Canadian Journal of Political and Social Theory/Revue canadienne de théorie politique et sociale. Vol. 8, No. 3, (Fall/Automne, 1984).

THE POWER OF REASON AND THE LEGACY OF KEYNES

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It is fashionable these days to announce that "Keynesianism is dead". Both the right and the left have been trumpeting this conclusion with ever increasing volume. Robert Campbell's "Post-Keynesian Politics and the Post Schumpeterian world"* incorporates this notion as the starting-point for his analysis and critique of the eclipse of Keynesianism and the current state of the political economy of public policy.

Perhaps a clear disavowal of past orthodoxy is a healthy beginning to the process of constructing a new and improved theory of the complex political economy of advanced capitalism. Such a new theory is all the more important in light of the current depression, the recrudescence of previously bankrupt ideologies about the virtues of laissez-faire, the apparently successful ideological revival of nineteenth-century market liberalism and the tragic circumstances of the unemployed. But in our haste to dispose of the corpse of Keynesianism we may well be discarding prematurely a number of extremely valuable insights associated with the original theorist, as opposed to with his interpreters.

As is often the case in human endeavour and, in particular in intellectual work, progress is rarely linear. Rather, it moves in a lurching step function manner. Furthermore, the inevitable, if regrettable tendency to distort ideas once they have left the hand of their original developer must be taken account of in any wholesale abandonment of ideas or conceptual system. This is critical in particular where the perilous state of economic theory is concerned.

It is precisely this problem of distorted interpretation that surrounds the work of John Maynard Keynes. It is always, of course, much easier to rely upon preconceived conceptions or accepted conventional sources of interpretation than to return to the original source in any attempt to deal with the work of an original thinker. The currently fashionable dismissal of Keynes by contemporary philistine technicians of neo-classical economics notwithstanding, Keynes was above all else a great thinker. His unwillingness to be bound by any artificial disciplinary borders and his capacity for employing imagination in the search for truth ensured that he would be no mere mechanic in the practice of the discipline of economics. Having said this any interpretation of Keynes' writings

* Ed.'s Note: See *CJPST*, Vol. 8, Nos. (1-2) 1984, pps. 72-91.

is bound to be altered by the peculiar prisms through which an interpreter encounters his work. It could not be otherwise. Furthermore, precisely because Keynes was a great thinker as well as a great polemicist his ideas were in a constant state of flux.

It is not surprising therefore that there are contradictory tendencies in his work. This is to be expected in the work of someone who was emerging out of one dominant paridigm and beginning the process of establishing another. As it turned out this alternative paridigm was an aborted revolution. It fell victim to the forces of reaction, both intellectual and political, that shaped the reception of Keynes' work. The fact that Keynes' ideas were never truly implemented was masked as it were by the particular circumstances of the post-war period. The destruction of the competitive Japanese and European national capitals that occured in the Second World War permitted the post-war period of reconstruction and the long boom of the business cycle recovery that lasted more or less uninterrupted until the early 1970s, despite the failure to implement Keynes' ideas.

In order to understand why it is misleading and ultimately damaging to the cause of social reform to speak of Keynes as Campbell does as a "hyper rationalist" who believed that "a little clear thinking" was all that was required, and to hold him accountable for the bureaucratization of economics and the "trivializing and tranquilizing" of political life, it is necessary to recover the core of his original argument. In doing so we must place it in the context of his personal biography and that of his times.[1] Only by doing this can we appreciate just how badly Keynes' project was distorted and deformed by his interpreters, in particular those neo-classical economists who popularised Keynesianism as it came to be taught in the standard economics text books and understood by governments. What began as a truly revolutionary challenge to orthodoxy within the walls of the establishment, rather quickly and perhaps not surprisingly was shorn of its radical content. Insofar as Keynes' work represented a radical challenge it is not surprising that the establishment and ruling class were unwilling to participate in their own euthanasia. Nevertheless, the fact that governments in varying degrees did accept, albeit reluctantly a role for state intervention in the economy in the interests of economic stabilization did give observers the illusion that Keynes' ideas were actually implemented. As such, once the work of Keynes had become transformed into Keynesianism the die was cast for the inevitable discrediting of Keynes once the business cycle returned with a vengeance.

The distortion of Keynes into what Joan Robinson called bastard Keynesianism[2] is a matter of more than purely hermeneutic importance. As Keynes himself argued ideas are important: both in terms of the role they play in influencing actual policy making and in terms of their hegemonic power. Once a given ideational system has been established and entrenched it is extremely difficult to dislodge it. This is all the more critical in times of social crisis when ideas once vulgarized have a way of becoming embodied in social and political movements and thereby assuming a dynamic of their own.

