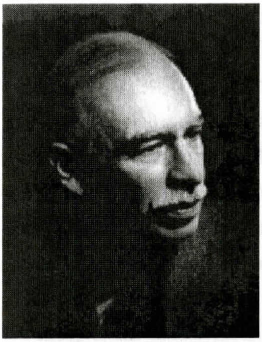
5
John Maynard Keynes and the Turbulent Birth of Macroeconomics



INTRODUCTION

No human frailty is more complex than our ability to believe strongly in things that are clearly not true. As examples, those prior to Columbus who believed the earth was flat had the same kind of blindness that afflicts mainstream economists who ignore the complex web of social classes that leaves unfinished, if not absurd, all of their work. It can be quite costly to trudge forward into the cold and piercing winds of life on the basis of wrong ideas, and especially so if we are experts with an audience.

Another such costly idea was held for almost two centuries by the classical school of economics and, like so much of modern thinking about the economy, this one has origins in the early 18th century. Its most famous advocate was Jean Baptiste Say, a French businessman who coined what became a famous claim, that "supply creates its own demand." He meant by this phrase that when businesses pay for the goods produced they produce a flow of income to business, government, and wage earners adequate to buy all of the output. Natural, internal forces automatically end overproduction before it becomes a recession or depression (and we will have a more detailed explanation of Say's model below).

This theory was greatly at odds with the observable fact that capitalism is an unstable system in which every expansion of the total output is followed with the inevitable decline, or what we call, downturns, recessions, or depressions. Though historians differ about the exact number, there have been over 40 such recessions/depressions since 1800. There have been eleven of them in the past fifty years, including a deep recession (what some would call a depression) in 1982, and what has been called the "great recession" that started in 2007. These kinds of downturns spread a decline in employment, income, crucial public spending, and increasing public unrest across the globe. Further, the most serious ones in the last century have not ended without massive public interventions that give lie to the theory that economies will return to equilibrium on their own.

Despite this unchallenged history of the ups and downs of capitalist states, the classical theory held sway in economic thinking roughly from the late eighteenth century until the middle of the Great Depression in the 1930s. It was John Maynard Keynes who dealt it a crushing blow in a 1936 book, *The General Theory of Employment, Interest, and Money*, sometimes abbreviated as simply *The General Theory*. This book swept away much of the debris of classical thinking about business cycles, and what to do about them.

To economists in the classical school, the self-regulating character of capitalism meant that the government's role in the economy should be limited. Adam Smith wrote his famous treatise *The Wealth of Nations* in 1776 primarily as a tract against the "mercantilist" thinking of his time. The mercantilists believed in government economic policies that would foster favorable trading conditions with other nations. This required a mosaic of government rules and regulations, including favoring monopolies in crucial trading industries. Under mercantilism, the state was an instrument for the benefit of a few industries and individuals, often to the detriment of everyone else. Smith's biggest fans, members of the emerging capitalist class in Britain and France, believed that unregulated capitalism would, in contrast, benefit all groups in society. By allowing members of all economic classes to seek their self-interest in a competitive system, capitalism would produce the most productive outcome possible. Though, as we have seen, Smith allowed for a few government functions, such as education, police protection, and national defense, he thought an economy that was largely unregulated by government would be both superior and self-regulating.

In the central tradition of economics[1] between 1776 and 1936, business cycles were ignored as a legitimate subject of study, and public policy to lessen their damaging effects was consequently out of the question. In the United States during these years, the classical school's domination of economic thinking among both academics and capitalists claimed countless victims. President Herbert Hoover, responding to the ravages of the Great Depression in the early 1930s, could only proclaim to a disbelieving public the classical article of faith: "Prosperity is just around the corner." Irving

Fisher, among the most respected U.S. economists of the time, no doubt helped to confuse Hoover by declaring, just prior to the 1929 stock market crash that began the Great Depression, that the economy was on a "permanently high plateau." It was into this theoretical morass that Keynes stepped in 1936 with *The General Theory* to change forever the way we all think about the capitalist business cycle.

So, who was this Keynes fellow?

JOHN MAYNARD KEYNES, THE PERSON

Keynes was an Englishman who lived from 1883 to 1946, and after 1913 produced a torrent of books and articles about the economic world. In the course of his 63 years he was: a brilliant student at England's most famous prep school; an equally brilliant student and then professor at Kings College in Cambridge; a financier who made a fortune for himself, and later for Kings College by overseeing its endowment fund; president of a life-insurance company; patron of the arts; husband of a famous Russian ballerina; member of the influential "Bloomsbury set" of intellectuals; esteemed official of the British Treasury; and a board member of the Bank of England. He also played a crucial role as the chief British participant in a conference in Bretton Woods, New Hampshire, in 1944, where the allies in the war against Germany and Japan designed what would become the post-war system of system of international finance. Most important to his lasting fame, Keynes's writing held the rapt attention of the political and intellectual world during his adult life, and continues to have lasting influence over sixty years after his death.

The General Theory is only the most famous of his many economic writings. One of Keynes's earliest works was an acclaimed book on probability theory. Another early book, *The Economic Consequences of the Peace* (1919), catapulted him into an international spotlight that never dimmed while he was alive. In this book, Keynes argued with impressive foresight that the victorious allies in World War I had exacted such heavy reparation payments from the Germans that the German economy would sink into ruin, producing dangerous political chaos. From the 1920s on, Keynes focused mostly on economics and, as we shall point out later, he often paused to write sharp critiques of the methods and analyses of other mainstream practitioners.

While Keynes was a powerful critic of some aspects of mainstream economics, his work was clearly different from the political economy practiced by Marx and Veblen. Keynes never gave up the idea that capitalism was the best of all possible modes of production. Indeed, given what he saw as human nature, he believed that competitive markets in capitalism were uniquely designed to minimize the often-deadly effects of human competition. Keynes championed government intervention in capitalism because he believed that without it, the system he preferred would collapse into economic and political chaos. In other words, Keynes wanted to save capitalism from itself.

Marx called for revolutionary overthrow of the capitalist class and the development of a socialist system rather than the reforms of the sort Keynes sought in government policy. And Veblen imagined an industrial democracy, guided by engineers and scientists who, compared to the capitalists, would organize the economy for production rather than profit. Therefore, if we look only at the political policies Keynes called for, in comparison to those advocated by Marx and Veblen, we can see that he was a very different kind of political economist than they were. Despite their fundamental differences, all three shared two principal conclusions that set them aside from most of those in the central tradition. The first is their view that unregulated capitalism, for various reasons, is a disaster waiting to happen; and second is their belief that economists in the central tradition had so narrowly defined their discipline that they had come to misunderstand, or completely ignore, crucial dimensions of capitalism. We will discuss these two points later in this chapter, but first we turn to Keynes' critique of the classical explanation of business cycles.

DEFINING OUR TERMS

Business cycles have such enormous effects on life in capitalist societies that economists have developed an array of names for them. In the early nineteenth century, some economists referred to economic declines as "gluts" or "overproduction." Later in the nineteenth century, these gave way to the more ominous "economic crises," a term popularized by Marx.

