

Keynesianism and the Crisis

Brian O' Boyle

Introduction



John Maynard Keynes 1883-1946

The economic crisis that gripped the world in 2008 shows no signs of abating, with growth and accumulation generally stuck below their pre-recession levels. The global debt mountain has also reached staggering proportions, whilst investment and employment continue to stagnate. Increasingly commentators realise that this is no ordinary recession. Capitalism is slowly being trapped in a 1930's style depression, as financial meltdown compounds severe weaknesses in the real economy.

As a profession, mainstream economics is completely unable to cope with this development. For 35 years the 'professors of bourgeoisdom' have championed the superiority of the markets, deriding colleagues that dared to cling to the ideas of John Maynard Keynes. The 'Great Depression' had long since past and proponents

of 'efficient markets' used the crisis of the early 1970's to consign the Keynesians' to the 'pre-scientific' dustbin. Instead of stimulating economic activity, Keynesian intervention, they said, had merely succeeded in causing stagflation (inflation and stagnation). Markets could only prosper under total freedom, as a generation of economists' reverted to the laissez-faire doctrines of the 19th century. Milton Friedman became the poster boy for this neoliberal counter-revolution, as deregulation and private enterprise promised an economy endowed with perpetual vitality. The latest collapse of the global financial architecture decisively shattered this neoliberal fairytale. 'Efficient' markets turned out to be massively unstable, whilst the capitalist economy has once again fallen into deep distress. The 'Keynesian crisis' of the 1970's has given way to the 'free market crisis' of the early 'naughties' and unsurprisingly there are numerous Keynesians queuing up to take their revenge.

Nobel Laureates like Joseph Stiglitz and Paul Krugman have become cheerleaders for a return to some form of government intervention. For them the crisis has been a classic case of financial hubris triumphing over the real economy, with the inherent inequality of the neoliberal period merely compounding issues. In a sense we have come full circle, as the currently dominant ideology is blamed for a crisis of the capitalist system. Like the neoliberals' before them, prominent Keynesians' are now attempting to pin the blame on their theoretical rivals, whilst whitewashing the crisis of the 1970's. From the immediacy of the present this strategy may seem convincing, but from the perspective of the last 100

years it is completely inadequate. Since the 1930's free market ideology has alternated with Keynesianism without any fundamental changes to the nature of capital accumulation. *Crises have emerged regardless of the theories, whilst the role of the state has borne little relation to the ideas that legitimate it.*

The consequences of the Great Depression necessitated a massive increase in the levels of state intervention as the industrialised economies geared themselves for war. According to Paul Mattick, the levels of state activity more than doubled, from around 20% in the early 1920's to almost 50% of GNP during the war ¹. Despite shifts in official ideology, this level of activity never contracted to the laissez-faire levels of the turn of the century. The state became a permanent fixture, accounting for at least 35% of economic activity in all the advanced capitalist economies. This obviously gives a lie to the official rhetoric of the neoliberals, but it is no less damaging to the practical pretensions of the latter day Keynesians. The idea that the 'free market' worked perfectly well during neoliberalism is patently absurd. But so too is the idea that what we need is just more state intervention. After all, the state has been consistently intervening to support the economy and the ruling classes.

Keynes' analysis of the developmental tendencies of the system coupled with his focus on investment (and profitability) allowed him rightly to diagnose the death of laissez-faire capitalism. Indeed, his *General Theory of Employment Interest and Money* essentially gave theoretical expression to the practical reality of an aging capitalism. For 80 years the capitalist state has helped to contain the contradictions of

capital accumulation, but with the onset of the current crisis this arrangement may also be reaching its limits. Across the developed world state intervention is almost at breaking point, as public debt spirals and policy interventions become less and less effective. The logic of accumulation is pushing against the limits of the system and because of this it is highly unlikely that Keynesianism can rescue capitalism in the current conjuncture.

Keynes' critique of laissez-faire

In the *General Theory* (GT) Keynes is primarily interested in understanding the factors that determine the total output of a capitalist economy. Like Marx he assumes that everything is "produced by labour and by the results of past labour embodied in assets" though he replaces socially necessary labour time with a marginal benefits/scarcity theory of value ². This gives Keynes a sort of hybrid theory as labour is the sole physical unit of measurement within his system, but prices are regulated by relative scarcity (technical relations) rather than by labour time (social relations). If labour becomes (physically) abundant then its price will fall due to a fall in its (physical) productivity. This is similarly true of capital assets "which command a price according to their scarcity or abundance" ³. In the 19th century capital was still relatively scarce, meaning that both its physical productivity and its price were historically high. This was an age of exuberant investment as entrepreneurs hurriedly reinvested their profits in a frantic race to maximize profits ⁴.

