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Keynes' Economic Program, Social Institutions, Ideology, and Property Rights

John F. Henry

Conventional economists view the economy as a set of relationships independent of any larger society. The prevailing position is to construct theory by building the argument on the basis of a non-socially determined, hypothetical individual. As one illustration of this position, consider the statement of Frank Knight, one of the discipline's most eminent twentieth-century economists:

> I do not see how we can talk sense about economics without considering the economic behavior of an isolated individual. Only in that way can we expect to get rid by abstraction of all the social relationships . . . (1960, 71)

From this foundation, economists then develop policy prescriptions that are claimed to move us closer to the optimal outcomes that would obtain if we allowed economic laws to run their natural course. Social norms, institutions, and behavior should conform to economic standards which are predicated on good theory, theory that is developed independent of any specific social context. In this regard, economic theory is seen as akin to natural law, and the closer the laws of economics are to the laws of physics, the more scientifically based the policy recommendations of economics will be (Mirowski 1989).

Various economists have protested this view of things. One such economist was John Maynard Keynes, who saw the economy as embedded in larger society. The fol-

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lowing argument attempts to specify portions of Keynes' policy program as integral to the maintenance of a specific propertied society that must be correctly understood if effective policy is to be implemented to save such a society from itself.

It is well known that Keynes' general theory has been vulgarized (or bastardized, in Joan Robinson's words) to accommodate the equilibrium strictures of orthodox economics (Davidson 1991, 22–9; Robinson 1980, 120–9). One consequence of this vulgarization has been the lifting of Keynes' theory out of the economy he was examining and the conversion of that theory into terms acceptable to neoclassical theorists. Keynes' theory (so-called) was separated from the specific institutional and social relations of a monetary economy in a specific stage of development and subjected to analysis and criticism as a purely ideological construct. What has remained is a program centered on mere fiscal and monetary tinkering at the edges of an economy that is, at best, unspecified.

One effect of this vulgarization process has been to place the terms of the debate squarely in the hands of the vulgarians. To be sure, protests have been made over the last fifty years, most notably those originating in Cambridge, United Kingdom, but these skirmishes clearly have not been able to win the war of ideas.

What follows is an attempt to specify portions of a Keynesian economy and to demonstrate the relationship between such an economy and his general theory. Perhaps the most important argument contained in this paper is the demonstration that it is impossible to separate Keynes' theory from the economy that it attempts to explain. Indeed, as I will attempt to show, one must go further than this: it is impossible to separate the economy from the larger society that contains it. Keynes was quite mindful that the economy was not a separate entity and that public policy bearing on the economy had to take non-economic factors into account. To do otherwise would be to risk establishing a policy that would be so damaging of the social order based on specific property rights and relations that it could lead to social turmoil and potential destruction. Keynes was an embedded economist: institutions and social relations not only mattered, they had to be understood and their relation to economic activity had to be included in the theoretician's analysis.

The Nature of the Economy

The starting point for specifying some of the features of a Keynesian economy is a description of Keynes' general position on the nature of a modern (mid-century) capitalist or monetary economy. Initially, and most important, he distinguished this economy from that of the hypothetical "cooperative" economy that lies at the foundation of all forms of neoclassical theory.

> [T]he characteristics of the special case assumed by the classical [sic] theory happen *not* to be those of the economic society in which we actually live, with

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> the result that its teaching is misleading and disastrous if we attempt to apply it to the facts of experience. ([1936] 1973, 3; my emphasis)

> The distinction between a co-operative economy and an entrepreneur economy bears some relation to a pregnant observation made by Karl Marx . . . . He pointed out that the nature of production in the actual world is not, as economists seem often to suppose, a case of C-M-C' . . . . That may be the standpoint of the private consumer. But it is not the attitude of *business*, which is a case of M-C-M', i.e. of parting with money for commodity . . . in order to obtain more money . . . . ([1933a] 1979, 81; emphasis in original)[1]

For Keynes, a capitalist economy was not one in which a symbiotic, mutually advantageous harmonious relationship existed between those who controlled property and the larger community: there is a discordance between the production of goods and the production of money. As noted by Dudley Dillard in a most perceptive paper on *The General Theory*: "Real goods appear to the individual producer as an artificial form of wealth until they are converted into money which appears as real wealth to the individual producer." From the community's perspective, goods *are* real wealth, while money appears as artificial (1954, 28–9). In a monetary economy, the objective of the firm is to generate the highest possible financial return. The production of material goods represents an intermediary stage through which such gains are created. The satisfying of the principal objective may well require what Thorstein Veblen termed the "sabotage" of productive output in order to realize maximum monetary gain.

From this vantage point, Keynes argued his position on the relationships among money, time, and uncertainty: a capitalist economy is a debt economy where money is the unit of account in which debts are both created and discharged ([1930a] 1971, 3); money is held because of our lack of prescience regarding the future ([1937a] 1971, 115–6); and money serves as the link between the present and an unknowable future ([1936] 1973, 293).

Second, by the turn of the century capitalism had been transformed from a roughly competitive form of organization to one characterized by large, noncompetitive, oligopolistic structures where management and ownership as well as production and finance had become separated. (Keynes dated this transition to 1870 ([1920] 1971, 9ff.). "Self-regulating" markets, which rely on competition, no longer prove reasonably efficacious, and, if this type of economy is to survive, institutional and ideological change must occur, moving society away from a laissez-faire program (however honored in the breech) toward some form of collectivist regulation:

> Let us clear from the ground the metaphysical or general principles upon which . . . *laissez-faire* has been founded. It is *not* true that individuals possess a prescriptive 'natural liberty' in their economic activities. There is *no* 'compact' conferring perpetual rights on those who Have or on those who Acquire. The world is *not* so governed from above that private and social interest

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> always coincide. It is *not* so managed here below that in practice they coincide. It is *not* a correct deduction from the principles of economics that enlightened self-interest always operates in the public interest. Nor is it true that self-interest generally *is* enlightened . . . . Experience does *not* show that individuals, when they make up a social unit, are always less clear-sighted than when they act separately . . . .
>
> I suggest, therefore, that progress lies in the growth and the recognition of semi-autonomous bodies within the State—bodies whose criterion of action within their own field is solely the public good as they understand it, and from whose deliberations motives of private advantage are excluded . . . . I propose a return . . . toward medieval conceptions of separate autonomies. ([1926] 1972, 287–9; emphasis in original)