During the 1930s, the collapse of U.S. capitalism was so deep and prolonged that it came to be known permanently as the "Great Depression." However, when the economy took another dip in 1937-38, after four years of slow growth, economists came up with "recession" as a way to distinguish that dip from the Depression. A few mainstream economists, their thoughts clearly under the mesmerizing spell of the classical school, tried in the 1950s to popularize a peculiarly hopeful term, "rolling readjustments." Fortunately, this term didn't stick but it is useful to note that profoundly different political ideologies are embedded in the concepts "economic crisis" and "rolling readjustment."

We will use the term "business cycle" in a general sense, and we will use other terms—gluts, recessions, depressions, or crises—as they fit the scenario

that we are discussing. As with all descriptive language, one's choices among these terms often reveal personal biases. One oft-quoted analysis of these choices roots them completely in subjective circumstances: "If you lose *your* job, we're in a recession; if I lose *mine*, we're in a depression."

No matter what they were called, capitalist business cycles produced a long-standing debate throughout the nineteenth century, and the two sides can be succinctly expressed:

The Classical School: Economic recessions and depressions are natural and localized consequences of capitalism that are automatically self-correcting.

The Alternative Schools: Economic crises are complex, inevitable, and unpredictable consequences of the capitalist order that come with tremendous costs.

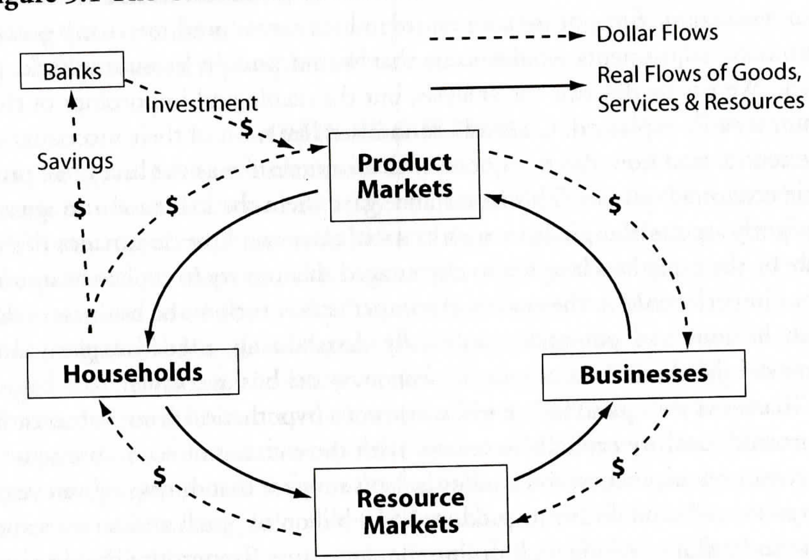
THE CLASSICAL SCHOOL AND BUSINESS CYCLES

Until Keynes exploded their theory, economists in the classical school believed that "overproduction"—the production of goods that cannot find buyers—was impossible except in the very short run. Economists in this school believed that when some firm, or even an entire industry, produced too many goods, automatic adjustments would occur that would put the economy back on track. We briefly describe the analysis, but the ideological importance of this claim is easily explained. Classical economists, like most of their successors in the central tradition, did not question that capitalism was the best of all possible economic systems. This firm stance gave them the inclination to ignore unsightly aspects of capitalism, such as social classes and the dominance of the state by the capitalist class. It also encouraged them to try to explain away obvious imperfections in the system. An imperfection such as the business cycle, both obvious and potentially politically destabilizing, needed explanation. How did the classical economists explain away the business cycle?

To answer this question, we will construct a hypothetical model of an early nineteenth century capitalist economy with three classes of economic actors: wage earners, capitalists, and landlords. Let's suppose that during a given year, the owners of capitalist firms produced $10 billion of goods and services and were successful in selling it all during the same time. To produce that level of output, the capitalists would have had to buy materials and labor time, and rent space from landlords. Thus they would have paid out most of the receipts from their sales in material costs, wages, and rents. Whatever was left after making all the payments to these "factors" of production could be kept as profits.

The process we are describing here is a key one to understand for this reason: at the aggregate level of the economy, the process by which the capitalists produce goods is the same as the one by which participants in the economy receive income to buy back the output from the capitalists. If we break into this flow of income and spending at the beginning of production and look at just one part of the stream during a particular month, we can see that, in exchange for their members' labor time, households received wage payments. And during the same month that they receive this income, they will send most of it back to the capitalists in exchange for consumption goods and services. This interdependence between producers, consumers, and workers is now called the "circular flow of income and output," and you were part of it the last time you cashed your paycheck and headed off to buy something. The circular flow is so crucial to an understanding of aggregate economics that there is always a circular flow diagram early on in principles of economics textbooks, and we have reproduced one below (see Figure 5.1). Because it is the conceptual center of macroeconomics, it will help the beginner to study such a diagram long enough to understand its basic meaning (perhaps before you go on here).

Figure 5.1 The Circular Flow Model of the Macroeconomy



Businesses produce goods and services for sale to individual buyers in product markets in exchange for money. Households provide resources (labor, land and capital) for sale to businesses in resource markets in exchange for money. Some household money gets saved, and this money is returned to the circular flow of the economy via investment.

Now, let's go back to our earlier example and assume that as the $10 billion in sales revenue flowed into the capitalist (business) coffers during the year, they paid it out to individual households as follows:

$7 billion went to laborers as wages
$1 billion went to the landlords as rents
$2 billion was kept by capitalists as profits

We are going to suppose that the laborers spent *all* their $7 billion of wages on goods and services (products), and the landlords spent *all* their $1 billion on consumer goods, too. This $8 billion, as you now know, will have gone back to the capitalist producers during the same year, and it will be the biggest part of what they have in order to start up the next year's cycle of production.

Now consider the $2 billion going to the capitalists this year. Let's suppose they spent $1 billion on consumer goods for themselves, and "saved" $1 billion. We'll also make the reasonable assumption that the $1 billion they saved was soon put back into the spending stream when they purchased—"invested in"—new capital goods, such as machinery and factories. Machines wear out and new technologies emerge that could lower costs for the capitalist, so that each year capitalists use up part, or all, of that year's savings to buy these new capital goods. This process is sometimes called "capital accumulation." In our model, the upshot is that the capitalists will have put all their profits back into the spending stream by purchasing $1 billion of consumer goods and $1 billion of capital goods. Capitalists might also save some of their profits in banks, but we will assume that the banks automatically lend out these funds to consumers, governments, or to other capitalists to use for their own investments.

We can sum up the results of our hypothetical model in this way: during the year, capitalists produced $10 billion because they thought they could sell it. They actually did sell it all because every dollar they paid out in the form of wages and rents, as well as the profits they paid themselves, came right back to them in the form of someone's consumer spending, plus their own spending for capital goods.

