Keynes, Policy and the *General Theory*

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Introduction and conclusion

Introduction

Work up to now has been concerned with emphasising the monetary dimension of Keynes's theory and policies.

Plainly this has been greatly neglected, and those Keynesians who argued that Keynes was exclusively concerned with fiscal policy have much to answer for. But more recently I have become pre-occupied with how this might be. How such nonsense can have prevailed; especially because even many post-Keynesians, while giving front place to the monetary dimension of Keynes's economics, appear largely content with the Keynesian interpretation of his policy.

I have become more aware of shortcomings in GT, especially if it is read out of context. And let's face it, it is scarcely read at all, so it is pretty much bound to be read out of context – present company excepted.

- Methodologically, of course, it takes a vast step away from classical or neo-classical reasoning. We can see this as a problem in Keynes's time, but the problem must be so much more acute now, given how steeped in the mathematical method modern economics has become. I cannot conceive what coming to the GT with such a background must be like.

- As a matter of structure, I think his beginning with the labour market was confusing, when really his new theory arose from S/I.

- Then there are the omissions and incomplete exposition:
    - The lack of monetary detail
    - The half-baked story on S/I
    - The incomplete and misleading analysis of the relation between LP as a theory of money as a store of value and means of exchange considerations
    - The lack of a substantial discussion over short and long run and period considerations
    - The lack of an international dimension / theory, which seems to me particularly harmful given his policy pre-occupation in this area.
    - The lack of a treatment of debt

Now on all counts we can absolve Keynes. He was writing a theory for discussion with his peers, in context. He explicitly set aside policy. He was writing it as he discovered it. … not thinking through. It was rushed. Totalitarianism. It was not intended to be his final word. But tragically, bar really only very few additional theoretical contributions, and practical contributions that were largely behind closed doors, it was his final word. Illness, the war and death intervened.

In my view it is partly the loss of the policy perspective that these shortcomings have become exacerbated, and allowed the recovery of Keynes to become such a mess. Let me give an example. The point of TLP was to how considerations of money as a store of value meant that the long-term rate of interest could be set by the monetary authorities. In this way it was the cornerstone of his theory. But the LP/LF debate seems to be conducted oblivious to this conclusion. With policy conclusions recognised the debate is of a vastly different order of importance. And of course Keynes was right: policymakers could set the long-term rate of interest of they chose, and liquidity preference theory showed how [see my paper]. LF considerations are trivial in the great scheme of things.

My intention today was to give you my usual story about the reality of Keynes's policy initiatives. But the reality of the economic environment has impinged on me.

Much of the discussion is therefore aimed at public spending initiatives, given the increasing number of stimulus packages that are being announced, and the increased 'mainstreaming' of Keynes.

But in doing this work – which was partly done for a presentation to HMT economists – I see further explanations for the loss of the monetary dimensions of Keynes's economics.

And this is the rapidly changing economic environment within which Keynes was operating, which demanded shifts of perspective and policy emphasis that ran away from and even detracted from the theoretical discussion.

I crudely characterise these as cure versus prevention, and these are necessarily different. You can prevent lung cancer by not smoking. You cannot cure it by giving up.

[SL]

So section 1 on monetary background sets the context, and is fundamentally about prevention. The rest is about cure. Brought together vaguely at the end.

[SL]
His pre-occupation was the gold standard.

And the context for the discussion today, the post war return to gold.

[SL]

Conclusion

Certainly this is all very diverting, and indeed has diverted. But we must not see it as the sum of the GT.

For there is not a complete theory of the economy here. There are certainly some very powerful insights, for me encapsulated perfectly by Kindelberger. I personally love Keynes's own flight of fancy that I showed at the start of the presentation. Moreover some lines of inquiry opened up that would be very fruitful.

Keynes had to connect these various developments to his wider theory of an economy, which remained concerned fundamentally with explaining why economies malfunctioned, and with prevention.

In the ToM he held that economic failure was based on the operation of S, I and r. This story remained central to the GT, but in greatly revised manner:

- Savings were taken out of the picture, merely as determined by investment
- Liquidity preference explained the long-term rate of interest
- And *this* rate of interest in conjunction with the mec explained the level of investment.

There was no reason that the ltroi that prevailed should permit sufficient investment for full employment. Moreover he derived a cycle mechanism also based on r, I and mec. Which I believe can be extended to show a boom as a debt inflation, and a bust as a severe process of de-leveraging.

To prevent economic failure the ltroi could and should be set low. [Direct you to my working paper]

Failing to act according to this prescription is I believe the fundamental cause of today's economic decline. I would usually show a slide of long-term rates, and the associated build up of debt.

We have smoked. We have got lung cancer. Giving up smoking will not restore the patient to health. A low rate of interest is necessary for the resolution of the crisis, but unlikely to be sufficient.

In the first instance we are a long way for a low r. ltroi on corporate debt still exorbitant. So we need far more imaginative monetary action, much as in 1932.

And we need spending. The 3% number …

And yes we probably need a good deal of economic nationalism, in spite of what the *Economist* magazine says.

Propaganda has it that protectionism exacerbated the great depression, I really think this needs tackling. The GD was caused by monetary failure. All I see in the unemployment statistics is recovery coming when off gold and spending begins. I cannot fathom how we are meant to see protectionism exacerbating the decline or inhibiting the recovery. It seems to me a side issue, detracting from the real forces governing decline and recovery.

Though alarm is a natural reaction too on the part of vested interest, as we all discover that globalisation is not all that it was cracked up to be. And that national action rather than market force is necessary to any recovery. There may yet be a case for free trade, but it is certainly more complicated than the *Economist* would have us believe. Keynes's considered view should be consulted.

> But if nations can learn to provide themselves with full employment by their domestic policy (and, we must add, if they can also attain equilibrium in the trend of their population), there need be no important economic forces calculated to set the interest of one country against that of its neighbours. There would still be room for the international division of labour and for international lending in appropriate conditions. But there would no longer be a pressing motive why one country need force its wares on another or repulse the offerings of its neighbour, not because this was necessary to enable it to pay for what it wished to purchase, but with the express object of upsetting the equilibrium of payments so as to develop a balance of trade in its own favour. International trade would cease to be what it is, namely, a desperate expedient to maintain employment at home by forcing sales on foreign markets and restricting purchases, which, if successful, will merely shift the problem of unemployment to the neighbour which is worsted in the struggle, but a willing and unimpeded exchange of goods and services in conditions of mutual advantage. (Chapter 24, section IV)

But the furore over economic nationalism is a good illustration of the wider nature of what is going on.

I don’t think we should be in any doubt that something very terrible has happened to the world economy. US unemployment. …

And it is my view that this has at its roots the ignoring of the substance of Keynes’s work. But there is no sign of any economists thinking that this reflects a substantial failure of their economics. Indeed there is the truly terrifying sight of monetarists seeing events as a vindication of their perverted worldview.

Economists may be endorsing radical cures, cures that do not work within their theory. But it is all seen as temporary – a big shock has his the economy, not some endogenous process of debt inflation and debt deflation – they say.

Exactly the same thing happened in the 1930s; Keynes called it the society for the preservation of ancient monuments.

The challenge for PKEs, as I see it, is to get our view heard. I want us to agree that the system failed because it was based on flawed theory. And I want us to argue that there is in Keynes’s work a theory that remains relevant to understand our predicament, to aid its resolution and to underpin the building of a just and sustainable future.