Third, Keynes recognized classes and class relations as determining the essential social structure of such an economy. He usually divided society into two general classes—workers (often called the "earning class") and capitalists, then further divided this second class into the "business class," or "entrepreneurs," and the "investing" or "saving" class, labeled "rentiers" in his later works:

> For the purpose of this enquiry a triple classification of society is convenient—into the investing class, the business class, and the earning class. These classes overlap, and the same individual may earn, deal, and invest; but in the present organization of society such a division corresponds to a social cleavage and an actual divergence of interest. ([1923] 1971, 4)

Last, Keynes recognized that the continuation of capitalist society required a social acceptance based on an underlying ideological program. Capitalism is a system that fractures society through its promotion of individualism, greed, and the use of money (income and wealth) as a measuring rod of one's value to society ([1925b] 1972, 267–9). Its main (perhaps only) claim to survival is economic progress based on efficiency and rising income over time. In the modern period, however, doubt had developed as to the possibility of continued economic success, the ability of capitalism to "deliver the goods" (268).

Now, it is well known that Keynes exhibited a marked disdain for the Soviet experiment and its reliance on the "common man" for the success of that experiment. Yet he did observe in his brief visit to the Soviet Union something in that early socialism that could well overcome any economic inefficiency associated with non-capitalist economic organization—communism as a "religion" had great moral force which served as a unifying and galvanizing principle that was utterly lacking in capitalist society:

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> The exaltation of the common man is a dogma which has caught the multitude before now. *Any* religion and the bond which unites co-religionists have power against the egotistic atomism of the irreligious . . . .
>
> If irreligious capitalism is ultimately to defeat religious communism it is not enough that it should be economically more efficient—it must be many times as efficient. (267-8)

A new "religion" was needed in the modern period, a new set of institutions, in particular a new ideology that provided a moral underpinning to the very amoral capitalism and a socializing constraint that prevents a rampant capitalism from destroying itself through its own individualist objectives.[2] While Keynes never specified what shape this secular "religion" was to take, it's reasonably clear that the new ideology was to transcend the destructive and restricting constraints of the "money-motive" ideology. The money motive, while certainly promoting of material wealth, is unable to produce the unifying, galvanizing, public-spirited cohesion necessary to maintain society: indeed, it produces the opposite effect. The "common man" requires some sense of larger purpose beyond that of mere money making, and this sense must be created as a substitute for the lost, mainly religious, ideologies of the previous century.

The Keynesian Program: Socialized Investment

Given Keynes' understanding of the economy, economic success depends on the ability and willingness of capitalists and workers to spend. Commodities are produced to sell, and the objective of the capitalist firm is to realize more money at the end of the production-exchange process than it had invested at the beginning of that process. To produce, firms must (generally) incur debt; markets, then, are institutional arrangements through which debts are cleared, the firm avoids bankruptcy, and the next production-exchange cycle can begin. Now, while capitalists "get what they spend" (the widow's cruse), there is no guarantee that the inducement to invest will be sufficiently strong to bring forth that amount of investment spending necessary to elicit a successful financial outcome in the aggregate. Expectations of future profit, based on guesses of the economic environment some time down the road, may be such that expected revenue will be too low relative to the costs associated with production. This is particularly true during the downturn stage of the business cycle. If *all* firms invested in some coordinated program, the threat of recession would be considerably reduced. But *each* firm believes that its investment program will result in negative profits as it cannot depend on the behavior of other firms providing the spending to bring forth sufficient demand to allow the purchase of the goods produced by the individual firm.

Keynes rejected Benthamite utilitarianism. This was in part due to the attack on Bentham's moral philosophy launched by the Cambridge philosopher G. E. Moore while Keynes was an undergraduate there, but largely due to a flaw Keynes saw in

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Bentham's theory relating actions to utility. This flaw led Keynes eventually to reject a neoclassical microfoundations approach to aggregate behavior. In Bentham, an action is undertaken to secure an increase in pleasure or to avoid an increase in pain. The actor, then, must know the consequences of the action before it is undertaken. But one cannot have information as to the consequences of an act until the act is actually committed and the relation between that action and the actions undertaken by all other individuals is discovered—the aggregate effects. People act in the face of an uncertain future and cannot calculate the relative costs and benefits of any specific action. As is well known, Keynes' position on uncertainty was developed in his 1921 *Treatise on Probability* and permeated his theoretical analysis from that point forward (Skidelsky 1988, 3–6; Davis 1991).

To deal with this fundamental issue of uncertainty in the context of a monetary economy, Keynes advocated two main programs: a low interest rate policy and socialization of investment. Of secondary significance was the low interest rate policy—cheap money ([1936] 1973, ch. 17; Lavoie and Seccareccia 1988, 145–57). As modern central banks had the power to set the interest rate on money, and as the interest rate on money governs all "own-rates" of interest, a cheap money policy, which lowers the cost of production (reduces the debt burden of firms) would encourage investment as the spread between expected returns and the rate of interest increased.

Further, a cheap money policy assists in euthanizing the rentier, that parasitic portion of the capitalist class that extorts its income through an artificial scarcity of finance capital (Keynes [1936] 1973, 221, 376; [1930b] 1972, 132, 353 ff.). Rentiers represented the main body of speculators who periodically add to the instability of a capitalist economy through their actions in stock markets. Hence, a cheap money policy significantly reduces the influence of this semi-class. And a low interest rate program has significant redistributional effects that promote a better functioning economy (see below).