This model embodies the theory that all output will find a buyer—a theory that formed the core of classical thinking about the business cycle until Keynes's *General Theory*. As we pointed out, this theory became known as "Say's Law," named for the French economist Jean-Baptiste Say. What's the basic problem with this theory? *Not all savings are automatically converted into spending during the same year, month, or six months, or whatever time period we might be analyzing.* Going back to our example, let's take a closer look at the $1 billion saved by our capitalists. What might the capitalists in our economy have done with that $1 billion if, during the year, threatening events—such as epidemics, war, catastrophic weather, or a financial crisis—had produced a sweeping wave of pessimism among them? Such events might also have frightened the other potential savers in the economy, the landlords, and what would be the effect of their fears on their own spending? Both of these classes might reasonably have responded to fears about the future by saving for the coming bad times, rather than using all of their income to buy consumer or capital goods. If they had done this, that is, not put back all the $3 billion they earned in our model, there could only have been one result: the capitalists would have produced goods that were not then sold, causing them to accumulate unwanted, unsold goods—inventories—and very likely to produce less output during the next time period. An economic downturn—initiated by overproduction or a glut of goods—would have begun because all of the supply would not have created its own demand.

Despite the reign of a modified version of Say's Law in the central tradition up to the 1930s,[2] some economists saw through the classical error. Thomas Malthus in the early part of the nineteenth century, Karl Marx in the middle, and John Hobson at the turn of the twentieth century, are only the most well-known who argued that savings not returned to the income stream quickly enough could cause a downturn. Marx undoubtedly spoke for many of these ignored economists by referring to Say's analyses of the aggregate economy as "trivial," "tedious," and "insipid nonsense." Whatever they might have thought about Say and his law, however, these critics could not break its transfixing hold on classical economists. That break would have to wait for Keynes in 1936.

We now turn to a second foundation of classical thinking: the idea that sustained involuntary unemployment in capitalism is not possible.

THE CLASSICAL THEORY OF UNEMPLOYMENT

The classical economists believed, with good reason, that work for capitalist wages was essentially irksome. This meant that, below a certain level of wages, nobody would work and that as wages rose more people would offer their labor power to the highest capitalist bidder. Given the two sides of this labor market, if the supply of labor were to remain constant, for instance, but capitalists decided to increase their output, they would need more workers and this would drive up wages. Alternatively, if the supply of labor remained constant, but the demand for labor time fell, wages would fall.

To connect this theory of a single labor market to the classical theory of unemployment, consider the following example: take a hypothetical large city with an active labor market for skilled carpenters. Let's assume that the going wage is $15 an hour, and as we begin our analysis there are 10,000 carpenters on the job. Suppose that, for whatever reasons, there is a substantial decline in the demand for construction throughout the whole region. This event will likely reduce the selling prices of construction projects and thus the value of the output of the carpenters who work on them. As the value of what carpenters produce declines, their services will also be less in demand, and in turn, we would expect their wages to fall. However, suppose that these wage rates don't fall because the carpenters make it clear they will fight wage cuts individually, or collectively through labor unions, or in other ways. This kind of resistance produces the well-known, real-world phenomenon called "wage rigidity," and in response to it, if the decline in construction demand is steep enough, some employers will lay off some of the carpenters.

Suppose the capitalists lay off 2,000 carpenters, and the remaining 8,000 of them continue working for the old wage. Now, in terms of the classical theory, here is a crucial question: are these 2,000 laid-off carpenters "unemployed?" According to the classical economists they are unemployed, but *voluntarily* so. That is, they are *choosing* to be unemployed, and if they would lower their wage demands enough, construction firms would once again find it profitable to hire more carpenters. Perhaps, if all the carpenters were willing to take a cut in pay from $15 to $10 an hour, and if that wage fit the new market conditions, it would again be profitable for the capitalists to hire all 10,000 of them. In other words, as long as carpenters are unwilling to accept lower wages in the face of falling demand for their services, there will be voluntary unemployment but not involuntary unemployment. That is to say, their unemployment is their fault! The implicit and connecting idea here is that hiring the carpenters at a lower wage will allow the builders to sell their output at a lower price. This lower price will produce a greater demand for the projects, and that will lead to an increase in the demand for carpenters. In other words, our unemployed carpenters are out of work because of their resistance to wage cuts.

The classical school generalized this theory—that without wage rigidity all individual markets were always at, or tending towards, full employment—to the entire economy. So strong was the hold of this model on the minds of economists in the central tradition that it was, as Guy Routh reports, "maintained right into the depths of the depression of the 1930s," when unemployment in both Britain and the U.S. was about 25%. As a prominent example, consider the comments made in 1932 by the president of the Royal Economic Society, the principal organization of the British classical school: "General unemployment appears when asking too much is a general phenomenon.... [The world] should learn to submit to declines of money-income without squealing." (Routh 1986, 57)

To sum up this quick review of the classical school's explanation for economic downturns and the consequent unemployment, we have the following: (1) aggregate supply will always equal aggregate demand, except temporarily, because capitalists will automatically use any savings out of the income stream to purchase capital goods; and (2) deviations from full employment in *all* individual labor markets result from worker resistance to falling wages in contracting industries. How, then, did Keynes go about putting these models more or less into the dustbin of history?

THE BROAD OUTLINES OF THE "KEYNESIAN REVOLUTION"

We want to be clear about our purposes in this section. The central structure of the Keynesian macroeconomic framework is formed by interrelated theories of consumption, investment, government spending, net exports, and the way in which behavior in these various sectors causes a capitalist economy to expand and contract. Such a framework is central to any introduction to modern macroeconomics, and all economics students will thus be made to learn its structural outlines and most important details. We will leave to economics courses the proper development of macroeconomics and take up only what helps us to explain the broad impact of Keynes' ideas on economics and on public policy, and of course, the relationship of these to political economy.

In 1936 when Keynes published *The General Theory*, many economists eagerly seized its details and implications, especially their relation to the causes of the Great Depression all were living through. Most of these economists were young and from the United States, many from Harvard's economics department. At the same time, the book produced a great debate among economists throughout the capitalist world, and many were not then, nor are they now, convinced of its usefulness. However, enough economists in the United States and Britain were converted to his way of thinking to begin to sink the classical ship. One such young economist, Harvard's Paul Samuelson, legitimized Keynesian economics by putting it on a par with classical microeconomics in a 1948 introductory textbook that remains the model for most economics textbooks.

Another reason that Keynes' critique took hold was that others outside the central tradition, who understood and accepted his principal conclusions, had already developed much of his critique. As early as the 1700s, thinkers outside the mainstream had already advanced arguments about underconsumption, involuntary unemployment, and the policy measures that might solve the problem of depressions. In the 1860s, Marx had developed a number of ideas about business cycles, including that they resulted in part from an imbalance of spending in the investment and consumption sectors of the economy. Similarly, in 1899, the Englishman John A. Hobson had argued that unemployment was caused by "over-savings." Hobson, however, was soon to realize that he had made a heretical argument and would be punished for it. As he later wrote, there were several negative responses to the book:

> The first shock came in a refusal of the London Extension Board to allow me to offer courses of Political Economy. This was due, I learned, to the intervention of an Economics Professor who had read my book and considered it in rationality as equivalent to an attempt to prove the flatness of the earth...[The second came] when suddenly, without explanation, the invitation [to offer a course to a charitable organization] was withdrawn. Even then I hardly realized that in appearing to question the virtue of unlimited thrift [savings] I had committed the unpardonable sin. (Quoted in Keynes 1936, 365-6)

By the late nineteenth century it had become, at least according to Hobson and Keynes, an unpardonable sin not to agree with the classical explanation of the business cycle! And as we have seen, right up to the point when Keynes was writing *The General Theory*, Britain's most widely respected economists were still telling the world that the only way out of the Great Depression was to lower wages all around.

