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Perspectives on Keynesian Economics

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Foreword

The impressive conference on John Maynard Keynes and the collective book that it yielded were financed by a generous grant from The Thomas Guggenheim Foundation. We are deeply grateful to the foundation and in particular to Professor Thomas Guggenheim for the support and for his active participation in the conference.

I would like to take this opportunity to give you a few of my own reflections on John Maynard Keynes.

Since Keynes the Economist and his ideas will be discussed within this volume, I will not venture down the lane of "Keynesian Economics". Nevertheless, I would like to say a few words about Keynes the man, the philosopher, the leader – his impact on human society and perhaps on the course of history – and if there is a lesson we may learn from his achievements.

I would begin by saying that Keynes and Keynesianism, as perceived in the simplest way, remind me of a famous quote from a philosopher and thinker named Antonio Gramsci. He might be paraphrased as advocating that we should switch from the pessimism of reasoning to the optimism of action.

This certainly reflects Keynes's attitude toward economic policy, as he was an optimist and great believer in action. Keynes was the economist who challenged the famous definition of economics as "the dismal science", and transformed it, as Reich (1999) noted, into "a revolutionary engine of social progress".

John Maynard Keynes was cited as amongst Time Magazine's "100 Scientists and Thinkers of Twentieth Century", together with Einstein, Freud, Fleming (who discovered penicillin), Salk (who developed the polio vaccine), the philosopher Wittgenstein, the Wright brothers and others (Reich 1999). In my personal view, Keynes was high on this list.

Keynes was charismatic in presenting his ideas – the fact that he managed to recruit most of the greatest economic minds of the twentieth century as his disciples is testimony to the power of his personality. Among his most notable disciples are John Hicks, Joan Robinson, Richard Kahn, Roy Harrod, James Meade, Alvin Hansen, Paul Samuelson, James Tobin, Robert Solow, and among the "younger generation", Joseph Stiglitz and Paul Krugman – and this is a very partial list. It was noted in an influential print media that Keynes, who died in 1946, ". . . was the twentieth century's most influential economist. His ghost animated governmental policies for 25 years after World War II". It was further said that "Keynes is enjoying an intellectual revival" (R.J. Samuelson).

Since the beginning of the 1980s, the world witnessed the fall of Keynesianism. It was accompanied by the flourishing of global market activity, especially in financial markets, and by the globalization of ownership and production. The shares of government expenditures decreased, inequalities grew, and strict policies to balance government budgets were implemented. This latter was reflected in U.S. policies, the Maastricht Rules, the recipes of the World Bank and the IMF, and in the formal economic policies of many other countries.

This is accompanied with the fact that in the 1960s economic growth in Western economies averaged 5% per year, and in the 1980s only 2.7%, and Europe had a rate of unemployment of 3% in the 1960s and 11% in the 1980s. This was not attributed to the change of the ruling political economic philosophy that switched from Keynesianism to Monetarism, a change that included a highly focused aim at reducing government involvement in the economy, a rigid striving for balanced budgets, and an indifference to social justice and income distribution. These differences in the rates of unemployment are typically explained as due to a rise of the "natural rate of unemployment" (a Friedmanist concept), which is allegedly due to over-taxation and over-regulation of governments, especially in the labor markets.

However, from 2007 or 2008, due to the financial crisis, we have been witnessing a revival of Keynesianism. People realized that there are dangerous flaws in human nature – possibly in the "Homo Economicus" – that lead to potential severe failures of free markets. One has only to note the abundance of words recently written and verbally expressed on human greed. Some of the most prominent economists have revived Keynesian formulas advocating massive government intervention. These include, among others, Robert Schiller, Paul Krugman, and Joseph Stiglitz. I apologize for not giving a comprehensive list at this time.

Economists and policy makers seem to realize that many of Keynes' ideas that fell into oblivion, both in internal and international economic policies, are both relevant and probably the only efficient recipe to avoid a world catastrophe, a prolongation of a state of deflation, and the potential emergence of extremely undesirable regimes. This resulted in massive government expenditures in the U.S., Europe, and other countries, and significant budget deficits and the re-emergence of forgotten Keynesian ideas such as the need to increase international coordination of fiscal and monetary stimulus through the IMF and the World Bank. These were ideas advocated and expressed by Keynes in Bretton Woods in 1944, and reduced by the American delegation there headed by Harry Dexter White.

Another of Keynes' ideas from Bretton Woods, the institution of an international reserve currency that he called the "Bancor", was raised recently by the Chairman of the Chinese Central Bank. He, more than anybody else, understands the problems and risks of the extensive accumulation of national currencies, namely the dollar, the euro, and the yen in the foreign exchange reserves of countries, thus advocates the switch to an international reserve currency as a substitute.