The willingness of neo-conservatives to master this lesson more thoroughly than the left explains in part their extraordinary success in recent years. There is perhaps nothing more deadly and disarming that the economistic orientation shown by certain analysts on the left towards ideas as distinct from material forces. For peculiar historical reasons, including the Anglo-American antipathy to continental marxist and social-democratic thought, the very real threat posed by Keynes to the ideological dominance of classical laissez-faire as the principal explanatory system for the operation of the "free market" economy ought not to be under-estimated. Had Keynes' ideas been communicated in an undistorted form and absorbed by those who were part of the socialist and social democratic movement in the post-war period it is quite likely that social democratic politics would have developed in a very different fashion than was in fact the case. Of course, one cannot ignore the role which other powerful cultural and environmental factors played in shoring up the ideological hegemony of the prevailing social order. Nevertheless, as Michal Kalecki long ago argued,[3] Keynes' full employment economic policies could never have been implemented without fundamental change in the capitalist social order. It was just because of their radical nature that they were to be bastardized and a "political" cycle of unemployment complete with the appropriate neo-classical rationalizations established.

It is in the above sense that Robert Campbell and others are correct in arguing that ultimately the solutions to the economic crisis lie in the realm of politics rather than technique, but incorrect in asserting that Keynes' prescription was purely technocratic and hyper-rationalist. To be sure Keynes did believe in a kind of Edwardian liberalism in which the eventual triumph of good will assisted by a neutral state beholden to no one particular class, but dedicated to the public good was assured. Nevertheless, his proposals involved the definite restriction and eventual elimination of upper class wealth and power.[4]

Campbell chooses to interpret Keynes in terms of two versions of Keynesianism, supply side and demand side. Neither of these versions as they are described are undistorted variants of Keynes' work. In reality, Keynes approached the operation of the capitalist economy from a far more holistic point of view in which both the insufficiency of aggregate demand and the instability of the investment function were key ingredients in the diagnosis of the causes of economic depression. Keynes was able to show that full employment, rather than being an expected outcome, was actually an accidental outcome of the system. The explanation for the tendency of the economy to produce less than full employment and for the business cycle itself lay deep within the structure of the capital accumulation process. It thus makes little sense to speak of Keynes as a demand side or supply side theorist. In reality he was *both*. Furthermore, he was not a believer in the idea that has come to be associated with his name, namely that simple state intervention in the economy on the side of demand stimulation in the absence of other more fundamental changes would be sufficient to sustain cycle free economic growth.

In order to better understand the critical role that the investment process played in Keynes' theory it is necessary to understand in some detail his personal background. As is generally well known Keynes was the product of an upper class background. His father was a well established professor of economics at Cambridge. Unlike many of those who were born to privilege Keynes was also brought up with a profound commitment to reason and truth, and no less importantly to social responsibility and justice. Because of his intellectual talents which were considerable and went far beyond his brilliance in economics Keynes rather early on became a star in the British establishment. As such he was a man who had access to ministers of the crown, bankers and diplomats. Thus when he did break with the establishment of the economics profession it was an event that automatically received considerable attention.

Keynes was also an expert in matters of logic and probability. Indeed, he wrote a major dissertation on the logical foundations of the theory of probability. Finally, Keynes had an intimate knowledge of the capital accumulation process and in particular, its highly speculative, uncertain and risk taking character. Indeed, he made a fortune out of speculating in the commodity markets. He was also successfully involved in running a major British insurance company. Keynes' intimate knowledge of the financial side of capitalism, his connections with the British political and business establishment and his intellectual training equipped him to understand better than most of his contemporary economists how inherently risky, uncertain and prone to miscalculation the process of capital accumulation might be. In much the same way as Marx regarded capitalism as grounded in the anarchy of private production Keynes eventually came to view the capital accumulation process as fundamentally irrational and therefore incapable of producing socially rational results.

One of the bastions of economic orthodoxy that Keynes struggled to demolish was Say's law. Despite Keynes' best effort Say's law has recently resurfaced again with the revival of laissez-faire. Why should the economic theories of an otherwise obscure early nineteenth century French economist, Jean Baptiste Say, still be influential in economic theory and thereby indirectly in public policy? The ironies of history are many. Say achieved lasting fame in economic theory on the basis of a small aspect of his *Treatise on Economics*, the notion that supply creates its own demand. Despite it becoming the target of considerable criticism at the time of its original formulation it has continued to trouble economics to this very day. The reason is not hard to find. If supply truly did create its own demand then a free market economy would tend toward a full employment equilibrium. Gluts of unemployed resources such as labour could be eliminated so long as they were prepared to adjust their price, that is their wage, downwards to the point where they would be hired. Hence, the claim that we still hear today — if only workers would ask for more reasonable wages all would be well. This notion which still has considerable currency rests upon the fanatasy that simply adding up all the buyers and sellers in a market and adjusting the prices of the goods bought and sold appropriately will result in a market clearing equilibrium.[5] Should temporary gluts appear the explanation is less than perfect foresight in judging the correct price. In such circumstances the solution is easily at hand. Cut the price of the goods in excess supply until the market clears. Thus Say's law has has enormous ideological appeal because it supports the free market fantasy: the perfect vision of eighteenth century enlightenment, the frictionless equilibrium, the idyll of capitalist goodness.