More substantive than these largely ignored critiques of the classical theory were the actual practices of one European country, Sweden, which had implemented its own "Keynesian" policies before *The General Theory* was published. John Kenneth Galbraith has described how, since the early part of the century, Swedish economists and government planners had instituted policies that made sure that "over-saving" in the Swedish economy was offset by government expenditures. (Galbraith 1987) Swedish fiscal policy, in practice before Keynes argued for it, was part of the Swedish "middle way" we discuss in Chapter 9.

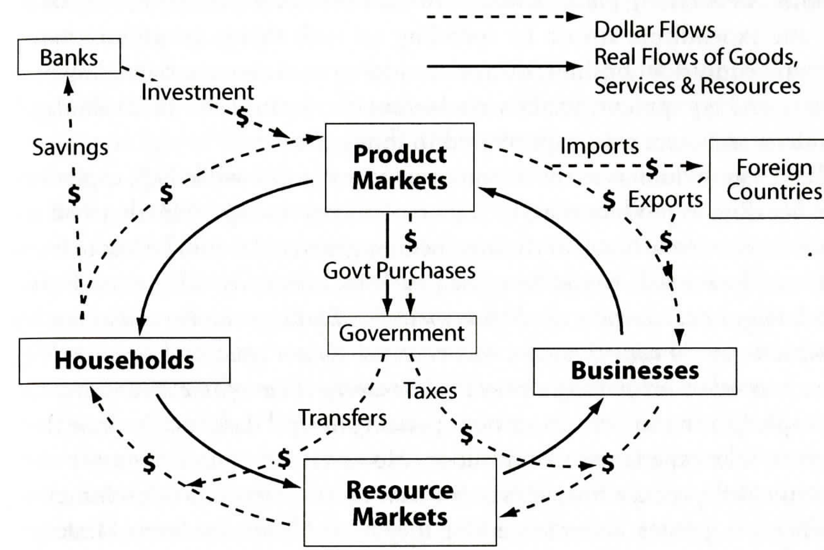
All this theory and practice was well known by Keynes, a fine student of history and of his own discipline, and he drew upon both to build his own system. He also chose as a specific strategy in *The General Theory* to explain his analysis in the terms of the conceptual foundations of the classical school. If you were to try to read the book, you would almost certainly be cornered by confusion. Yet, if you plowed on you would find that the book opens up at the end because, quite intentionally, Keynes wrote the closing chapters for the general public. There he took up the implications of his theory for public policy in a discussion that justifies his renown for eloquence as a writer.

THE KEYNESIAN CRITIQUE OF SAY'S LAW

A major contribution of Keynes's *General Theory* was its critique of Say's Law. Keynes argued conclusively, in terse theoretical parts of his book, that this "law" was the wishful thinking of those who dreamed of a self-regulating capitalist system. The assumption that savings would always be spent on capital goods during the same production period was not quite so far-fetched when made by Adam Smith. In his time the merchant and landlord classes did virtually all the saving, and it appears that usually—but certainly not all the time—they quickly converted their savings into capital goods because rapidly expanding capitalist markets had created vast opportunities for new investment. However, Keynes noted that by the nineteenth century, and certainly by the early twentieth century, industrial capitalist systems had become vastly more complex.

Even in a world in which the economic role of government was supposed to be minimal, governments had become ever more involved in economic affairs. Thus, the saving "leakage" from the economy was joined by the "tax leakage," because whatever governments took in taxes reduced the circular flow of income. Like savings, these taxes could lead to underconsumption if the tax leakages were not put back into the income stream by government. Still a third leakage occurs when, for example, people in the United States buy imports which, dollar for dollar, reduce the amount they would have bought from U.S. firms. In fact, from the point of view of Say's Law, we can think of taxes and imports as identical to savings: they are a drain from the system that must be returned or overproduction will occur. Figure 5.2 illustrates the circular flow model of the economy with all of the leakages included.

Figure 5.2 The Complete Circular Flow Model of the Macroeconomy



We can express Keynes' idea more clearly if we consider the magnitudes of these leakages from the spending flow in our own economy. Take 2003 for example (and it doesn't matter what recent year you use). In 2003, U.S. business firms employed over 137 million people and these people produced output that was sold for nearly $11 trillion. As this $11 trillion flowed through the U.S. economy, most of it, about $7.8 trillion, was put back in by household consumption spending. However, much of it was drained out of the expenditure stream as leakages:

> More than 10 million businesses saved—"accumulated"—about $1.5 trillion to help finance their expenditures for capital goods.[3]
> More than 110 million household units saved about $176 billion and put most of that in banks or other financial institutions to be lent out to others.
> All the levels of government took a total of about $2.0 trillion out of the expenditure stream through taxation.
> Households and firms spent about $0.5 trillion on imports, another leakage from the domestic expenditure stream.

This means that during 2003, the tax, savings, and import leakages out of the flow of income were almost $4.2 trillion, or about 38% of all the expenditures! Of course, at the same time that these leakages were occurring, "injections" were taking place as well. Governments were putting money back into the expenditure stream by spending on such things as military hardware and education; business firms were adding to the stream by buying machinery and equipment; banks were lending the savings out to all kinds of spenders; and there were exports sold to foreigners.

These figures lead us to the relevant theoretical point: while U.S. capitalists were deciding to produce the $11 trillion of output during 2003, they had no idea, of course, how much of the income they generated would be lost to leakages, and how much would be gained back by injections. *The reason is that these leakages and injections result from an impossibly large number of decisions by people who, at the time they save, tax, or spend, do not typically know anything about how others are putting money into, or taking it out of, the income stream.* The capitalists in this process are not operating in total darkness, because they have past sales experiences to draw upon. However, the volume of output that the capitalists produce for sale, say, for next month, depends upon hunches, or other best guesses, about something they *cannot know*: the level of leakages and injections that will occur as the income their production generates flows through the economy. If their estimates of sales are not realized—which, in theoretical language, will occur if there are too many leakages that are not offset by injections—they will likely accumulate inventories, and during the subsequent time period they will likely produce less total output. Thus, when the *typical* business firm is not selling all the output it is producing, there will be general overproduction, and this general overproduction will ultimately lead to a decline in output, employment, and income.

THE MULTIPLIER AND THE LIQUIDITY TRAP

Two other parts of Keynes' critique of Say's Law merit a brief description here. Keynes developed the first of these, called the "multiplier," with other Cambridge economists, and it was a powerful addition to his model of the macroeconomy. We will explain the multiplier with a simple example. Imagine a rosy scenario in which the local billionaire decides to pay back the community by giving the first person he or she sees a $100 bill. Suppose you are the lucky recipient, and you spend it on that tattoo of your favorite professor you've been aching to put on your arm. Your purchase alone increases spending in the economy by $100, and it also increases the income of the tattoo parlor by $100. Suppose the owner of the parlor spends $80 of it for a new hairdo. This will add $80 of new spending and income to the $100 spent for the tattoo, both of them additions to spending brought about by

that initial $100 the billionaire gave to you. The beautician now has some more money to spend, and on down the line, each new level of spending creates multiples of its own.