Because workers consume all of their wages, the level of investment is the cru-

¹1969: 142

²GT:213

³ibid

⁴GT: 213

cial determinant of *effective demand* in a capitalist society ⁵. Investment demand was extremely forthcoming in the 19th century and laissez-faire economics merely reflected the reality of a vigorous and healthy capitalist society. Under the influence of Jean Baptiste Say, 19th century (vulgar) economics accepted the idea that merely supplying useful items was enough to stimulate the corresponding demand (Say's Law). This was as true in the labour market as in the markets for goods and services and it implied that capitalism could never operate below a *fully resource employed equilibrium*. As soon as any worker offered their labour there would be an entrepreneur ready to demand it. As soon as any entrepreneur decided to save, there would be another one waiting to invest. Any momentary disparities between supply and demand would quickly be rectified by changes in prices and the upshot was a vision of markets working perfectly well, unencumbered by state interference.

As a student at Cambridge, Keynes had assimilated this doctrine in its entirety, but when he looked at the reality of the 1930's it was clear that something must have gone drastically wrong. Unemployment was not only historically high; it had been stuck there for a number of years. This meant that the economy was operating way below its full potential and he regarded the explanations of his laissez-faire contemporaries as woefully inadequate. When asked about the persistence of unemployment, Keynes' professor insisted that the problem was due to labour's refusal to accept a reduction in their real wages ⁶. This meant that unemployment was essentially *voluntary* and

could only be corrected when real wages fell in line with the labour's productivity.

Keynes objected to this assertion on the grounds of fairness, but he also highlighted a number of theoretical problems with Professor Pigou's theory of unemployment ⁷. In the first place he argued that it was patently ridiculous to argue that labour becomes "more truculent in the depression than in the boom - far from it"⁸. In depressed conditions labour is generally more amenable to reductions in pay, *but it is often impossible to take a cut in real wages in a capitalist economy*. If workers accept reductions in money wages they will soon find their employers reducing their commodity prices. To remain competitive entrepreneurs must pass on reductions in money wages, meaning that "there may exist no expedient by which labour as a whole can reduce its real wage to a given figure by making revised money bargains with the entrepreneurs"⁹. In this scenario labour could remain *involuntarily unemployed*, unable to do the things demanded of them by the bourgeois professors. This was reason enough to refute the logic of the classical theory, but there was an even more fundamental reason, related to the nature of the employment relation. Despite the fiction of Say's Law, labour simply cannot *choose* to be hired in a capitalist society. This decision is made by the capitalists' and in periods of recession it is highly unlikely that labour will be employed no matter what it is willing to accept in return.

Capitalists' are not only concerned with the ratio of wages to productivity; they are *concerned with whether their products will actually be sold*. Entrepreneurs

⁵GT: 27

⁶GT: 17

⁷GT: 272-279

⁸GT: 9

⁹GT: 13 original emphasis

choose the number of workers they believe “will maximize the excess of proceeds over factor cost” meaning that employment is ultimately set by the levels of expected returns¹⁰. In a bourgeois society it is *profitable* employment that ultimately counts. Workers will only be hired if they are commercially viable and this will ultimately depend on the levels of effective demand in society at large. In a depression this demand would be intolerably low, meaning that Say’s Law was completely indefensible. Capitalist factories lay idle while people starved, hoards of money were accumulated without anyone willing to invest them, and all the while the economy languished in perpetual stagnation. For Keynes the assertion that supply automatically creates its own demand was a dangerous fiction borne of the idea that the capitalism was a kind of barter economy without money or entrepreneurial self-interest. In the end the classical theory may well “represent the way in which we should like our economy to behave. But to assume that it actually does is to assume our difficulties away”¹¹.

