, the struggle for subsistence that has been the most pressing problem of the human race.

Despite the Great Depression and the world wars in the twentieth century, terrorism and the Great Recession in the twenty first century, Keynes’ forecast of income growth has, if anything, likely been too pessimistic. Per capita incomes in the United States, as in other industrial countries, have increased by about 6 times since 1930, and are on target to exceed the upper range of Keynes’ predictions by 2030. Put in a different way, nostalgic viewers of the American period drama, *Mad Men*, set in the 1960s, would perhaps be surprised to know that incomes today are three times what they were in those seemingly idyllic days when advertising executives drove big cars and lived in large suburban houses. Indeed, someone who earned twice the average US income in 1900 would be deemed to be below the poverty line in 2009. What Keynes got astonishingly right, way before other economists, was the explosive effect of steady compounding growth, as technological innovations combined with capital investment to make workers more productive, thus raising their incomes. While Keynes’ predictions were about developed countries, with world GDP at about $ 78 trillion in 2017, and global population at about 7.6 billion, average global income per person is about $ 10,000, enough to keep everyone in moderate comfort (remember, services like haircuts and housing cost a lot less in developing countries).

Keynes believed that once humanity solved the economic problem, we would then turn to our more permanent problem: how to use the freedom from economic cares that technological advances and compounded growth had won us “to live wisely and agreeably and well”. Keynes saw the solution of the economic problem as a way for humanity to

“return to some of the most sure and certain principles of religion and traditional virtue-that avarice is a vice, that the exaction of usury is a misdemeanor, and the love of money is detestable, that those walk most truly in the paths of virtue and sane wisdom who take least thought for the morrow. We shall once more value ends above means and prefer the good to the useful. We shall honor those who can teach us how to pluck the hour and the day virtuously and well, the delightful people who are capable of taking direct enjoyment in things, the lilies of the field who toil not, neither do they spin.”

In sum, Keynes thought we would stop glorifying the manufacturer, the merchant, the moneylender, and money and instead turn to philosophy, beauty, leisure, and friendship once again. We would not let our values be determined by the market but by the community. Before the advent of that nirvana, however, he cautioned

“But beware! The time for all this is not yet. For at least another hundred years we must pretend to ourselves and to everyone that fair is foul and foul is fair; for foul is useful and fair is not. Avarice and
usury and precaution must be our gods for a little longer still. For only they can lead us out of the tunnel of economic necessity into daylight.”

Keynes thus seemed to see market forces as a necessary evil, to be endured so long as the economic problem existed, but to be abandoned as soon as a nirvana of plenty was upon us. We are within reach of the economic nirvana that Keynes thought would be enough, but few want to abandon their jobs to contemplate the fundamental questions of our existence. If anything, “avarice and usury and precaution” seem to be growing in importance.

What did Keynes miss? We start with this question in this chapter (a preview of the answer – he missed the social and political issues we have been concerned with, he got the economics largely right), and then go on to ask what would happen if the rebalancing of pillars does not occur. I will speculate on three possible dystopias, one for each of the pillars. I have tried not to depart too much from reality, but even so, the scenarios are worrying – precisely because they might well happen.

**Keynes’ Errors**

Keynes got a lot right but a few misses stand out, bearing out baseball legend Yogi Berra’s musing that “It’s tough to make predictions, especially about the future.”

Keynes believed that there was a level of consumption at which people would get satiated and want little more. Yet if there is a satiation point, few seem to have reached it. As philosophers across cultures have recognized, and as economists since Adam Smith have theorized, people habituate to whatever level of consumption they have, and aspire for still more. Indeed, the philosophy of liberal utilitarianism, which underpins markets, as well as our measurement of progress through per capita GDP growth, is centered on more being better. Moreover, the range of products that one can buy keeps changing and expanding. People are constantly being made aware of needs they never knew they had – and over time those needs become indispensable: the electric iron, the electric fan or air-conditioning, and fast access to the Internet have become goods of mass consumption everywhere since Keynes’ time.

Keynes did realize that the powerful desire to keep up with the Jones could also increase what everyone thought they needed over time. However, perhaps he underestimated the strength of these forces. Peoples’ satisfaction with a certain level of consumption also depends on what it is relative to everyone else around. A recent study finds that the higher is the income inequality in a neighborhood in the United States, the higher is the fraction of high status cars bought. Perhaps a more alarming consequence of the consumption arm’s race, higher also is the borrowing that households undertake to maintain that consumption. Another study finds that close neighbors of those who win lottery prizes in a province in Canada tend to spend more on conspicuous goods like cars, borrow more, and go bankrupt more often. The bottom line is that despite being much richer and consuming much more, people want still more, even at the risk of financial distress.

This also means they have needed more income to pay for their insatiable consumption than Keynes imagined. As we have seen, people increasingly generate their high incomes not from ownership of land (where one could be an absentee landlord) or from ownership of physical or financial capital (where one can get a share of the profits just from owning capital) but from their own capabilities or human capital. This, however, means that those with higher incomes today typically have to work much harder for it
than in Keynes’ time. The idle rich have become the working rich. They have no time to contemplate the meaning of life as they clock eighty-hour work weeks.

This, however, leads to two related and important omissions. Keynes did not discuss the distribution of income. Perhaps he believed that society would find a way to ensure that it was not too skewed. For instance, he defined technological unemployment as “our discovery of means of economizing the use of labor outrunning the pace at which we can find new uses for labor”. This suggested he believed that widespread permanent joblessness because of the spread of machines was unlikely. He has proven right so far. The farm worker, harvesting crop with his sickle, moved to painting the automobile in the factory and now waits tables in a fine restaurant – the lower end of the workforce has been displaced by machines but new jobs have always opened up. This is perhaps why unemployment in industrial countries is still very low at the time of writing. However, as discussed earlier, even with low unemployment, income inequality has risen, especially in the Anglo-American economies.

Relatedly, Keynes mentioned the political support for the liberal market system only in passing, referring only to our “determination to avoid wars and civil dissension” as well as our “willingness to entrust to science the direction of those matters which are properly the concern of science” as important assumptions in his forecast. He did not anticipate the concentration of incomes, or the possible monopolization of opportunities in the market. Surprisingly though, despite the rise in his time of both fascist and socialist parties capitalizing on economic distress, he did not speculate on the threats from those quarters. Perhaps he was both a techno-optimist as well as a political optimist.

Let us, therefore, take a slightly different tack from Keynes. Let us assume that the human potential for innovation and production is nigh unlimited in the next half-century or so, and the human capacity to consume is not satiated. The question is whether we can maintain the political and social cohesion to achieve it. Of course, the answer depends on the extent to which the balance between community, markets, and the state is perturbed.

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i See the discussion in “Economic Well-being in a Historical Context” by Benjamin Friedman in Revisiting Keynes, Lorenzo Pecchi and Gustavo Piga ed., MIT Press Cambridge, Massachusetts, USA.

ii See Bricker, Jesse, Rodney Ramcharan, and Jacob Krimmel, “Signaling Status: The Impact of Relative Income on Household Consumption and Financial Decisions”, 2014, working paper, Federal Reserve Board. In another study of the consequences of this consumption arms race, my colleagues at the University of Chicago, Marianne Bertrand and Adair Morse, found that before the financial crisis in 2008, the more the incomes of the rich in a state in the United States, the more the middle class spent; a rise in the income of high income households within a state by 10 percent increased consumption among middle income households within that state by 2.2 percent, relative to similar middle income households elsewhere. Again, because people borrowed to keep up their consumption, bankruptcy filings in states with higher incomes at the 90th percentile were also higher.