But Keynes was not particularly sanguine about the benefits of such a program. If animal spirits are dim, no interest rate level would have the desired effect.[3] Rather, Keynes advocated a program directly confronting insufficient investment spending—a "somewhat comprehensive socialisation of investment":

> For my own part I am now somewhat sceptical of the success of a merely monetary policy directed towards influencing the rate of interest. I expect to see the State, which is in a position to calculate the marginal efficiency of capital-goods on long views and on the basis of the general social advantage, taking an ever greater responsibility for directly organizing investment; since it seems likely that the fluctuations in the market estimation of the marginal efficiency of different types of capital . . . will be too great to be offset by any practicable changes in the rate of interest. ([1936] 1973, 164)[4]

Keynes never provided a blueprint of the specifics or the mechanisms through which his proposed socialization of investment would be undertaken (though, see

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Crotty 1999; Kregel 1985; 1994–5, 267–8). This would be out of character. For Keynes, any new social arrangement would have to be worked out over time, experiments undertaken, and so on. Keynes expected that the actual doing of something, the actual implementation of a different policy, would bring forth the requisite ideas that could lead to a successful end: "As soon as we have a new atmosphere of *doing things*, instead of one of smothering negation, everybody's brains will get busy, and there will be masses of claimants for attention, the precise character of which it would be impossible to specify beforehand" (1929] 1972, 99). We can, however, develop an understanding of what he intended and why he saw this institutional change as necessary.

With the transition from a roughly competitive to an oligopolistic economy—the development of the corporation or joint-stock company—capital had become "socialized" (Keynes [1926] 1972, 289). The old, individualistic enterprises had been replaced by large "public" organizations in which management had become separated from ownership. Managers were no longer mere short-term profit maximizers but, according to Keynes, had a larger, more "public-spirit" view in mind when undertaking decisions. A new epoch had arrived in which legally private business firms had become transformed into economically public production organizations. The older unity of production and finance had been severed, and a new, currently disjointed arrangement had developed. It now became necessary to modify the *forms* of organizations to accommodate the changed *substance* of those organizations.[5]

> I do not see why we should not build up in this country a great public service running the business side of public concerns recruited from the whole population with the same ability and the same great tradition as our administrative Civil Service. (Keynes [1927b] 1981, 697)

> So far from wishing to diminish the authority of the Bank of England I regard that great institution as a heaven-sent gift, ideally suited to be the instrument of the reforms I advocate. We have here a semi-independent corporation *within the state*, with immense prestige and historical tradition, not in fact working for private profit, with no interest whatever except the public good, yet detached from the wayward influence of politics . . . .The Bank of England is a type of that *socialism* of the future which is in accord with the British instincts of government . . . .The Universities are another example of the semi-independent institutions divested of private interests which I have in mind. *The state* is generally sterile and creates little . . . . But when a corporation, devised by private resource, has reached a certain age and a certain size, it *socializes* itself, or falls into decay. But none perhaps, except the Bank of England . . . has yet completed the process. (Keynes [1925c] 1981, 347-8)

It seems evident that the bodies overseeing socialized investment schemes would comprise academics, corporate managers, and civil servants selected for their business acumen and "all trained at Oxford and Cambridge and imbibed with a public service

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ethic . . . (Skidelsky 1992, 227), but who would be free of government interference. Further, the objectives of the investment program undertaken by these corporations are not to be based on short-run profit goals but conducted in the interests of the "public good" (left undefined).

As firms were themselves increasingly corporatist and decisions were already being made in an administrative manner within a context of cartels, inter-locking directorates, and so on, it was time for some level of state involvement in both the regulation of firms' behavior and as an active partner in the operation of the firm itself in the national interest, eliminating (or reducing significantly) the anarchic adjustment process found in the earlier, competitive era of capitalism. This micro-based function was to be coupled to a socialized investment scheme where the state, possibly through a "board of national investment," would direct the accumulation process with a social, rather than private, objective in mind. Eventually, a "new system of coordination must be designed not just as a regulator of relations between capital and labor or among firms within an industry, but as the regulator of relations among industries and sectors within the economy as a whole" (Crotty 1999, 572).

What Keynes seemed to have in mind in this proposed course of action was not so much the technical aspects of the nature of the firm itself in terms of its production but the socialization of the risks associated with large organizations in a world of uncertainty. As such organizations are economically significant, the general economic health of the larger society must be protected from their potential default. With a central bank providing a large degree of assurance to a fragile banking system and maintaining a low (and certain) low interest rate policy and with national bodies directing the flow of investment, thus reducing the uncertainties associated with individualistic investment programs, firms face an environment in which there is a much higher probability of economic success (though at a lower rate of profit—see below, "Redistribution Policy"). Further, if the price level can be stabilized, including the price of credit, firms are in a much better position to estimate both future demand and costs, thus further reducing the risks attendant to uncertainty. (See below, "Policy on Prices.")

Thus, in contrast to the static equilibrium analysis favored by neoclassical economists (in whatever specific form this analysis takes), in which the firm exists in a non-social, non-historic context and in which its operations are based on the constraints of a hypothetical "cooperative" economy, Keynes developed theory and addressed significant policy considerations from a historically driven and socially informed perspective. The capitalist firm of the inter-war period exists within a matrix of socially determined forces that are not those of a century before and certainly bear no relationship to the idealized, abstract structures of Walrasian general equilibrium models. Rather than building a reductionist argument from the "economic man" of neoclassicism, Keynes saw the underlying social class forces as the building blocks of appropriate theory, forcing the need to adjust economic policy to accommodate changed circumstances induced by the evolutionary flow of the economy generated by those societal forces.

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Labor Policy

Chapter 2 of *The General Theory* is largely given over to a demolition of the neoclassical concept of a labor market. Succinctly, there is no labor market in *The General Theory*. The absence of such a market means that, rather than creating conditions to allow the neoclassical labor market to adjust efficiently to the equilibrium wage and employment (full? the NRU? the NAIRU?), policy must be effected to organize labor to accommodate the national requirements of the socialized investment program. (See Galbraith 1997 for an elaboration of these points.)