These successive transactions thus "multiply" the first round of spending—the $100 spent on the tattoo—and make the total change in spending some multiple of that first round. The multiplier adds a certain speed and energy to upward and downward movements of the economy, and it added to the new macro theory that Keynes used to undermine the classical theory. It also carries with it depressingly bad news for those committed to *laissez-faire* because it implies that government spending can have a large, positive effect on the economy: our $100 bill would have produced a similar multiplier effect had it been new government spending for goods and services, or simply handouts to needy citizens. We'll say more about that later.

The theory of the "liquidity trap," another of Keynes' principal ideas in *The General Theory*, has resurfaced in public discussion in relation to the long-term depression of the Japanese economy during the 1990s and the financial crisis of 2007. In trying to explain the depth of the Great Depression, Keynes argued that societies could wallow in a slump for long periods of time even if interest rates—which at low levels are supposed to induce capitalists and consumers to borrow more, and in turn to spend more and end the downturn—fall to zero. He called this problem a "liquidity trap," and argued that it would occur if there were a collapse in confidence among consumers and capitalists that encouraged them to seek "liquidity," meaning they would choose to hold on to their money, rather than buy things, until they perceived that the economy was improving.

KEYNES AND THE CLASSICAL THEORY OF UNEMPLOYMENT

Keynes developed several critiques of the classical claim that there could be no long-lasting *involuntary* unemployment, and we will concern ourselves with the two most prominent ones. Remember that for classical economists, lasting unemployment resulted when workers were not willing to take lower wages in declining product markets. Thus, their suggestion for unemployment policy—even in the middle of the Great Depression, when the unemployment rate was 25% in both the United States and Britain—was for the working classes to take lower wages. Keynes saw two fatal errors in this thinking. The first had partly to do with the relative power between workers and their bosses, for it was apparent to Keynes, and almost everyone else, that unless there was a sustained and deepening downturn, workers mightily resisted wage cuts. However, because the classical economists ruled out government intervention as a way to lower wages, nothing was left to do except to wait for workers to see the light and accept the necessary wage cuts. When they didn't—which was almost always—this meant that wages never fell quickly in recessions, preventing the economy from self-adjusting as the classical theorists believed it would. To the classical school, this resistance from workers to falling wages also meant that the recessions should be blamed on them, rather than on the system itself.

The second error of the classical school can be explained like this: suppose that an economic contraction becomes deep enough, and sustained enough, to lower the demand for labor in all the principal labor markets. There would be a point in such a contraction at which wages would begin to fall, when and by how much depending on countless conditions. We have already pointed out that, according to the classical economists, falling wages would lower costs and prices, thus inviting a greater demand for goods and services. In turn, they believed that this greater demand would *automatically* turn around the economic decline. Keynes pointed out, however, that a *general* fall in wages—the largest single part of national income—would likely cause an eventual *decline* in the demand for goods and services that workers buy, rather than an increase encouraged by lower prices.

Keynes offered several other possible consequences of a fall in wages, some of which might be expected to raise expenditures by business firms, but he did not see them as having the capacity to offset the decline in total spending that would come from falling wages. Falling wages, if they did have the effect of reducing total consumer demand, could also greatly reduce the optimism of the capitalists and lead them to reduce their spending on new equipment. This latter possibility was important to Keynes because he knew that the sustained and deep depression of the 1930s had, by 1936, done exactly that in the leading capitalist countries. In general, such a progression would mean that the decline in consumption spending, along with the decline in capitalist spending on capital goods, would send the economy spiraling downward even further.

To Keynes, then, the levels of employment and unemployment depended on a series of factors: the collective decisions of people to spend as consumers and capitalists and to fund government spending programs, the decisions of foreigners to buy U.S. products, the multiplier, and all the remaining parts of his theoretical framework. That is, in his model the unemployed are victimized by crises in capitalism, *and the classical solution of lower wages would only make the crises worse.* In his argument, Keynes came closer than he probably would have liked to Marx's idea of an "industrial reserve army" of unemployed that we discussed in Chapter 3. What these two theories share is the conclusion that unemployment is an inevitable feature of capitalism over which workers have no control and not a matter of voluntary choice on the part of the unemployed. Unemployment goes up when aggregate spending declines, and thus if we are looking for culprits to blame, it would have to be the millions and millions of individuals in households and business firms deciding to cut back on their spending. Unemployment in capitalism, therefore, is *systemic and inevitable*, rather than the result of individual decisions to work or not to work at market wages. It is hard to imagine a more resounding rejection of classical economics than this Keynesian conclusion about unemployment.

THE CURRENT STATUS OF KEYNESIAN ECONOMICS

Aside from pushing from the limelight central parts of classical economics, the principal long-term influence of *The General Theory* has been to broaden the focus of macroeconomics. Today, aggregate sectors of spending, and their dynamic interrelationships, are understood as central to the study of the capitalist business cycle. Keynes had no particular qualms about the microeconomic models that his own mentor, Alfred Marshall, had been so important in bringing to the mainstream; and his principal work in 1936 built on many of the theoretical foundations of the classical school. For this reason, as we have said, Keynes never really left the central tradition of economics. In fact, the macro theory he produced gradually became part of the mainstream, a process that led Paul Samuelson to write in the 1964 version of his textbook that:

> [Today] the broad fundamentals [of Keynes' theory] are increasingly accepted by economists of all schools of thought, including, it is important to notice, many who do not share Keynes' particular policy views and who differ on technical details of analysis. (Samuelson 1964)

Samuelson's point here does not mean, by any stretch of the imagination, that there have not been challenges, before and after 1964, to Keynesian ideas. These have come particularly from economists unhappy with his conclusions about the need for government intervention in the economy. Two of these challenges, called "monetarism" and "rational expectations," have come from the economics department at the University of Chicago, which has been one of the strongest bastions of anti-Keynesian sentiment in the United States academy since the 1930s. There are also "post"-Keynesian economists who believe Keynes' ideas constitute the best understanding to date of capitalism, and they compete for the attention of other academic macroeconomists and the policy makers in government.

It is far beyond the scope of this essay to go into the current academic debate about macroeconomic theory.[4] But there is fresh evidence of the fact that, even after more than 70 years of challenges from some mainstream economists, Keynesian ideas continue to play a major role in current academic debates about the macroeconomy, as we shall see later when we discuss the economic policies of Barack Obama.