John Maynard Keynes was a rebel – he diverged from orthodox classical economics to suggest a new paradigm that had as its goal the creation of a better world. In this sense, he should be a role model to all of us, to all economists at large, and in particular to those in academia who produce and disseminate ideas and concepts that are later used by practioners and policy-makers.

Keynes began his career during World War I as a traditional neoclassical economist, having been a student of the noted Alfred Marshall. Somewhere along the line, he started to deviate from the fundamental notions and implications of classical economics in the realm of laissez faire, and adopted a different approach. In his "Tract on Monetary Reform" (1923), he articulated a conservative monetary policy, even though it expressed views on the need to implement government policies to achieve stability. The belief in the role of government as a stabilizing agent grew during the 1920s and 1930s, and peaked with the publication of Keynes' "The General Theory of Employment, Interest and Money" in 1936.

One of the major lessons that should be learned is that there is a "herd effect" in human thought, which is particularly strong in academia, and in most scientific fields, whereby scholars tend to be prisoners of mainstream concepts and fashions. It requires much courage, strength, and persuasion to deviate from the existing consesus and introduce new and unorthodox ideas. This herd syndrome exists in most of the scientific fields, and also in economics. The potential damage of dogmatically applying ruling concepts – regardless of the circumstances and of their social effects – is in the close link between the prevalent economic thought with policy-making. This might lead societies to undesirable outcomes and conditions.

Keynes (1936, Preface) gave a superb example of originality and independence of thought from which human society, as a whole, has benefitted. He was quite specific in expressing his view on this issue: "... the difficulty lies not in the new ideas, but in escaping from the old ones".

Keynes was criticized and accused in a number of fields. He was accused by the Right of being a Communist and Marxist. He was accused by the extreme Left of being a brutal capitalist and totalitarian, an admirer of the Nazis and anti-semitic. I believe that all these allegations were wrong and unjustified. Keynes, who wrote the following words (1933, 21–22), was, in my view, not a Nazi supporter or an anti-semite:

> "... To our generation, Einstein has become a double symbol – a symbol of the mind travelling in the cold regions of space, and a symbol of the brave and generous outcast, pure heart and cheerful spirit... so it is not an accident that the Nazi lads vent a particular fury against him. He does truly stand for what they most dislike, the opposite of the blond beast – intellectualist, supernationalist, pacifist, inky, plump ... How should they know the glory of the free-ranging intellect and soft objective sympathy to whom money and violence, drink and blood and pomp, mean absolutely nothing?"

In "The End of Laissez-Faire" (1926, Ch. III) Keynes sarcastically commented on Marxian Socialism: "... how a doctrine so illogical and dull can have exercised so powerful and enduring an influence over the minds of men and through them, the events of history ...". Moreover, In "Essays in Persuasion" (1930, 329), he wrote:

> " ... The love of money as a possession – as distinguished from the love of money as a means of the enjoyments of life – will be recognised for what it is, a somewhat disgusting

> morbidity, one of those semi-criminal, semi-pathological propensities which one hands over with a shudder to the specialists in mental disease ..."

These two citations are certainly evidence that Keynes was neither a Marxist nor a brutal Capitalist. Indeed, in "The End to Laissez Faire" (1926, Ch. 5), he also wrote: "for my part, I think that capitalism wisely managed can probably be made more efficient for attaining economic ends than any alternative system in sight". Keynesian ideas evolved into what became the concept of the "mixed economy", and later, at the end of the twentieth and the beginning of the twenty-first centuries, the idea of "public-private enterprise".

John Maynard Keynes was a brilliant and charismatic man, with a legendary charm, supreme intellectual abilities, and a sharp – and at times, painful – discourse. He was adored by his followers as a prophet, and totally rejected by his opponents. Some people claim that he was one of the three most important economists in human history, the greatest and most influential economist in the twentieth century, and possibly in the beginning of the twenty-first century. Others – from both Left and Right – see in him the source of economic troubles, inefficiency, and injustice. Nevertheless, all, opponents and supporters, admire his greatness as a man and as an intellectual.

Bertrand Russell named Keynes one of the most intelligent men he had ever known and said: "Every time I argued with Keynes, I felt that I took my life in my hands, and I seldom emerged without feeling something of a fool" (cited in Hoggard 2008). His great opponent Friedrich von Hayek wrote after his death: "He was the one really great man I ever knew and for whom I had unbounded admiration. The world will be a much poorer place without him" (cited in Skidelsky 2003).