For Keynes, a "labor market" could exist only in a "share," or "co-operative," or "real-wage" economy. In a monetary economy, "it is not true that the entrepreneur's demand for labour depends on the share of product which will fall to the entrepreneur, and it is not true that the supply of labour depends on the share of the product which will fall to labour" (Keynes [1933a] 1979, 83). For labor markets to exist, the equilibrium adjustment process must be undertaken in terms of the real wage (or marginal product). This cannot be the case. Labor and capital bargain in terms of the money wage, and this bargain is undertaken independently of the price level of wage goods which is set in non-labor markets (Keynes [1936] 1973, 9). Keynes also observed—

- That there are wide variations in the level of employment, with "no apparent change either in minimum real demands of labour or its productivity" (9).
- That there is usually an inverse relation between changes in the money wage and changes in the real wage (10).
- That as the usual case is that more labor would be forthcoming at the current money wage than is employed, even though the real wage is falling, is proof that the wage cannot be associated with the marginal disutility of labor (the second neoclassical postulate) (10).

Further, workers are not concerned simply with the level of absolute wages (real or nominal) but with their relative wages (13–15), and the "struggle" over money wages principally affects the "*distribution*" (emphasis in original) of aggregate wages rather than the levels of wages and of employment.

Last, a reduction in the level of money wages may have a perverse effect on employment (from a neoclassical labor market perspective). If wages fall, money demand for consumption goods falls. If this reduction in demand causes capitalists to believe that prices will fall (the deflationary scenario—see below), then expected aggregate demand falls, causing less output and employment in the next period (ch. 19).

As there is no labor market and no tendency toward full employment, rather than adopting a neoclassical hands-off policy toward labor markets (save for removing barriers to the self-adjusting process, reducing distortions caused by incorrect incentives, and so on), there must be a considered policy program surrounding labor itself.[6]

Keynes never laid out a detailed labor policy beyond that of promoting full employment. However, in some of his writings there are inklings of what such a policy

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would include, allowing a better understanding of his view on the relationship between such a policy and the facts of modern society.

> It is not only in the direction of the regulation of capital that the state must be prepared for new functions. It must be prepared to regard the regulation of wages of great industrial groups as being not merely of private concern, and it must quite deliberately in its wages and hours policy treat the gradual betterment of workers as the first charge on the national wealth . . . . The problem of the education and the mobility of labour is going to be at least as important . . . . It must be the concern of the state to know and have a policy as to where labour is required, what sort of training is wanted . . . and . . . to work out plans for the transfer of labour to localities and other trades which are expanding and not declining. That is one example of the general policy which the Government has to be prepared for—namely, the deliberate regulation from the centre in all kinds of spheres of action where the individual is absolutely powerless left to himself . . . . (Keynes [1927a] 1981, 646–7)

Further, it is time to raise the question as to whether society should institute a policy of paying wages on a "fair" and "reasonable" basis (Keynes, [1925a] 1972, 303). Observe: if the concept of the marginal product is abandoned (the foundation of the neoclassical labor market perspective), one cannot resolve the issue of social justice through a mere technical argument. The wage becomes a socially determined construct, and all other income categories—profit, interest—are also subject to institutional control.

In this context, Keynes did make some interesting observations regarding the relation between economic policy and the larger social issues that are the consequence of the workings of a monetary economy. Such an economy imposes constraints on what can be accomplished through such policies and determines how these policies must be shaped.

The notion that wages should be "fair and reasonable" and socially determined was inextricably connected to Keynes' abiding concern for an intelligent approach to the preservation of the propertied regime of his period.

In post–World War I England, the prevailing (Conservative Party) position was centered around restoring Britain to economic prosperity through wage reductions in the "old," export-based industries. The standard complaint was that the prices of exportables were too high, and this was caused by inflated, union-driven wages (ignoring, among other issues, the ill-advised return to the gold standard in 1925). Hence, a wage reduction of 15 percent (or so) would restore England's competitive position and the economy would thrive.

Keynes, not surprisingly, argued against this position. In his "Economic Consequences of Mr Churchill," he pointed out that not only would it be unjust to lower the wages of workers who were not the cause of the problem, but such an action would

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produce a response by those workers: "[T]hey are bound to resist so long as they can; and it must be war, until those who are economically weakest are beaten to the ground" ([1925d] 1972, 211). (And, with the General Strike of 1926, Keynes here might be judged to be decidedly prescient.)

Keynes continued his attack on ill-advised wage-cutting programs that were informed by standard neoclassical labor market theory in the next decades.

In his 1930 testimony before the Macmillan Committee, Keynes addressed the social effects of an attempt to reduce money wages (and thus "clear" the labor market through a reduction in real wages—the standard neoclassical argument he was by that time attacking), noting the potential danger to the property relations extant as such a program could well lead to revolution ([1930c] 1981, 64).

And, in his 1940 evaluation of the government's budget proposal of that year, we read the following: "It is obvious that wage policy raises far-reaching psychological and political issues. It can only be handled by a simple, *trustful* and imaginative policy which covers a wider field than technical finance" ([1940] 1978, 223; emphasis in original).

Keynes' recommended approach to the problem was, of course, an increase in aggregate demand organized through a socialized investment scheme which would stimulate domestic consumption. At the same time, attention must be paid to the allocation of social labor to accommodate the requirements of different sectors of the economy. In a BBC broadcast of 1942, in a fairly obvious propaganda effort to disseminate his theoretical views to a large audience, Keynes took up the issue of the postwar adjustment problem. Here, while focusing on the building program that would be necessary, he clearly indicated that labor must be directed, under a centralized management, into the various sectors of the economy to accommodate the larger economic program of full employment. According to Keynes, after the "daily needs" of the population are satisfied, the export industries must have the "first claim" on labor; the remaining surplus of labor would then be directed through a "programme of re-stocking and development over a wide field," including construction. The pace of this program was to be controlled so as to avoid both unemployment and inflation (defined here clearly as caused by spending above the full employment level of output) ([1942] 1980, 267–8).

Clearly, Keynes understood that a proper labor policy would have to take account of underlying social institutions, relations, and constraints and that such a policy, whatever its specific features, could not be developed on a merely technocratic basis but would have to be moderated by a concern for larger social interests and objectives.