KEYNES, THE POLITICAL ECONOMIST, I: ECONOMIC METHODOLOGY

We now want to expand our argument for having included Keynes in a book on political economy. The Keynes you will encounter in your regular textbook will seem to conform to the "scientific method" used by mainstream economists. But there was another important political economy side to Keynes' thinking—a side that demonstrates the broad sweep of his ideas. We will let Keynes demonstrate this by speaking for himself at some length here and below. Writing in 1931, (and using the characteristically sexist language of the time) he said:

> The study of economics does not seem to require any specialized gifts of an unusually high order. Is it not, intellectually regarded, a very easy subject compared with the higher branches of philosophy or pure science? An easy subject, at which very few excel! The paradox finds its explanation, perhaps, in that the master economist must possess a rare *combination* of gifts. He must be mathematician, historian, statesman, philosopher—in some degree. He must understand symbols and speak in words. He must contemplate the particular in terms of the general, and touch abstract and concrete in the same flight of thought. He must study the present in the light of the past for the purposes of the future. No part of man's nature or his intuitions must lie entirely outside his regard. He must be purposeful and disinterested in a simultaneous mood; as aloof and incorruptible as an artist, yet sometimes as near the earth as a politician. (Keynes 1963, 140-1)

Referring more precisely to the quantitative techniques of the mainstream economists, Keynes wrote in *The General Theory*:

> Too large a proportion of recent "mathematical" economics are mere concoctions, as imprecise as the initial assumptions they rest on, which allow the author to lose sight of the complexities and interdependencies of the real world in a maze of pretentious and unhelpful symbols. (Keynes 1936, 98)

As an example of the kind of ideas that Keynes was willing to entertain, consider his explanation of what motivates economic actors in capitalism. In the following passage from *The General Theory*, where his specific focus is what motivates capitalists to invest in capital goods, note that Keynes implicitly dismisses the constricted creature called "economic man" as a misleading description of human behavior.

> [A] large proportion of our positive activities depend on spontaneous optimism rather than on a mathematical expectation, whether moral or hedonistic or economic. Most, probably, of our decisions to do something positive, the full consequences of which will be drawn out over many days to come, can only be taken as a result of *animal spirits*—of a spontaneous urge to action rather than inaction, and not as the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities.... Thus if the animal spirits are dimmed and the spontaneous optimism falters, leaving us to depend on nothing but a mathematical expectation, enterprise will fade and die—though fears of loss may have a basis no more reasonable than hopes of profit had before....In estimating the prospects for investments [in capital goods], we must have regard, therefore, to the nerves and hysteria and even the digestions and reactions to the weather of those upon whose spontaneous activity it largely depends. (Keynes 1936, 162-3, emphasis added)

If we take these three passages together, we can see in Keynes' methodology a far-flung net—or a particularly big vacuum cleaner, if we use the metaphor of U.S. economist Robert Solow—in which to catch things that might help his analysis. For Keynes, apparently, the entire universe of ideas and knowledge had potential for helping theorists understand the world outside the swirl of prejudices and confusions inside their heads. His methodology for studying economic activity broke all the self-imposed bonds of the central tradition. Though he insisted often that economic *theory* was a matter of simple logic, it seems hardly to have mattered to him whether economics was a science. In other words, though Keynes's ideas about the economic world were in some ways deeply embedded in classical thinking, they were outside it in critical ways. Perhaps now, after reading about Veblen and Marx, one can see how much closer his research impulses were to theirs than to those of the economic mainstream. His method of work was that of a political economist with a broad scope and an understanding of the instability and uncertainty that characterize the actual economy.

KEYNES, THE POLITICAL ECONOMIST, II: THE POLITICAL KEYNES

By the early 1920s, Keynes had come to believe in the need for government intervention in certain areas of economic life, and thus the policy prescriptions he offered in *The General Theory* merely extended ideas he had held for some time. The specifics of his antirecession policies will not come as a surprise to readers at this point. When an economy is mired in an economic contraction, Keynes argued, it is a consequence of inadequate spending in all the key sectors. Economic downturns were most likely to originate from a decline in capitalists' purchases of capital goods, because volatile and unpredictable "animal spirits" ruled these expenditures. When the spirits led the capitalists to reduce their spending on buildings and equipment, all those who had been supplying such products before would now be out of jobs and income, and the effects of their declining spending would spill over into the consumption sector, causing a decline there as well. Further dragging the economy down would be a negative multiplier effect, and soon enough an economic crisis would be underway.

Given this theory of how the aggregate economy could quickly slide into a recession, the solution seemed obvious to Keynes: as investment and consumption spending fell, the government should take up the slack in demand by borrowing money to increase its own expenditures, or reducing interest rates to encourage spending in other sectors of the economy. And it didn't matter for what those expenditures were made. As this spending worked its way through the economy, it would ultimately produce a better outlook for businesses, which meant more investment on capital goods. With the help of the multiplier, this would start the whole process moving back upward to recovery and economic growth.

Aside from the Swedes, who succeeded with this kind of fiscal policy before Keynes argued for it, other capitalist governments did not readily jump on the Keynesian bandwagon. The New Deal in the United States generated a spate of new government programs such as unemployment compensation, federal welfare, and public works projects that gave jobs to the unemployed, but the government was not ready to risk the huge deficits that Keynesians were urging as the way to end the Depression. However, starting in about 1940, Keynesian policies were "tested in the field" by most capitalist governments during World War II. In the United States, government leaders tossed aside the classical

school's admonition against government intervention in the economy, including its rule against deficit spending, to fight the war against Japan and Germany. Running massive deficits to finance the construction of bombs, planes, and ships, federal government spending led to a massive recovery. By 1943-44, the unemployment rate fell to its lowest recorded level, about one percent of the work force.

With the war as a gigantic lab experiment that seemed to prove the Keynesian theory, most in the scholarly and political world gradually came to adopt it. After World War II, almost all capitalist nations passed laws, such as the Employment Act of 1946 in the United States, making the maintenance of stable prices and full employment a responsibility for the federal government. These were laws in part written by, and certainly reflecting the views of, Keynesian economists. A symbolic high point of the influence of Keynes occurred in 1963, when in a speech at Yale University John Kennedy used the idea of the Keynesian multiplier to justify the cut in personal income taxes that he was urging upon the Congress as a way to cause a sluggish economy to grow faster. The essentially Keynesian basis of domestic U.S. economic policy remained in place for about 25 years, and in 1971 an economic conservative, Richard Nixon, argued that "we are all Keynesians now."

Even as Nixon spoke, the U.S. economy had already begun to develop a number of structural problems, particularly pockets of hard-core unemployment and rising inflation, that could not be readily resolved by Keynesian policies. These problems in the United States and in Britain in the 1970s deepened through the decade and they propelled into power Margaret Thatcher in Britain in 1979 and Ronald Reagan in the United States in 1980. The public elected these two because it succumbed to their espousal of the old *laissez-faire* slogans of free enterprise, individual initiative, and especially the sentiment that government in principle was a bad thing for the economy. By the middle of the 1980s, the U.S. Republicans and British Conservatives held sway with an increasingly antigovernment rhetoric that became the stated economic philosophy of the major political parties in both countries. After the early 1980s, it became virtually impossible in the United States to be elected to public office at any level if one championed higher taxes. According to some political analysts, George H. W. Bush was pushed from the presidency by Bill Clinton in 1992 because he went back on his famous "read my lips" pledge not to support tax increases.

For his part, Bill Clinton jumped on the bandwagon when he came into power as a "new Democrat," claiming that "the era of big government is over." His economic policies—including "ending welfare as we know it"—

were largely indistinguishable from those of the Republicans. Together with Robert Rubin, his treasury secretary and economic advisor, Clinton squelched efforts in the late 1990s to regulate the financial industry. These two became the great enablers of the robber barons of the day, leaving them free to pursue globalization of the world's economic activity and sketchy financial schemes. This sort of catering to business and financial interests was now considered sound "economic policy," justified by the specious argument that their good fortunes will trickle down to the rest of us by creating a climate "hospitable" to business interests. Partly, Clinton moved toward the Republicans in order to get elected and re-elected; partly he did so because, more than any Democratic president before him, he aggressively and successfully financed his campaigns with money from rich individuals and powerful corporations.