Although a conference in the history of economic thought usually deals with the thought of economists who are already dead, in view of recent events and policies, I believe that the news of the death – and here I mean the intellectual death – of Keynes and Keynesianism was premature.

Beer-Sheva, Israel J. Weinblatt

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Introduction

The years 2009–2011 collectively mark nine decades since Keynes's *Economic Consequences of the Peace* (1919), "four score and seven years" since the appearance of his *Tract* (1923), 80 years since the *Treatise* (1930) and the "platinum anniversary" of the publication of his *General Theory* (1936), tomes which attracted attention and debate then, with the *General Theory* still generating much interest and controversy amongst economists and the public today; that is in a period of emergence from what has been, in retrospect, perhaps the most serious economic shock – financial, nominal and real – since the depression years and their immediate aftermath, 1929–1939.

The present volume is the outcome of a symposium organized by the Thomas Guggenheim Program in the History of Economic Thought held at Ben Gurion University, 14–15 July 2009. This meeting brought together leading economists and historians of economics, and focused upon the relevance of Keynesian economics from the perspective of the current crisis and in historical perspective. The volume is divided into two parts. The first part applies historical and methodological perspectives to the development of Keynesian economics, and assesses lessons that may be drawn from them for the present crisis. The second part of the volume focuses upon the development of models and policy issues characterizing and emanating from Keynesian economics, their relevance for economic analysis today, and the application of the Keynesian framework to the analysis of the current crisis and possible future crises.

Samuel Hollander's paper opens the first part of the volume. He starts by addressing anomalous positions taken by Smith, Marx and Engels, and Keynes: Smith's advocacy of government intervention in the credit market; the appeal of Marx and Engels to the competitive pricing mechanism in certain cases; and

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Editor's Note:
The references to publications in this introduction appear in the respective chapters of the volume.

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what he called the "conundrum" of "Keynes distorted representation of classical macroeconomics despite his keen awareness of the true classical position", that is to say, "Keynes's misrepresentation", in Hollander's view, of Ricardian macroeconomic policy. In the conclusion to his paper, when focusing on the anomaly in Keynes's approach to Ricardo, Hollander asks: "Is that perhaps an alternative suggestion?", to explain what he takes as Keynes "deliberate distortion" regarding the Ricardian position, and his support of the Malthusian position.

In his comments on Hollander's paper, David Laidler shows that Ricardo also overlooked certain issues. For example, as Laidler points out, Ricardo elided certain approaches from his *Principles* (1817), thereby creating a dissonance between that volume and, as Laidler put it, other "down to earth policy commentaries" of Ricardo. Indeed, the "cognitive dissonance" of Keynes on the one hand, and Ricardo on the other, may have played a role both in the conundrum raised by Hollander, and the dissonance pointed out by Laidler.

In her paper, Maria Christina Marcuzzo attempts to draw *lessons* for the recent economic crisis from the philosophical *weltanschuung* underlying Keynes's approach in the *Economic Consequences of the Peace* (1919) – that is to say, his emphasis on *reasonableness* rather than *rationality*. She provides a number of historical examples of what can be called the *rational–reasonable divide*, starting with the Franco-British split at Versailles, through the Anglo-American rift over re-payment of war debt, and up to the decision by the US government *not* to bail-out Lehman Brothers. Marcuzzo further maintains that any "return to Keynes" should not only be based upon demand management policies, so as to prevent world-wide deflation and recession, or the implementation of reforms in the international financial system, but, as she suggests, also on an across-the-board utilization of Keynes's idea of *reasonableness* as against what she sees as the *misplaced* notions of individual and market rationality.

In his comment on the paper, Moshe Justman agrees with the *rational–reasonable* (i.e. Franco-British) divide at Versailles, but questions whether this characterized war-debt repayment. Indeed, he asserts that despite Keynes asking the Americans to be "reasonable" regarding this, the US position, while possibly "unfeeling", was not actually "unreasonable". As for Lehman Brothers, he concludes that while in retrospect, it may have been the *wrong* decision, in light of the uncertainty at the time, this decision could *not* be considered "unreasonable".

Michel De Vroey's paper asserts that those claiming the *General Theory* to flow from Marshallian headwaters actually diminish the theoretical contribution Keynes *thought* he was making. According to him, Marshall had *no* theory of unemployment per-se. Moreover, he shows that this *theoretical* gap was not filled by others, such as by Hicks (1932) and Pigou (1933). In the former case, the result was a "misunderstanding" of Marshall's labor market adjustment mechanism, and a convoluted treatment in the latter. Thus, if one wants to "reinforce the validity of Keynes's argument" as put forth in 1936, "trying to anchor Keynes's theory" in "Marshallian theory" is counterproductive. In his opinion, Keynes did not remove the rigid wage assumption, as he himself, among others, had thought. He praises Keynes, however, for starting "the quest" for a solution to the problem, and concludes that Keynes was not "wrong"; he was simply unable to construct a rigorous model of his "intuitions".