Lastly, Keynes saw that a portion, perhaps a significant portion of the working class, finds itself in an undesirable condition of life. One result of this is that many seek escape in alcohol and drugs (and gambling as well). This is clearly not desirable—for the economy and for the larger society. But some institutionalized form of escape must be developed:

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> How far is bored and suffering humanity to be allowed, from time to time, an escape, and excitement, a stimulus, a possibility of change?—that is the important problem. Is it possible to allow reasonable licence, permitted saturnalia, sanctified carnival, in conditions which need ruin neither the health nor the pockets of the roisterers, and will shelter from irresistible temptation the unhappy class who, in America, are called addicts? (Keynes [1925a] 1972, 303]

The mention of Saturnalia is instructive. Briefly, Saturnalia is a celebration that can be traced to the late tribal period following the development of early agriculture and was held in the interval surrounding the winter solstice. With the development of class societies, the practice of Saturnalia was maintained but its social context was radically altered. Then, it became a mechanism to allow the producing classes a period of time when members of this class could vent their anger and frustration at the upper classes in a controlled, institutionalized fashion, turning the class relations topsy-turvy for a period of time. Early upper class members saw the necessity of this interval as a mechanism of control over the lower classes, as it was far preferable to permit a short period of social turmoil at one point in the year rather than allow the accumulation of anger and frustration to swell until it would vent itself in an explosion of revolutionary fervor. After centuries of vulgarization, modification, and adaptation, this festival eventually devolved into Christmas. (See Nissenbaum 1996.)

I do not know the extent to which Keynes understood the history and social context of Saturnalia, but as an Englishman he no doubt would have some notion of the significance of this festival as it continued to be practiced in that country (among others) into the early modern period. But it is not necessary that Keynes understood the full significance of this institution, as a revival of that particular practice is not his main point here. Essentially, he proposed an institutionalized mechanism through which workers could alleviate their disquiet from time to time and, in so doing, remain productive rather than sinking into the abyss of some debilitating form of relief. As he was here addressing a social problem promoted (if not directly caused) by the nature of the underlying economic system (as that system was perceived to be at the root of the unhappiness), and as the maintenance of the economy was contingent upon a reasonably well-functioning social order, then an appropriate labor policy would incorporate, in an informed and conscious fashion, various institutions designed to provide a safety valve to vent the frustration of the majority class.

Again, dispensing with the reductionist methodology of neoclassicism in which everything—including the standard view of a labor market with its attendant implications (unions create inefficiencies, and so on)—is derived from the supposed rational behavior of a utility-maximizing non-socially determined individual, Keynes argued from a perspective that placed employment, wages, and related matters squarely in a social context. Further, Keynes' workers were real workers, not merely a factor of production. As these workers represented a social class, indeed, the most numerous class

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in modern society, and this class was a necessary characteristic of a monetary economy, the continued existence of a propertied society within which the economy was embedded required proper policy directives aimed at maintaining this class at a reasonable level of comfort and quietude.

Redistribution Policy

Keynes was not an egalitarian (though see Fitzgibbons 1988, ch. 10) and saw value in maintaining an unequal distribution of income, partly on economic grounds and partly on political or social grounds. Yet he did not foster any illusions that the distribution resulting from "market forces" was that which was correct for promoting economic growth and social stability. Indeed, his concern for a "proper" distribution of income was so keen that he originally had planned a chapter specifically on distribution to be included in *The General Theory.*[7]

In the concluding chapter of *The General Theory,* we read:

> The outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes . . . [W]e have seen that, up to the point where full employment prevails, the growth of capital depends not at all on a low propensity to consume but is, on the contrary, held back by it . . . and that measures for the redistribution of incomes in a way likely to raise the propensity to consume may prove positively favourable to the growth of capital . . . .
>
> For my own part, I believe that there is social and psychological justification for significant inequalities of incomes and wealth, but not for such large disparities as exist to-day. There are valuable human activities which require the motive of money-making and the environment of private wealth-ownership for their full fruition . . . . But it is not necessary for the stimulation of these activities and the satisfaction of these proclivities that the game should be played for such high stakes as at present. Much lower stakes will serve the purpose equally well, as soon as the players are accustomed to them . . . . (Keynes [1936] 1973, 372-4)

There are two main elements to the redistribution program alluded to above. Initially, a redistribution from high- to low-income members of the population raises the aggregate marginal propensity to consume. As it is consumption rather than saving that stimulates investment, redistribution will have a positive effect on accumulation (or the growth of capital, in Keynes' terms). In class terms, this would require shifting income away from capitalists—in particular the rentiers—toward workers (or earners, in his terms). This objective is to be accomplished through two interrelated programs. As the state is to pursue a low interest rate policy through the authority of the central bank and the state is to organize a socialized investment program, the "scarcity value"

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of capital will be gradually eliminated. This will mean the "euthanasia of the rentier" (the parasitic portion of the capitalist class that extorts its income through high interest rates) *and* the gradual reduction of the profit rate to a level that just covers the "labour-costs of production *plus* an allowance for risk and the costs of skill and supervision" (375). In other words, the "stakes" are to be lowered.[8]

Second, Keynes saw this redistribution program as necessary, not just because it produces a better performing economy but because it maintains the property relations of a capitalist society:

> Whilst, therefore, the enlargement of the functions of government, involved in the task of adjusting to one another the propensity to consume and the inducement to invest, would seem to a nineteenth-century publicist or to a contemporary American financier to be a terrific encroachment on individualism, I defend it, on the contrary, both as the only practicable means of avoiding the destruction of existing economic forms in their entirety and as the condition of the successful functioning of individual initiative . . . .
>
> The authoritarian state systems of to-day seem to solve the problem of unemployment at the expense of efficiency and or freedom. It is certain that the world will not much longer tolerate the unemployment which . . . is associated . . . with present-day capitalistic individualism. But it may be possible by a right analysis of the problem to cure the disease whilst preserving efficiency and freedom. (380, 381)

That is, Keynes understood the social effects of and constraints on distribution and advocated a conservatising program promoting a less unequal distribution of income. Distribution was not to be left to the "natural" outcomes of "market forces" but rather was to be influenced by conscious policy-making considerations centered on the preservation of a reasonably well-functioning propertied society. The long-run health of such a society depended on such a distribution policy.