Not surprisingly, given his family background and his conservative economic policies as Governor of Texas, George W. Bush continued to pour out the *laissez-faire* rhetoric, although he contradicted it with his actions such as installing hefty duties on steel imports and signing legislation providing multi-billions of dollars to agribusiness. For all these politicians, sloganeering about the evils of government works as a political strategy. Their actions, however, reveal that they are no more antagonistic to government action than was Keynes, if not being so fits into their re-election strategies, or can add to their personal gain in other ways.

This widespread involvement of government in capitalism is the political reality in all modern capitalist countries, no matter what their politicians say in speeches or at press conferences about "keeping government off of peoples' backs." These same people expect their governments to manage the macroeconomy, and presidents who have failed to do so in the public perception—Jimmy Carter and George H. W. Bush are two recent examples—don't get a second term.

The Democrat, Barack Obama, became U.S. president in 2009 knowing well enough that unregulated capitalism was dangerously unstable and aware, too, that his Republican predecessor had worked with his Congressional allies for eight years to eliminate as many of the rules and regulations as they could. Obama also knew that, in the previous three decades, the U.S. economic order had become increasingly unequal. His schooling at Harvard, including his law degree, and his community organizing in low income areas of Chicago, had kept him from becoming yet another fan of *laissez-faire*. However, his experience in the classrooms and in Chicago neighborhoods did not prepare him for what he was to face as president.

When Obama took office in January 2009, the financial crisis which had exploded in 2007 was already pushing the U.S. economy towards a major downturn. Declining GDP, rising unemployment, and mortgage failures were principle harbingers of a major collapse, one that was spreading around the globe. The public infrastructure—schools, hospitals, roads—was ever more unattended as state governments lost tax revenue and no longer could afford to finance such projects.

In the face of this crisis, the Obama administration pursued a strategy with two central elements, the first of them to make risky loans of hundreds of billions of dollars to a few of the major banks, insurance companies and investment firms to keep them from total collapse. There was wide-spread resistance, mostly outside the government, to this policy because the public saw it as taking care of the banks before taking care of working people. The public reached this conclusion in part because the policy was pressed on Obama by principal economic advisers who were political conservatives, most of them from the banking industry. They included his chief economic advisor, Larry Summers, who had strongly urged Clinton not to regulate derivatives, and had declared that Milton Friedman's "greatest contribution may have been in convincing people of the importance of allowing free markets to operate." Also at the White House as a special advisor was Henry Paulson, Bush's Treasury Secretary who had come to government from being the CEO of Goldman-Sachs. Further, Obama picked as head of the Federal Reserve System Ben Bernanke, an ex-academic, who had claimed at Friedman's 92nd birthday party that, "Among scholars, Milton Friedman has no peers."

With such advisers, it was not surprising that Obama began his fight against the economic downturn by convincing Congress to approve a loan of $182 billion to the country's largest insurance company, A.I.G. In this process, among other favored recipients, Chase Manhattan Bank got $29 billion when it purchased the failing Bear Stearns. Obama also proposed to increase regulations in the financial industry, something the entire public, save that industry, wanted to have in place.

The second major element of Obama's anti-recession policy was passed in 2009 and he called it the American Recovery and Reinvestment Act (ARRA). It included federal tax cuts, allocated over $700 billion to expand unemployment and other social welfare benefits, and aimed to expand income and employment with spending on the public sector, including energy. With this proposal, Obama essentially brought Keynes back to the conference table at the White House where the government forges its economic policies, and many commentators in the media made note of this fact. Obama also proposed a complicated revision to the health care system, with central elements that further regulated insurance companies and funds allocated to try to guarantee insurance coverage to 31 million people without it.

According to most economists, President Obama's stabilization policies were a moderate success. The giant financial firms were mostly safe and had resumed paying out huge bonuses, despite a public outcry against them. In March 2010, Obama signed into law the health care plan, but, as a measure of the kind of resistance he faced to all of his proposals, it was not supported by a single Republican member of the House of Representatives. It also ushered forth a screaming, sometimes violent opposition from a loose amalgam of conservatives opposed to what they considered the dangerous spread of federal government power. The new health care program is complicated, not well understood by most of the population, and many of its elements will come into effect slowly over the years. It will be a long time, indeed, before its efficacy can be determined.

The ARRA had an immediate positive effect on the economy. In 2010 the unemployment rate, as measured by the federal government, fell below 10% for the first time in over a year. (However, it is worth remembering that this measure is fatally flawed because it does not include workers who quit seeking jobs and those who work part-time but want full-time work.) By 2013, the unemployment rate had fallen below 8% and GDP was on the rise, indicating that a recovery was underway. Meanwhile, in Europe, where governments pursued austerity instead of Keynesian stabilization policy, unemployment remained at over 12% and economic activity remained stagnant.

Along with the successful reintroduction of Keynesian fiscal policy, there was a call for significant re-regulation of financial markets in response to the financial crisis. As it became increasingly clear how deregulation created an environment ripe for plunder and pillage, economists and policymakers turned to the ideas of a Nobel prize-winning economist named Hyman Minsky, who had updated Keynes's theories to include a crucial new idea that he called the Financial Instability Hypothesis. This theory is explored in the box on p. 141.

With his successful anti-recession policies, President Obama has reinstated Keynes as part of the dialogue by his willingness to expand the role of government in responding to a major economic crisis. ARRA and his health care plan, in particular, represent a clear break with the neo-liberal policies that most recently originated with Ronald Reagan and which no president since 1980 had vigorously, nor successfully, challenged. Yet, Obama faced a

Minsky and Financial Instability in Capitalism

After the financial crisis, economists around the world began to rediscover the insights of Hyman Minsky, an economist who presciently described the formation of financial bubbles of the type that occurred in 1998 in technology stocks and in 2006 in real-estate markets. Minsky saw himself as a "financial Keynesian" for extending Keynes's ideas to "complex financial relations, markets, and institutions." (Dimitri B. Papadimitriou and L. Randall Wray, "The Economic Contributions of Hyman Minsky," *Review of Political Economy*, 10, 2 (1998), p. 201.) Minsky's Financial Instability Hypothesis (FIH) helps us to understand how financial markets regularly become fragile and unstable in modern capitalism.

According to the FIH, a financial crisis tends to go through five stages: displacement, boom, euphoria, profit-taking, and panic. (John Cassidy, "The Minsky Moment," *The New Yorker*, February 4, 2008.) Cassidy describes the stages as follows:

> A displacement occurs when investors get excited about something—an invention, such as the Internet, ... or an abrupt change of economic policy. The current cycle began in 2003, with the Fed chief Alan Greenspan's decision to reduce short-term interest rates to one per cent, and an unexpected influx of foreign money, particularly Chinese money, into U.S. Treasury bonds. With the cost of borrowing—mortgage rates, in particular—at historic lows, a speculative real-estate boom quickly developed that was much bigger, in terms of over-all valuation, than the previous bubble in technology stocks. As a boom leads to euphoria, Minsky said, banks and other commercial lenders extend credit to ever more dubious borrowers, often creating new financial instruments to do the job.... [T]he securitization of mortgages, ... enabled banks to provide home loans without worrying if they would ever be repaid. (Investors who bought the newfangled securities would be left to deal with any defaults.) Then, at the top of the market (in ... mid-2006), some smart traders start to cash in their profits.