In his comment on De Vroey's paper, David Colander first distinguishes between Marshallian "models" and "method". Following from this, in his view, while Keynes utilized the Marshallian "method", he did not utilize Marshallian "models" in his "attempt to develop a theory of unemployment". Rather, Keynes's approach was based upon what Colander calls "a complexity vision". He asserts that in taking this path, Keynes moved from the *ceterus paribus* assumption underlying Marshall's partial equilibrium micro-modeling method to a "macro-modeling method" based upon "interdependencies" that could bring on "serious coordination failures". In his view, Keynes "used the Marshallian method, which sees models as aids to intuition". He concludes by saying that while Keynes "did not develop an acceptable scientific theory" of how his "complex system would operate", he still provided "a vision" for those, in Colander's words, "willing to see" it.

In his paper, Mauro Boianovsky shows that Patinkin's *dynamic* interpretation of the disequilibrium nature of involuntary unemployment should be considered as his contribution to Keynesian analysis and its extension. In order to understand Patinkin's views, *all* his work, *both* published and unpublished, must be considered, not only the editions of *Money, Interest and Prices* (1956, 1965, 1989). He points, for example, to a 1957 draft typescript – that became the basis for his later rejoinder to the negative review by Hicks in *Economic Journal*. In this, Patinkin distinguished between *monetary* and *employment* theory as set out Keynes, and asserted that the latter was "the fundamental contribution of Keynesian economics". With regard to Keyne's notion of "effective demand" and employment, Boianovsky maintains that Patinkin made a "plea for a dynamic interpretation" of the theory of employment, that is to say, a "disequilibrium perspective". Taking the story up to the 1989 edition of *Money, Interest and Prices*, he says that rather than counterpoint Keynesian and Monetarist positions, Patinkin attacked key tenets of the "New Classical Macroeconomics", such as rational expectations. He concludes by maintaining that Patinkin did not belong to the "Neo-Classical Synthesis"; rather, as Patinkin himself put it, he was "more Keynesian than Keynes", albeit, a *disequilibrium* "Keynesian economist".

Michel DeVroey asserts that, in his view Boianovsky did not actually answer the question implied by the title of his paper. Following from this, he provides "an outline of the paper" that could have, according to him, been written. He starts by "questioning the Keynesian character" of Patinkin's writings, identifying two reasons for this: advocacy of the real-balance effect, and reading Keynes "through Walrasian rather than Marshallian lenses". According to him, Patinkin exhibited a form of "cognitive dissonance" regarding the slow adjustment process towards equilibrium in conjunction with the Walrasian approach he advocated; the latter taking place, according to DeVroey, in "logical time". He presents his *own* definition of what constitutes a "Keynesian" approach, delineating "two meanings": the first, based on "market failures" dealt with via demand policies; the second, emanating from a "precise conceptual apparatus", in his view, the IS-LM model.

He maintains that Patinkin *was* "Keynesian" with regard to the first, but as he "followed the Walarsian line", *was not*, on the second meaning. He claims that Patinkin was "not alone" in taking this "mixed position", and was actually a "mirror image" to the stance regarding "Keynes's conceptual apparatus", with which, in his view, Friedman "had no qualms"; and this, as against Friedman's "anti-Keynesian" policy stance. He concludes by saying that "modern neo-Keynesian authors" have also been affected by this "cognitive dissonance", albeit not attempting to "attach" their "reasoning to Keynes's".

Amos Witztum addresses a conundrum in his paper, relating to the Keynes–Robbins interaction over "the years of high theory". Witztum is struck by the dissonance of Keynes *not* attempting to *place* his 1936 volume, which was destined – as he put it in a letter to Shaw – to "revolutionise" economic theory, into the framework set out by Robbins, in 1932, and again in 1935, that, in essence, has demarcated the boundaries of "the subject matter of economics" up to the present day. He goes on to show the complex relationship between Keynes's ideas and those of his classical predecessors; this in the context of Keynes's somewhat enigmatic statement, made at the end of his 1936 volume, that once full employment is attained, the classical approach "comes to its own". In his view, given that the 1936 system set out by Keynes was based upon the delineation of "good" and "bad" equilibrium, Witztum assets that this ethical "non-neutrality", among other characteristics, did not seem to enable Keynes's approach to fit into the Robbins taxonomy of what constituted economic "theory" at the time. Despite this, however, Witztum concludes that the "implicit denial" of its place in the science of economics, that characterized Robbins's treatment of Keynes work, *from 1923 till the end of the 1930s*, "was unjustified".