Of course, reality was far more unkind and unforgiving. Persistent gluts of unemployed workers appeared and reappeared throughout the history of capitalism. Attempts to solve the problem by cutting wages often only prolonged the depression. In the face of the depression of the thirties classical economists simply retreated further into their cocoons spinning new and more elegant refinements of Say's law. Serious critics of the tendency toward gluts of unemployed workers were banished as cranks or outsiders.[6]

It was to this traditional classical orthodoxy that Keynes addressed himself when he broke from their blindness to reality in the face of the moral crisis surrounding the massive market failure and catastrophic unemployment that struck England as early as the late 1920s. The first major proposition that Keynes overturned was Say's Law. He showed precisely that a cut in real wages would not necessarily clear a glut on the employment market. In other words, even if wage prices are flexible downwards unemployment may persist. This is one of the first propositions that Keynes established in his work *The General Theory of Employment, Interest and Money*. And yet this is precisely what the neo-classicists refused to acknowledge in their bastardized interpretation of Keynes' work. Instead they argued that Keynes' theory was really a special case of the more general classical model in which prices were flexible. In other words they claimed that Keynes' argument rested upon rigid money wages, something that Keynes explicitly refuted.[7]

Keynes was able to show in his work that even if workers accepted wage cuts there was no guarantee that the level of employment that would be offered would correspond to the full employment level. Indeed wage cuts would just as likely result in price cuts without any expansion of employment. For Keynes, the explanation as to why wage-cutting was not a solution lay in the fundamental character of capital accumulation itself.

All investment decisions which ultimately are associated with employment creation involve, according to Keynes, a very firm, specific or even individual calculation of the expected rate of return, the turnover time for the invested capital: in other words how long it takes to make back the initial outlay, the risk involved, and the degree of uncertainty about whether the expected rate of return will actually occur. Each economic actor makes this calculation alone, as opposed to in concert with others. Thus, there is absolutely no guarantee that when we add up or aggregate all these private autarkic decisions that they will total up to economic activity resulting in offers of jobs corresponding to the level of full employment. (This is true irrespective of the nature of technological labour displacement associated with new capital investment.) Indeed, the full employment result is quite simply a random one among many other alternative outcomes. Much like a lottery the chances of any one set of decisions resulting in the jackpot are statistically low.

Furthermore, the investment decision is complicated by what Keynes rather unfortunately chose to call the marginal efficiency of capital. This notion corresponds to that rate of return on capital that will just induce wealth holders to invest their savings in a project of capital accumulation. If the marginal efficiency of capital is very high — it will always be a few percentage points above the rate of interest — there is a risk that capitalists will choose not to invest their savings because there are not enough projects with a sufficient rate of return in which to invest. Instead, they may hoard their money or speculate with it in a non-productive manner. This hoarding potential increases as the degree of risk and uncertainty increase in the economy. It was here that Keynes' intimate knowledge of the commodity markets served him well. Unlike his contemporaries Keynes developed a speculative theory of the investment process which linked it to the financial markets.[8]

It was on account of these factors and the psychological traits associated with the act of consumption that Keynes was able to show that contrary to the classical economists savings did not automatically translate themselves into productive investment. Instead, hoards of unproductive wealth could be and were amassed in the form of jewelry, real estate, *objets d'art* or simply held as cash. Hence, it was a critical aspect of Keynes' theory that the social class which most closely was bound up with hoarding and speculation, the *rentier* class, excercised far too much power in the economic system. It was this enormous power that had to be broken if capitalism ever were to be reformed.

In Keynes' view, the "euthanasia of the rentier class" could only come about after a long period of full employment in which state intervention and the specific targeting of investment would produce an economy in which there was no longer any shortage of capital and the marginal efficiency of capital therefore would tend toward zero. Keynes believed, rather naively it would seem, that a period of twenty to thirty years of full employment might produce sufficient abundance of capital invested in productive capacity of a peaceful as opposed to military nature that would bring about this result. Here Keynes quite clearly misread the growth and consumerist fixation of modern capitalism.

Furthermore, Keynes argued strongly for a serious structural redistribution of wealth and income so as to ensure the weakening of *rentier* power. Keynes, understood in his own terms, did represent a serious challenge to capitalism. While it is a serious distortion of his views to see him as a radical socialist, the fact is his "saviour role" for capitalism has hidden the extent to which his ideas represented a very fundamental reform of the power and class structure of capitalist society.