The sell-off, along with other dramatic events (for example, the collapse of Bear Stearns hedge funds) started a full-fledged panic, the subsequent crash of financial markets, the Great Recession of 2008-2010 and the anemic recovery of 2010-2013.

As did Keynes, Minsky advocated policies to correct the flaws in capitalism. He believed in stricter regulations on financial firms to encourage sustainable lending practices and discourage speculation. He also advocated a program where the government would become an "Employer of Last Resort," modeled after the Works Project Administration of the Great Depression, which would guarantee a public sector job at a minimum wage to anyone who could not find a private-sector job. (Papadimitriou and Wray, 1998.) This would help to correct any downturn that threw people out of work, while simultaneously making sure that useful tasks were completed in our communities.

sea of problems: a major economic crisis, the relative and steady decline of the United States in its power to have its way in the world, a rebellion by the Republican Party committed deeply to his failure for a host of reasons, and the abiding disappointment of many of his one-time supporters who saw him worrying more about bankers than about working people. Keynes was back at the White House table, but was this enough of a change? Many political economists, however much they might enjoy Obama's resistance to certain elements of neo-liberalism, see his administration as badly misled by the comforting illusion that U.S. capitalism can be civilized by modest, liberal reforms.

KEYNES AND INTERNATIONAL CAPITALISM

As we have written above, Keynes also was one of the principal designers of the post-World War II system of international finance, with its two major institutions, the International Monetary Fund (IMF) and the World Bank. It is true that Keynes's proposals on key elements of the system were rejected by delegates from the United States, in particular his idea that the international system should be overseen by an international bank especially geared to encourage economic growth. The United States, however, dominated the conference, and it preferred the IMF with the more restricted goal of working only to encourage price stability. Such a policy, of course, favored the United States, with its booming wartime economy, and penalized most of the other 43 allied countries, whose societies had been torn asunder by the war. And both the IMF and the World Bank would eventually become a monumental barrier to growth in many poor nations.

Nevertheless, there was a crucial ideological foundation to the IMF and the World Bank in its inception, one that remained in place at least until the 1970s. This foundation is the idea that capitalism is inherently unstable, it therefore necessitates both domestic and international regulation, and governments are what John K. Galbraith called a requisite "countervailing" power to that of private corporations. This matrix of regulations at both the domestic and international level was an assault on the classical system because "free trade" was, in that system, the analog to an unregulated domestic economy. One observer, looking back on the effects of the system the delegates produced, has written:

> Between 1945 and 1973, when the regime of [international] financial controls remained in effect, the war-ravaged economies of Europe and Asia were rebuilt, and the developed world as a whole enjoyed annual economic growth rates exceeding four per cent, which translated into the virtual tripling of total output. (Cassidy 1998b)

After the 1970s, much in this regard changed. The ideology of "free trade" was a part of the Reagan/Thatcher *laissez-faire* agenda, and picking up where they left off, Democrat Bill Clinton campaigned more vigorously for unregulated international capitalism than any president since before the Great Depression. In their championing of "free trade," presidents Reagan, George Bush, and Clinton used the considerable authority and power of the U.S. government to dismantle the system of international controls established at Bretton Woods. Some regulations, such as those controlling the values of currencies, were dropped in the 1970s. Others, such as the regulation of capital flows across borders, were eliminated in the 1990s as developing countries come under pressure from the U.S. and other powerful capitalist nations to adopt their own "free trade" policies.

Though we cannot know now the ultimate effects on the U.S. economy of the growing encroachment of *laissez-faire* policies, we can safely extract one conclusion from this comparison: the sustained period of economic growth in U.S. history, cited above by John Cassidy—1945-1970—occurred during the period in which both U.S. and international economic policies were most thoroughly Keynesian. It was also the only period in modern U.S. history that has produced a downward redistribution of income (albeit a small one). Since the mid-1970s, this distribution of income in the U.S. has become ever more unequal, and it is now the most unequal of all the industrialized capitalist nations. Meanwhile, growth rates in the developed world declined during the neoliberal era.

As final words on Keynes, we have seen that the Bretton Woods agreement was most importantly embodied in the International Monetary Fund and the World Bank. As we described in our first chapter, for three decades—under the tutelage of Milton Friedman and his "Chicago Boys"—these two institutions developed a policy of bullying poor nations seeking aid into trying to shape themselves into largely unregulated capitalist states. Deregulating the economies of poor countries has meant eliminating labor and environmental protections, "restructuring" government spending to starve social programs, and instituting an array of other reforms that serve the interests of corporations and Western governments. In 1995, the IMF and World Bank were joined by the World Trade Organization, made of up representatives of over 150 nations, with a principal goal of working out interstate agreements that facilitate unregulated international trade—that is, facilitating globalization.

Resistance to the WTO, an organization that is dominated by representatives from the United States and other large capitalist states, erupted in 1999 at its annual meeting in Seattle, Washington. A loose coalition of trade unionists, students, and organizers from a host of other groups, including anarchists and socialists, engaged in activities ranging from speeches and rallies to direct confrontation with the police and some of the organizers of the event. The conference was delayed, and over 600 protesters were eventually arrested for resisting the police, many of whom beat up peaceful protestors. This kind of resistance to the WTO and globalization has continued at most of its meetings, and has been joined by groups from all over the world. The message of the protesters is always the same: the spread of unregulated market capitalism is a boon to giant capitalist firms and can be utterly disastrous to hundreds of millions of people in poor countries and to the environment.

It is hard to imagine unfettered globalization as an outcome Keynes intended—he was more interested in stabilizing currency values, promoting economic growth, and facilitating orderly trade. Like most mainstream economists, Keynes assumed that good policy based on good analysis would win the day. In fact, in unregulated capitalism, the capitalists almost always win the day, and in large part because—as political economists have known all along—they have already won the state before the day begins. Despite all his contributions, Keynes would have made richer ones yet had he spent more time studying economists from the other end of the political economy spectrum, most notably Marx. Doing so might have helped him see more clearly how the capitalists, and the politicians they buy, turn "good' economic analysis into yet another advantage they have on the playing field.

CONCLUSION

Keynes and his ideas are included in this book because he shared two important ways of thinking with political economists. For his study of economic life, no information was outside his purview. He was a thoroughly erudite man, a voracious reader and consummate conversationalist, and he believed that dependence on all the senses—what one had read, heard about, seen, could intuit, and even what one felt—was central to the work of any good economist. This is a far, far cry from the restrictive methodological stance that dominates mainstream economics. Unlike typical mainstream economists, who claim to be "making correct scientific judgments," Keynes never stopped giving his opinions to the day that he died. Keynes also shared with political economists the conclusion that unregulated capitalism is an unsustainable system, and for it to last over the long run its aggregate performance will have to be overseen by a strong government, ultimately more powerful than the most powerful corporations. In our view, Keynes' development of this argument has no worthy rival.

SUGGESTIONS FOR FURTHER READING

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