The Keynesian System

According to the *General Theory* the level of output in society is determined by the intersection of Aggregate Supply (AS) and Aggregate Demand (AD). Having discarded the assumptions of a fully employed economy, Keynes argued that the particular nature of capitalist development meant it could “remain in a chronic condition of subnormal activity for a considerable period without any marked tendency toward recovery or towards complete collapse”¹². This sub-optimal equilibrium was almost

unique in human history, as in previous societies demand (human need) almost always exceeded the levels of productive capacity. This meant that any crisis was, at base, a natural disaster with little to be done by way of policy. In capitalism on the other hand, it was perfectly possible for the productive capacity to outstrip the available demand. Far from a natural disaster, this would be a crisis born of technical relationships and a series of ‘fundamental psychological laws’ that could be countered through government intervention¹³.

Convinced that the ultimate end of all production was consumption, Keynes noted that a society’s *marginal propensity to consume was always less than 1*. This means that if a society creates an extra €100 worth of income (AS) it will only spend a fraction of this (AD) before saving the rest (say 20%). This fraction should be relatively stable, but it would also decline through time as the wealth of the community gradually increased. In order to sustain a level of effective demand sufficient to encourage entrepreneurs to invest, there must therefore be ever greater opportunities for profitable ventures. Otherwise supply in one year will outstrip effective demand and expectations for the following year will be decisively weakened. Keynes captures the nature of the problem in the following passage

The psychology of the community is such that when aggregate real income is increased aggregate consumption is increased but not by as much as income. Hence employers would make a loss if the whole of the increased employment were to be devoted to satisfy-

¹⁰ibid

¹¹GT: 34

¹²GT: 49

¹³GT: 247

ing the increased demand for immediate consumption. Thus to justify any amount of employment there must be an amount of current investment sufficient to absorb the excess of total output over what the community chooses to consume. Moreover the richer the community the wider will tend to be the gap between its actual and its potential output a wealthy community will have to discover ampler opportunities for investment if the saving propensities of its wealthier members are to be compatible with the employment of its poorer members¹⁴.

As capitalism ages there is an ever increasing necessity to produce new means of production. Without this, effective demand falls below aggregate supply, with a good deal of the exigencies of capitalist society lying in the precariousness of the investment decision¹⁵. Unlike consumption, investment is an inherently future oriented activity based on *expectations* as to future yields. This makes it incredibly unstable with the animal spirits (conventions) that underpin these decisions being subject to violent swings that are generally irrational¹⁶. Even in the best of times, an ‘atmosphere congenial to the average business man’ must be cultivated lest the hysteria of the business community override their spontaneous optimism¹⁷. Yet even this may not be sufficient in a society characterised by an ever increasing stock of capital. In deciding whether or not

to invest the entrepreneur must weigh the marginal efficiency of capital (profit rate) against the cost of the investment (interest rate). The marginal efficiency of capital (MEC) is itself determined by the physical productivity of an asset multiplied by the (expected) future prices of its output. The more abundant the capital stock becomes the cheaper is the stock they produce, meaning that

If there is increased investment in any given type of capital during any period of time the marginal efficiency of that type of capital will diminish as the investment in it increases, partly because the prospective yield will fall as the supply of that type of capital is increased¹⁸.

There is a tendency for the MEC to fall through time meaning that as the need for investment increases the private returns to investment are moving in the opposite direction. This is a ‘realisation problem’ that becomes extremely difficult to resolve within the confines of capitalist production, particularly when entrepreneurs have a variety of options besides productive investment. Keynes believes that outside the special conditions of the 19th century “the desire of the individual to augment his wealth by abstaining from consumption has usually been stronger than the inducement to the entrepreneur to augment the national wealth by employing labour on the construction of durable assets”¹⁹. Given the inherent risks of capitalist investment, individuals have a strong psychological preference for liquid assets that

¹⁴GT 27, 31

¹⁵GT: 153

¹⁶GT: 154

¹⁷GT: 162

¹⁸GT 136

¹⁹GT: 348

can be used for immediate transactions, stored for precautionary purposes and/or used to speculate on the stock exchanges. In a monetary economy with complex financial markets it is paper (fiat) money that is used as means of exchange, a store of value and a vehicle for making speculative returns. All of this means that individual wealth holders have an extremely strong preference for liquid money particularly in times of crisis. In the classical theory interest was paid as a return for saving, but merely hoarding wealth pays no interest as Keynes quite rightly points out²⁰. In the General Theory interest is the reward for choosing *not to hoard* as individuals part with their liquidity for a specified period²¹. Because liquidity preferences are generally so strong, purchasing capital assets cannot be rendered sufficiently attractive without complex financial markets. If entrepreneurs' know they can liquidate assets they are more likely to invest, but this reduction in uncertainty comes at the cost of a sharp rise in speculation. Assets that command interest on the open market are liquid by definition. The more liquid an asset, the higher its future price is likely to be, meaning that a whole class of investors emerge with no intention other than to beat the market. Keynes thinks this is an inevitable outcome of investment markets organised around the desirability for liquidity, but he nevertheless laments that instability that this brings forth,