Policy on Prices

In a monetary economy, where money contracts are written in a time dimension and where the relationship between creditor and debtor constitutes a necessary link to the production process, money itself appears to be the absolute standard of value. As such, expectations are formed based on the historic record of the price level: if those expectations are disappointed, serious consequences may befall this form of economic organization.

At various points, Keynes took up directly the issue of the stability of prices and its relations to the functioning of the economy. While his views changed considerably over a fifteen-year period, he consistently emphasized the consequence of changes in

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the price level on larger society, which is held together by customary forces and through various ideologies regarding the normalcy and sanctity of that society.

In his 1923 *Tract on Monetary Reform*, for instance, Keynes devoted the first chapter to an examination of effects of changes in the price level on the class relations of capitalism.[9] The *Tract* was in response to the enormous swings in the price level following World War I: hyperinflation was followed by deflation and depression. At this stage of his development, Keynes' main concerns were with the redistributional consequences of large changes in the price level and the disastrous effects of deflation. As he was still in his "pre-Keynesian" theoretical period, he argued that monetary policy should be directed toward establishing stable prices and the economy would then move toward full employment. As we have seen, this somewhat monetarist position began to change in 1924 when we first begin to see Keynes' more mature position advocating state-directed accumulation through socialized investment programs. And, while the price stability argument resurfaced in the *Treatise on Money* of 1930, it disappeared in toto as he moved toward *The General Theory*.

Succinctly, inflation is injurious to the "investing class" (capitalist savers who by the end of this chapter are termed rentiers) because the future value of their savings is reduced and this impacts the incentive to save. This in turn (remembering Keynes' Marshallian approach at this time) reduces the funds available for investment and the economy suffers.

The effects of inflation on the "earning" (working) class are not as significant as had previously been argued. To the extent that this class is organized into powerful unions (and Keynes specifically mentioned railway workers, miners, and dock workers ([1923] 1971, 26), workers cannot only resist reductions in real wages but can actually force an increase in those wages. The business class, aware that inflation has allowed them windfall profits and mindful that those profits elicit public opprobrium, is willing to meet the demand for higher money wages. Unorganized workers find real wages falling during an inflationary process but are partly compensated by the rising employment offered by firms as they expand output given their expectation of rising prices in the future.

The "business class" (that portion of the capitalists in charge of production) is benefited by inflation as long as it's of a mild, nondisruptive nature. A future fixed payment of debt represents a smaller portion of current income in a regime of rising prices, and this class secures windfall gains since sales occur at a price level higher than when costs were incurred. Further, the expectations of rising prices affect the inducement to invest, for the expected returns of a new capital asset purchased today will be greater when output is sold at a higher price tomorrow, and the debt incurred to purchase that asset today will be repaid in depreciated money tomorrow.

Deflation, of course, is detrimental to this class. Writing in the 1930s—and closer to the analysis contained in the *General Theory*—when deflation *was* the prevailing price regime, Keynes emphasized the need to raise prices through concerted government action at the world level ([1933b], 1972, 335–66).

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One main, and often overlooked, reason for the deleterious effects of deflation on production is that, in a monetary economy where debt is incurred in order to produce, falling prices lead to increased fragility of the financial system as firms find it more difficult to service or retire debt incurred in the past. This often leads to destructive price wars and the bankruptcy of the more efficient firms—which are more likely to have a greater debt burden as they have borrowed heavily to introduce the more recent technological advances. Deflation, thus, may well reduce the potential efficiency of the economy.

Deflation causes an increase in unemployment (again, through firms' decisions to reduce output in the face of expected falling prices), and Keynes estimated that the reduction in income caused by unemployment outweighs any increase in real wages that may result as a consequence of the falling price level.

He also noted that in the modern period international trade has become much more important than in the past and, with the increase in time and distance between the point of production and the point of consumption, risk is much greater than that associated with localized trade. A significant part of this increased risk is due to potential changes in the price level. Rising prices reduce the risks associated with long-distance trade, while falling prices will increase this risk and cause business firms to reduce production.

Hence, given his concerns of the early 1920's, his largely Marshallian perspective, and his position on the relationship between price stability and larger social stability, Keynes advocated an activist monetary policy directed toward stabilizing prices.

> The individualistic capitalism of today, precisely because it entrusts saving to the individual investor and production to the individual employer, *presumes* a stable measuring-rod of value, and cannot be efficient—perhaps cannot survive—without one . . . .
>
> For these grave causes we must free ourselves from the deep distrust which exists against allowing the regulation of the standard of value to be the subject of *deliberate decision* . . . . (Keynes [1923] 1971, 35–36; emphasis in original)
>
> ...it is not safe or fair to combine the social organization developed during the nineteenth century . . . with a *laisser-faire* policy toward the value of money. It is not true that our former arrangements have worked well . . . . (16)[10]

By the time of *The General Theory*, Keynes had come to accept a rising price level as a normal aspect of capitalism in its expansionary periods ([1936] 1973, 289-309). Since he had discarded the Marshallian savings-investment relationship, the effect of rising prices on the rentier class would now be irrelevant. Further, he clearly distinguished rising prices from "true inflation" which sets in only at full employment; up to that level of spending, increases in expenditures are partly exhausted in rising output and only partly in rising prices. Hence a regime of rising,

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though non-inflationary, prices are to be expected and welcomed for it is associated with rising employment.

Now, the above, while of interest to be sure, is not the only thrust of Keynes' argument. The *Tract on Monetary Reform* chapter, for instance, is directed toward the relationship between changes in the price level and the somewhat tenuous social acceptance of a form of economic organization that is not natural and which must be at least somewhat responsive to social demands and perceived injustices.

