

Commentary

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ECONOMIC INVESTMENT AND ACTUARIAL RESEARCH

The Legacies of John Maynard Keynes and Deng Xiaoping

Among the great economic and political thinkers of the twentieth century who have influenced the geopolitics and the global economy of this century are the British economist John Maynard Keynes (1883-1946) and the Chinese political leader Deng Xiaoping (1904-1997). The recent global financial crisis and the economic strength of China have created a renewed interest in the lives and work of Keynes and Deng, particularly among economists, politicians and academics.

Keynes advocated macroeconomic management through a mixed economy embracing both private sector and public sector participation. He developed economic theories concerning how the public sector should implement active policies, including monetary policy actions by the central bank and fiscal policy by government to stabilize economic conditions over a business cycle. Current governmental economic stimulus policies and interest rate strategies owe much to Keynesian economics.

Deng instituted the "Period of Reform and Opening" in China, decentralizing the state economy by replacing central planning with market forces and reducing the role of state-run enterprises. Factories and business enterprises were permitted to retain profits, utilize merit-pay concepts and pay bonuses and provide other incentives, to boost productivity. His reforms to the Chinese economy encouraged foreign trade and investment, established Special Economic Zones, and emphasized growth in exports to the rest of the world. China's current economic strength and growth are directly attributable to Deng's policies.

Two recently-published books provide the reader with insights into the thinking of Keynes and Deng and the significance of their accomplishments relative to today's global economy. The first is *Keynes: The Return of the Master* by Robert Skidelsky. The second is by Martin Jacques with the title of *When China Rules the World*.

Skidelsky is Emeritus Professor of Political Economy at the University of Warwick in England. Jacques is a writer for *The Guardian* and *The New Statesman* and is currently a visiting senior fellow at the London School of Economics. Another book that indirectly relates to Keynes' view of extremely rare economic events is *Black Swan* by Nassim Taleb.

According to Skidelsky, Keynes rejected the idealized theories of classical economics such as perfect flexibility of wages and prices, perfect competition, perfect information, and rational economic behavior. Keynes had a particular interest in the nature of uncertainty; he considered three types of probability; the first is cardinal or measurable probability that is the domain of risk assessment; the second is ordinal probability involving qualitative assessments of probable outcomes; the third type of probability in the Keynes universe of probabilities is the domain of irreducible uncertainty. Keynes criticized the broad use of econometrics and the character of quantitative modeling; he believed there were important economic influences that cannot be reduced to statistical form. Former Chairman of the Federal Reserve Alan Greenspan explained the failure of risk-management models during the 2008 financial crisis by saying: "probability distributions estimated largely, or exclusively over cycles that do not include periods of panic will underestimate the likelihood of extreme price movements and furthermore, joint distributions estimated over periods that do not include panics will underestimate correlations between asset returns during panics." Skidelsky echoes Keynes in questioning the applicability of traditional risk-measurement methods to risks such as credit risk, liquidity risk, market risk, legal risk, catastrophic risk, regulatory risk, political risk, compliance risk, and reputational risk. In his book *Black Swan* Nassim Taleb argues that economics is character-

ized by the incidence of rare and extreme events that are not reflected in risk management models. Keynes envisioned a world of uncertain events to which measurable probabilities could not be assigned.

Martin Jacques has produced an insightful and scholarly book on the future of China, notwithstanding its improbable title. His carefully-researched 550-page tome examines Chinese history and culture with the benefit of insights gained from experience in his academic positions held at universities in Asia including Beijing, Kyoto and Singapore. He stresses the importance of viewing China as a civilization rather than as a nation-state and argues convincingly for China's expanded future influence on global economic, political and cultural affairs. Jacques explores the long history of China and the deep-rooted influence of Confucian philosophy in Chinese thinking and culture. He explains how China's former role as a major regional civilization with far-reaching influence is now being re-established as China's new economic power allows it to play a role in development projects in Africa and Latin America. Jacques confidently predicts that China will be the dominant regional leader in East Asia and will, within a few decades, become the largest economy in the world. Jacques quotes Deng Xiaoping as saying that China's modernization has two essential requisite conditions, namely, domestic political stability and international peace. Deng's reforms involved not just an economic revolution, but also a political revolution as it moved away from its former ideological model.

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