In his comment, Boianovsky takes issue with Witztum's treatment of Robbins's views of Keynes. As in his own paper in this volume – on Patinkin as a Keynesian economist – he advocates utilizing the *overall* body of work of an author, in this case, Robbins, in order to assess the Robbins–Keynes nexus. He maintains that after 1934, and from 1947 onwards, especially in his 1971 *Autobiography*, Robbins was positive on Keynesian employment and demand management policies. Boianovsky *does* recognize the fundamental difference between Keynes's 1936 definition of economics "not as pure science, but as an applied, moral science", as against that of Robbins (1932), which was that economics was a "science". According to Boianovsky, however, Witztum's conclusion that Robbins "implitly denied Keynes's place in the science of economics" – *based solely on Robbins's 1932 approach* – "remains unproven".

In his paper, Russell Boyer deals with some outstanding issues in the history international macroeconomics of "Keynesian" and "Johnsonian" vintage, and disputes the conventional accounts of Harry Johnson's movement from Keynesianism to Monetarism during his tenure at the University of Chicago. In the context of the paper, Boyer attempts to show how Johnson explicitly, and his then Chicago colleague, Robert Mundell, were influenced by Milton Friedman, and *especially* by Friedman's 1953 essay on flexible exchange rates. Boyer brings together, from a wide variety of sources, what he sees as compelling evidence of the Johnson–Mundell–Friedman nexus, and deals with the evolution of Johnson's view of Keynesianism. He then proceeds to outline, in detail, the transition in Johnson's thought in the context of the origins of the monetary approach to the balance of payments [MABOP]; going on to deal with Mundell's development of the notion of OCA, both, according to Boyer, based upon the *direct influence of the complete version of Friedman's 1953 essay, and not its better known, abridged form, in which,* according to Boyer *both of these ideas were elided*. Boyer also counterpoints the origins of the "Keynesian" view of the MABOP to the "Johnsonian" version, both as set out by Polak, as against Polak's assessment of Mundell's contribution to it. Boyer concludes by saying that, in effect, an intellectual "equilibrium", albeit *unstable*, characterized the Johnson–Mundell–Friedman connection while all three were at Chicago, and afterwards.

In his comment, Dror Goldberg comes to the defense of both Johnson and Mundell, arguing that, at most, they were "negligent and sloppy with regard to citation". He goes on to examine specific issues raised by Boyer, and asserts that Johnson's editing and abridgement of Friedman's 1953 essay, in his opinion, was "extremely reasonable". He continues on to maintain that the very title of Johnson's own paper on flexible exchange rates was a "great honor" that offset, in his view, Johnson's earlier attacks on Friedman. He goes on to justify his defense of Mundell by referring to the preface in *International Economics* where Mundell mentions Friedman, among many others, as having influenced him, seeing this as sufficient evidence of Friedman's impact on Mundell's ideas, in lieu of "exact references". Goldberg concludes by asserting that, according to Johnson, in his 1971 AER paper "The Keynesian Revolution and the Monetarist Counterrevolution", Friedman himself was lax in citation practice; with his own "quantity theory" approach having, in Johnson's view, at least, according to Goldberg having "merely reformulated Keynes's liquidity preference" approach.

In his paper, Warren Young attempts to systematically place the IS-LM approach in the framework of the Keynesian revolution. He focuses upon a number of issues relating to the relationship between the model and the revolution that emanated from Keynes's 1936 tome. In this context, he brings the reader back to an overlooked paper by Hicks, published in French in 1945, in which Hicks distanced himself from what he said in his own 1937 paper, that is to say that the *General Theory* is "the economic theory of depression". He goes on to discuss the equational–diagrammatic system summarizing what Hicks took, *in 1945*, to be representative of "Keynesian ideas", which included sequence analysis. IS-LM is nowhere to be found in Hicks's 1945 paper, except for a reference to his 1937 paper. Young then describes the diagrammatic approach of Klein (1947) and maintains that it is *identical* to that of Hicks's 1945 approach to Keynes. Following from this, he poses the question: why did the *Hicks–Klein* diagram not receive any attention by the economics profession, whereas the *Hicks–Hansen* diagram (IS-LM) became what Dornbusch and Fischer later called "the core" of modern macroeconomics. He then deals with the "sets of Keynesian ideas" and models characterizing the