Hence, Kalecki's warning that Keynes would never be implemented precisely because of his radicalism makes sense. Indeed, given the fact that a fundamental redistribution of wealth income and power has not taken place in the post-war period, and that the power of the *rentier* class is greater than ever, aided by a number of perverse "reforms" designed to stimulate saving and accumultion by the upper class, it is no wonder that the business cycle has returned with a vengeance. Of course, much has changed since Keynes wrote the *General Theory*. The transnational nature of capital and the disruptive nature of new technologies certainly complicate the problem of achieving full employment. But we ought to remember that neither of these factors are totally new. Indeed they were both powerful factors in the 1930s.

I am not arguing that all will be well if we simply return to Keynes properly understood. Nor am I suggesting that a new theory of economic management is not required. Nor am I suggesting that we ought not to consider developing an economic system that enables us to detach ourselves from the irrationalities of constant growth and the alienation of commodification. Nor, finally, am I suggesting that a far less bureaucratic and much more participatory mode of political and economic organization than that associated with the post-war welfare state ought not to be developed.

in the end if we are to be successful in reconstructing a new vision of a better society it is rather important that we pay proper respect to the courageous personal and intellectual efforts of those who have come before us. It is in this sense that it is quite essential to understand that Keynes however imperfectly, and however much a member of the establishment, did grasp the essentials of what was flawed in the capitalist system. It is true, of course, in the end that power and politics can never be banished by appeals to reason. And yet it is also true that reason does play a critical role in history. For it is the power of ideas and the visions of justice that accompany them, rather than brute force or crass privilege that come back time and time again to inspire and inform political action. it is an ancient legacy that we would do well to respect.

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Notes

1. The following are particularly useful in this regard:
   D. Moggridge, *Keynes*, London: Macmillan, 1976.
   E. & H. Johnson, *The Shadow of Keynes*, Chicago: University of Chicago Press, 1978;
   Fausto Vicarelli, Keynes: *The Instability of Capitalism*, Philadelphia: University of Pennsylvania, 1984.

   For the theoretical controversies surrounding his work see:

   D. Maggride, ed. *The Collected Writings of John Maynard Keynes*, Cambridge, Macmillan, Cambridge University Press, 1979.

   S. Weintraub, *Keynes, Keynesians and Monetarists*, Philadelphia: Univ. of Pennsylvania Press, 1978;

   P. Davidson, *Money and the Real World*, N.Y.: John Wiley & Sons, 1972.

   J. Hotson, *Stagnation and the Bastard Keynesians*, Waterloo: Univ. of Waterloo Press, 1976;

   A. Leijonhuvud *On Keynesian Economics and the Economics of Keynes*, N.Y.: Oxford University Press, 1968;

   H. Minsky, *John Maynard Keynes*, London: Macmillan, 1976.

   Joan Robinson, *Contributions to Modern Economics*, Oxford: Basil Blackwell, 1978 *Economic Heresies*, N.Y.: Basic Books, 1971.

   A. Coddington, *Keynesian Economics: The Search for First Principles*, Boston: George Allen & Unwin, 1983.

2. See J. Robinson, *Economic Heresies*.

3. See M. Kalecki, "Political Aspects of Full Employment" 1943 in *Selected Essays on the Dynamics of the Capitalist Economy*, Cambridge: Cambridge University Press, 1971.

4. See J.M. Keynes, *The General Theory of Employment, Interest and Money*, London: Macmillan, 1964, bk. IV, ch. 16, p. 221; bk. V, ch. 20, p. 290, ch. 19, p. 262; bk. VI, ch. 24, pp. 376.

5. See discussion of Say's law in J. Schumpeter, *History of Economic Analysis* N.Y.: Oxford University Press, 1954.

6. See ch. 23 in Keynes' *General Theory* and Keynes' note on Marx pp. 81-83 and his letter to J.A. Hobson pp. 210-211 in vol. XXIX, *The Collected Writings*.

7. See the discussion of this in A. Leijonhufvud, *On Keynesian Economics*; For a classic example of contemporary distortion of Keynes see M. Parkin, *Modern Macro-economics*. Scarborough: Prentice-Hall, 1982. This is a Canadian text from a monetarist point of view which is becoming a standard offering in undergraduate courses. The text suggests that unemployment is caused by minimum wage laws, labour unions and excessive unemployment compensation. A case of "rigid wages" with a vengeance. This "rigid wage" approach however persists in even non-monetarist texts see for example, R.V. Cherneff, *Macro Economics: Theory & Policy*, Scarborough: Prentice-Hall, 1983, pp. 69, 203-204, 221-222.

8. See H. Minsky, John Maynard Keynes and *The General Theory*, Bk. IV and ch. 22 and reference to Marx (see note 6) in Collected Writings.