Of the maxims of orthodox finance none is more anti-social than the fetish of liquidity the social object of investment should be to defeat the dark forces of time and ignorance which envelop our future. The actual, private object of

the most skilled investment today is to beat the "gun", as the Americans so well express it, to outwit the crowd and to pass the bad, or depreciating half crown to the other fellow.²²

Instead of directing capital to its most socially advantageous ends, speculators continually disrupt the process for short term rewards. The capital development of a country is likely to be severely hampered by the instability of the financial markets and this introduces yet another difficulty in sustaining the requisite levels of effective demand. We earlier highlighted the problems associated with a falling MEC and a decreasing MPC within the circumstances of 20th century capitalism. Now we have an extra difficulty as the interest rates demanded by holders of liquidity are likely to be higher than the entrepreneurs are willing to accept. Interest rates are sticky downward to such a degree that under the prevailing institutional and psychological conditions, an aging capitalism will not be able to maintain full employment. The post war experiences in the USA and Britain were the concrete manifestations of this phenomenon, as an overaccumulation of capital meant that the MEC was declining faster than the rate of interest on monetary assets. In this environment no one felt the urge to invest and the resulting depression was a standing testament to the poverty of laissez-faire economics.

Managing Demand

Of all the fictions characterising neoclassical economics, Say's Law is by far the most important. If supply creates its own demand the capitalist economy nec-

²⁰GT : 167

²¹ibid

²²GT: 155

essarily tends towards a fully resource employed equilibrium. This means that society's scarce resources are continuously allocated to their most appropriate ends by the individual decisions of the entrepreneurs. Far from inherent instability, the capitalist economy is characterised by timeless balance and social harmony. Each actor receives exactly what they contribute to production meaning that there can never be a problem with income distribution. Private investment is always equivalent to private savings meaning there is no possibility of hoarding or speculation. Money is effectively neutral save for its ability to facilitate transactions, whilst the whole process tends towards maximizing social welfare (being the outcome of the maximizing choices of society's members).

For Keynes all of this amounted to a little more than a dangerous fiction. Say's Law had hardly described the workings of the economy during the rapid accumulation of the 19th century, but in the midst of the 1930's depression, 'doing nothing' was tantamount to giving up the capitalist system. Keynes wanted to save capitalism not to bury it, and his policy prescriptions always flowed from the perspective of the 'enlightened bourgeoisie'.

In the short term, Keynes argued that it was always possible to stimulate effective demand through deficit spending. This involved replacing private investment with government initiatives funded out of direct taxation or monies borrowed on the open market. The existence of an investment multiplier meant that any money invested by government would eventually more than pay for itself²³. So long as there is slack in the economy "it will be possible to increase employment by increasing expenditure[as]

effective demand spends itself partly by affecting output and partly in affecting price"²⁴.

State induced investments could help to regulate the levels of effective demand, once there was a corresponding level of monetary expansion. Higher incomes generally increase the interest rate through a higher level of money (transactions) demand. This could be countered by increasing the money supply in such a way that "employment will [further] increase in proportion to any increase in the quantity of money"²⁵. Taken together, fiscal and monetary interventions could resolve some of the most immediate problems of the Great Depression.

These are the policies most closely associated with Keynesianism today, but the General Theory also contained important prescriptions for the medium and longer terms. Regardless of how effective they were Keynes' short run tools could not work in isolation. Rather, there had to be more drastic steps taken to redistribute income from wealthy savers to ordinary consumers. The need for abstinence had legitimated the inequality of the laissez-faire system on the basis that the resulting savings were socially beneficial. Keynes turned this logic on its head, justifying a more progressive taxation policy on the basis of the need to stimulate consumption²⁶. Effective demand was the most important consideration and any shift in income towards labour had to be accompanied by political supports for capital investors. Anxious to minimize the destabilizing effects of hoarding and speculation, Keynes argued that the political authorities should "reduce the interest rate to that point relative to the schedule of

²³GT: 113

²⁴GT 284, 285

²⁵GT: 295

²⁶GT: 321

the marginal efficiency of capital at which there is full employment”²⁷. Moreover, he explicitly championed financial regulations that would harness the ingenuity of speculators in the interests of the community²⁸.