He first observed that the evolution of capitalism over the previous century had resulted in the capitalist class dividing (though not neatly nor without overlap) into a portion that controlled production and a portion that controlled finance. And the relative success of this system created a psychological or social climate that was generally accepting of capitalism and where capitalism was increasingly viewed as the normal state of affairs:

> For a hundred years the system worked . . . with an extraordinary success and facilitated the growth of wealth on an unprecedented scale. To save and to invest became at once the duty and the delight of a large class . . . .The morals, the politics, the literature, and the religion of the age joined in a grand conspiracy for the promotion of saving. God and Mammon were reconciled. Peace on earth to men of good means. A rich man could, after all, enter into the Kingdom of Heaven—if only he saved. A new harmony sounded from the celestial spheres. "It is curious to observe how, through the wise and beneficent arrangement of Providence, men thus do the greatest service to the public, when they are thinking of nothing but their own gain," so sang the angels. (Keynes [1923] 1971, 6)

But:

> . . . amidst the general enjoyment of ease and progress, the extent to which the system depended on the stability of the money to which the investing classes had committed their fortunes was generally overlooked; and an unquestioning confidence was apparently felt that this matter would look after itself. (6–7)

Keynes observed that this abnormal belief in a stable currency was without foundation, that the *relatively* stable price level of the previous one hundred years was an aberration, and that rising prices had been the historic rule ([1923] 1971, 10). Moreover, generally rising prices, according to Keynes, promoted significant beneficial outcomes. In particular:

> Those secular changes . . . which in the past have depreciated money, assisted the new men and emancipated them from the dead hand; they benefited new wealth at the expense of old, and armed enterprise against accumulation. The tendency of money to depreciate has been in past times a weighty counterpoise against the cumulative results of compound interest and the inheritance

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> of fortunes. It has been a loosening influence against the rigid distribution of old-won wealth and the separation of ownership from activity. (9)[11]

Rising prices, however, have a significant deleterious effect on the individual businessman and on the health of the society in general, particularly if this increase were substantial and expected to continue; this effect is not economic but social:

> But if the depreciation of money is a source of gain to the business man, it is also the occasion of opprobrium. To the consumer the business man's exceptional profits appear as the cause (instead of the consequence) of the hated rise of prices. Amidst the rapid fluctuations of his fortunes he himself loses his conservative instincts, and begins to think more of the large gains of the moment than of the lesser, but permanent, profits of normal business . . . . In his heart he loses his former self-confidence in his relation to society, in his utility and necessity in the economic scheme. He fears the future of his business and his class, and the less secure he feels his fortune to be the tighter he clings to it. The business man, the prop of society and the builder of the future, to whose activities and rewards there had been accorded . . . an almost religious sanction, he of all men and classes most respectable, praiseworthy and necessary, with whom interference was not only disastrous but almost impious, was now to suffer sidelong glances, to feel himself suspected and attacked, the victim of unjust and injurious laws—to become, and know himself half-guilty, a profiteer.
>
> . . . To convert the business man into the profiteer is to strike a blow at capitalism, because it destroys the psychological equilibrium which permits the perpetuance of unequal rewards. The economic doctrine of normal profits, vaguely understood by everyone, is a necessary condition for the justification of capitalism. The business man is tolerable so long as his gains can be held to bear some relation to what, roughly and in some sense, his activities have contributed to society. (23–4)

Continued acceptance of a capitalist system depends, in no small measure, on a tacit acceptance of the propriety of profit making. To the extent that inflation undermines this propriety, the system as a whole is placed in jeopardy. As the economy is not separable from the larger society, and what people accept as "meek, right, and salutary" is determined by a socially determined set of conditions—partly based on custom—some social, institutional control must be exercised to assure that individualist activity does not undermine the societal acquiescence that permits the individual gain that is at the heart of the system. Thus, since a moderately rising price level is consistent with the interests of business, does not severely injure workers (to the extent they are organized), and only jeopardizes the fortunes of "savers," Keynes here promotes a policy of control directed toward stabilizing the price level, allowing, even encourag-

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ing, moderately rising prices while avoiding true inflation—and the central bank is called upon to exercise this control.

Population Policy

In a much neglected essay[12] Keynes took up the relationship between population change and economic activity in a monetary economy. Interestingly, he began the argument by linking his comments to uncertainty (bringing in criticism of Benthamite utilitarianism) and observed that, as future population can be reasonably well estimated from past demographic data, this is one of the few areas where we can muster a "considerable power of seeing into the future" ([1937b] 1973, 125).

Keynes observed that population change constitutes an important factor in determining the demand for capital—which "increases more or less in proportion to population" (technology and changes in the standard of living aside) (125)—and an increasing population promotes optimism: with rising population, aggregate demand is likely to be greater than anticipated[13] and the effect of investment leading to over-supply of capital will more readily be corrected. Declining population, on the other hand, induces pessimism for the opposite reasons and, thus, declining population may well have serious consequences, particularly in the first stages of such a population trend.

Keynes argued that in the current period the demand for capital has been reduced by capital-saving, rather than capital-using technology, and that rising consumption standards are directed toward types of consumption that have a relatively short period of production, in particular services. Thus, the main stimulus to increasing investment is through population growth, and Keynes estimated that close to half of all investment between 1860 and 1913 was due to a rising population (128–30).

A stable or—worse—declining population, then, augurs badly for a capitalist economy, unless society undergoes fairly radical changes in other directions to compensate for this.

> With a stationary population we shall, I argue, be absolutely dependent for the maintenance of prosperity and civil peace on policies of increasing consumption by a more equal distribution of incomes and of forcing down the rate of interest so as to make profitable a substantial change in the length of the period of production . . . .
>
> Yet there will be many social and political forces to oppose the necessary change. It is probable that we cannot make the changes wisely unless we make them gradually . . . . If capitalist society rejects a more equal distribution of incomes and the forces of banking and finance succeed in maintaining the rate of interest somewhere near the figure which ruled on the average during the nineteenth century . . . then a chronic tendency toward the underemployment

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> of resources must in the end sap and destroy that form of society. But if . . . there is . . . a gradual evolution in our attitudes towards accumulation, so that it shall be appropriate to the circumstances of a stationary or declining population, we shall be able . . . to maintain the liberties and independence of our present system, whilst its more signal faults gradually suffer euthanasia as the diminishing importance of capital accumulation and the rewards attaching to it fall into their proper position in the social scheme. (132–33)

Hence, independent of such possibilities, a Keynesian program would include a policy designed to increase population, in part to safeguard extant property relations as these were dependent on the relative success of the economy itself: "civil peace" depended on prosperity and a successful accumulation process given the prevailing attitudes. Population, as with variables generally regarded as purely of an economic nature, was analyzed from a social perspective which formed the context within which Keynes developed his theoretical argument and policy prescriptions. All his general theory must be seen as speaking to the operations, outcomes, and control of a propertied society which is to be maintained through conscious and concerted policy.

