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John Maynard Keynes saved capitalism from itself

But America's past economic success is no guarantee of its future, writes Joseph Stiglitz

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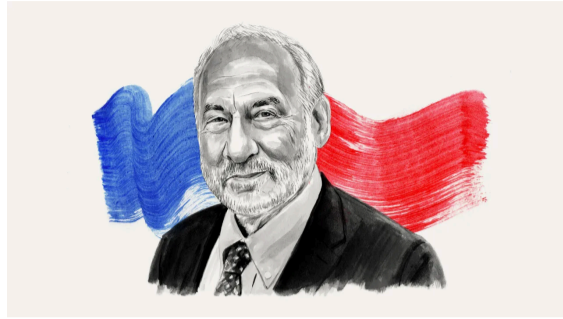


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TWO HUNDRED AND FIFTY years ago, the United States was largely an agrarian economy—affected, of course, by weather but without real business cycles. Those came with the development of capitalism in the 19th century. And so began the deep fluctuations of the modern era, the two worst being the Great Depression of the 1930s and the Great Recession that began in 2008. Fortunately, John Maynard Keynes, the great economist of the 20th century, showed us that we did not have to suffer these dysfunctions of capitalism. The government could do something about them.

As the expression goes, necessity is the mother of invention. By the time Franklin Roosevelt took office in 1933, the United States had already lost four valuable years sinking deeper into depression. Roosevelt couldn't wait for Keynes to spell out what to do. He intervened decisively—one might say intuitively. Some elements of his agenda are still controversial; despite the unemployment rate peaking at close to 25% during the Great Depression, most economists and businesspeople said: "Leave it to the market. It will correct itself eventually." But as Keynes quipped, in the long run we're all dead.

Keynes's 1936 book "The General Theory of Employment, Interest, and Money" constituted an intellectual revolution. Contrary to the prevailing doctrines of the day, he argued that markets left alone could remain mired in extended periods of deep unemployment. Even if there were self-correcting "forces" bringing the economy back to full employment, they worked too slowly on their own to prevent significant economic hardship. He explained why monetary policy—favoured by many conservative economists when intervention was deemed necessary—would be ineffective in a deep downturn. Most importantly, he provided a solution: government spending could stimulate demand and lift the economy out of the mire.

The good news was that the constitution had sufficient flexibility to allow these new ideas to be tested and show their worth, even though the Founding Fathers could not have anticipated this vital role for government. In those days, the government was far smaller. During the first half of the 19th century, the federal government collected just 2% of GDP and there was no central bank until the Federal Reserve was created in 1913. The central government had neither the resources nor the tools to stabilise an inherently unstable capitalist system.

Keynes was no left-wing radical; he was not overly concerned with inequality, he believed in the market economy and he believed that his proposed intervention—not a revolution, but a minor "fix"—would save the day.

Nevertheless, many people were suspicious of Keynes because he provided a rationale for a larger government. Some ideologues on the right would have preferred that the country remain in a depression than have the government come to the rescue. As they saw it, if the government could do that, who knows what else it might do? It might guarantee everybody a minimum pension, health care and an education. And those things might require taxes beyond the miserly amounts Americans were paying. This was especially dangerous—to the forebears of today's billionaire oligarchs—because some 20 years earlier the United States had adopted the 16th Amendment to the constitution, allowing the levying of a (progressive) income tax.

In retrospect, Roosevelt's pragmatism and Keynes's ideas saved capitalism from the capitalists. Had the latter had their way, the failures of unfettered capitalism, an economy stifled in a seemingly never-ending depression, would likely have meant that it would not have survived democratic pressures. Instead, President John F. Kennedy, under the influence of strong Keynesian economists (including John Kenneth Galbraith, Robert Solow and Paul Samuelson) adopted Keynesian policies as the cornerstone of his economic framework.

Throughout the 1970s, with the country facing inflation (then, as today, largely caused by unprecedented increases in oil prices), the right claimed Keynes was passé. While Keynes had emphasised the role of government in sustaining total (or aggregate) demand so the economy remained at full employment, Ronald Reagan flipped the language around to emphasise supply. Conservatives argued that if taxes were low and regulations light, the dynamics of the market would ensure growth with full employment. So optimistic were they that they even claimed cuts in tax rates would spur so much growth that tax revenues would increase. Of course, that didn't happen.

In subsequent decades, America repeatedly went into downturns, some quite deep, demonstrating forcefully that unfettered markets were not good at self-regulating. During the Great Recession and in the covid-19 pandemic especially, Keynesian interventions—government spending—proved enormously effective.

And yet, in spite of all the evidence, the political battle continues. In the early 1990s, there was an attempt to pass a balanced-budget amendment, a provision which would have all but prevented effective Keynesian policies. Fortunately, it was narrowly defeated. During President Donald Trump's first term, there was a revival of "supply-side policies", with a major cut in taxes to corporations and the super-rich. The policies failed, as the earlier Reagan policies had: deficits increased and the boost to growth was minimal, if anything.

If the constitution were created in the 21st century, knowing that the government has the capability to ensure that the economy operates at full employment, it would likely have mandated that it do so. The closest we came was the Employment Act of 1946, which created the Council of Economic Advisers in the White House, which I chaired under President Bill Clinton. It committed the United States "to foster...conditions under which there will be afforded useful employment for those able, willing, and seeking work". In spite of having the tools to accomplish this mission, too often, for too many, we have failed. ■

Joseph Stiglitz is a Nobel-prizewinning economist and a professor at Columbia University.

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