Conclusion

Keynes' general theory was developed to explain the functioning of a specific form of economic organization in a specific stage of its historic development. This economy was embedded in a larger society and that society contained various institutional features that both informed and constrained the economy.

Keynes was mindful that economic relations were not above or apart from the larger society, and, as he worked toward *The General Theory* (and beyond), his ideas were formed within a definite social context and directed toward a real *social* economy. His theory, therefore, cannot be lifted from that economy and its surrounding society with its particular institutions, habits, and social relationships. Proper policy, that which facilitates a better functioning economy while preserving the property rights and relationships that form the foundation of that economy, cannot be effected unless one understands the social constraints on policy and the impact policy has on the various classes that comprise the social organism underlying the economy. To follow the neoclassical program, predicated on a hypothetical barter economy, where economic laws ostensibly exist independent of society and where society is to conform to those laws, is to risk the destruction of the property regime that economists claim to support. Conventional economists are increasingly incapable of seeing an economy at all, at least one that remotely resembles a modern monetary economy. Forms of scholasticism and "pretty, polite techniques" have increasingly substituted for real knowledge about a real economy that functions within a real society. Isolated rational agents constantly adjusting to equilibria though frustrated in their search by a

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faulty signaling process is no substitute for an understanding of what drives the real economy.

One consequence of the abandonment of Keynesian theory (in its Keynesian, non-vulgarized form) is that policy makers are "flying blind" (Papadimitriou and Wray 1994) and cannot comprehend the recent inflation-free movement toward a level of employment dramatically fuller than the "full" of the NRU of NAIRU (Yoo 1998). The Fed has proven effective mainly in fighting inflation where no inflation exists. A more sinister consequence of abandoning rational economic theory is that of the "revenge of the rentiers" (Smithin 1996), a development that has engendered a far-reaching and potentially disastrous shift in income distribution, about which Keynes warned directly.

But cracks in the surface phenomena have begun to appear, creating the potential for a new period of theoretical enlightenment. Will economists of a Keynesian persuasion respond by incorporating society itself in their analysis of what ails capitalism? Or will they mimic those economists held up as charlatans? Some think we are entering a period where, once again, Keynesian-type arguments will be listened to. What shall be the response?

Notes

1. It might be noted that Keynes dropped references to "cooperative," "entrepreneurial," C-M-C' versus M-C-M' types of economies in the final version of *The General Theory*. This may have been due to his attempt to soften the political implications of his theory in order to attract the widest possible professional audience.
2. One is struck here by the similarity of Keynes' remarks to those of Hayek. Recognizing that people long to reactivate the "primitive instincts" of collectivism associated with pre-class society, and that the individualism associated with capitalism destroys any social cohesion, Hayek emphasized the need for religion—understood as religion proper—as a stabilizing, "traditional" force providing "order" to an otherwise orderless society. Indeed, the last chapter of *The Fatal Conceit*, which should be read as Hayek's last word, is given over to this issue (1989, ch. 9). On this point, see Henry 1998.
3. In an empirical examination of the relation between the interest rate and the rate of investment, Steven Fazzari estimated that a reduction in the interest rate affects mainly the investment decisions of small firms. Large firms are basically impervious to interest rate changes, basing their decisions largely on their view of the future economic environment, i.e., expectations. See Fazzari N.D.
4. The first statement of this program appeared in a 1924 *Nation and Athenaeum* article, "Does Unemployment Need a Drastic Remedy" (Keynes [1924] 1981, 219–223).
5. Hyman Minsky developed a "stage theory" exposition on this theme, focusing on how the changing structure of capitalism has invoked significant modifications in the relation between finance and production. See Minsky 1993.
6. This program remains to be developed. For one recent proposal that is consistent with Keynes' general theory and policy program, see Wray 1997 and 1998.
7. In the 1933 draft table of contents, chapter 12 was entitled "The Influence of Changes in the Distribution of Income between Rentiers and Earners" (CW 19, 63).
8. Euthanizing the rentier would produce another desirable result. An increase in the interest rate brings with it a transfer of income away from the spending classes (workers and active

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capitalists) toward the saving class. This causes a contraction in spending, leading to or exacerbating a downturn in the business cycle and exaggerating that downturn's amplitude (Keynes [1936] 1973, 313–32). Thus, an orchestrated low interest policy that contains a redistributional program as an ancillary feature helps promote a more stable capitalist economy.

9. This chapter was reprinted in modified form as "Social Consequences of Changes in the Value of Money" and included in *Essays in Persuasion* (CW 9, 59–75). It should be noted that, at this time, Keynes was still under the influence of a Marshallian savings-investment model where savings by one section of the population provided the funds for investment by another section.
10. And note, Keynes dedicated this work "to the Governors and Court of the Bank of England, who now and for the future have a much more difficult and anxious task entrusted to them than in former days" (xv).
11. Observe that in this quote Keynes seems to attack some of his own argument in this chapter. Keynes was always very careful in the use of language and in the way he approached various "delicate" issues. It is possible that here he's using the historic record to attack then-current principles that were held near and dear by the propertied classes and their representatives, principles that could not be addressed in a frontal attack.
12. "Some Economic Consequences of a Declining Population" was an expanded version of his Galton Lecture, delivered to the Eugenics Society February 16, 1937. A statement on the need for some population policy is first found in "The End of Laissez-Faire" (Keynes [1926] 1972, 292). See Toye 1997 for an extensive treatment of Keynes' views on population and related topics.
13. It is not clear why this increase in aggregate demand cannot be anticipated if we are able to fairly well gauge population trends from current demographic data.

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