Taken together these policies would go along way to solving the contradictions of capitalist investment, but eventually the state may have to take more central control. Near the end of the *General Theory*, Keynes’ concludes that such are the difficulties in sustaining the conditions for profitable investment that it may well be necessary to replace the market with socialised investment,

The State will have to exercise a guiding influence on the propensity to consume, partly by fixing the rate of interest, partly through its scheme of taxation and partly, perhaps in other ways. Furthermore, it seems unlikely that the influence of banking policy on the rate of interest will be sufficient by itself to determine an optimum rate of investment. I conceive therefore that a somewhat comprehensive socialisation of investment will prove the only means of securing an approximation to full employment.²⁹

This was certainly no an attempt to mimic the state capitalism of the Soviet Union, as private initiative and personal freedom still demanded that “the ownership of the instruments of production [was

not] important for the State to assume”³⁰. The capital stock was to remain in the hands of the bourgeoisie, but Keynes was clear that a functioning society could only be forthcoming if the most objectionable features of laissez faire capitalism had been destroyed.

The best way to achieve this was to increase the stock of capital until it became so abundant that its holders could expect to receive little more than the “labour costs of production plus an allowance for risk and the costs of skill and supervision”³¹. This would involve lowering the MEC to a point at which private capitalism would cease to exist and Keynes was clear that he saw “the reinter aspect of capitalism as a transitional phase which would disappear when its work was done”³². The death of the rentier would also be accompanied by “the euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity value of capital”³³. With these conclusions Keynes was effectively diagnosing a moment when capitalism as currently constituted would no longer be able to function. This explains the depth of his solutions as he tried desperately to manage the inevitable transition in interests of the (enlightened) bourgeoisie.

Assessing the theory

Theoretical merits

When writing about his theoretical rivals Marx made sure to distinguish between the classical political economists’ and the vulgar apologists who buttressed the ideas of

²⁷GT: 373

²⁸GT: 375

²⁹GT: 378

³⁰ibid

³¹GT: 375

³²GT: 376

³³GT: 376

the ruling classes. Smith and Ricardo had made important advances in understanding capitalism. Vulgar economy intentionally discarded these advances in favour of a utopian fiction of perfectly working markets. Keynes sees himself as a critic of classical political economy. In fact, he is challenging the vulgar (*neoclassical*) economics that had usurped the classics' in the marginal revolution (1870's).

Say's Law was the theoretical upshot of assuming individual choices based on full information and flexible prices. In this best of all worlds' the investment decision was no more problematic than buying a loaf of bread or a bag of sugar. The actor merely weighed the marginal benefit (profit) against the marginal cost (interest) and made their decision. If too few people chose to invest the price of money would fall until they changed their minds. This was also a world without speculation, hoarding or unemployment as flexible prices always ensured that demand was equal to the relevant supply. The advance on this system made by Keynes should be obvious. Just as they had needed genuine knowledge at the outset of capitalism, the bourgeoisie were desperate for answers during the Great Depression. Laissez-faire had proven useful in the heady days of the 19th century, but only a deeper understanding of 'actually existing capitalism' could help the ruling classes in the 1930's.

The General Theory set out to provide this understanding by focusing on the dynamics of monetary production under competitive conditions. Keynes essentially replaced the CMC (barter) economy of the neoclassicals, with an MC...M' economy driven by the profit calculations of the entrepreneurs. This allowed him to capture important aspects of the system intentionally neglected by his vulgar opponents. The role of profit was brought front and

centre, as employment was only ever forthcoming when deemed to be profitable. The precariousness of the investment decision was also highlighted as was the role of liquidity in a modern economy with complex finance. Yet by far the most important advance was the foregrounding of *capitalist dynamics*. In the neoclassical system time is utterly irrelevant as Say's Law holds in perpetuity. For Keynes on the other hand capitalism necessarily changes as it ages. Wealth and capital had advanced considerably over time and although these developments were generally to be welcomed they also brought attendant dangers,

To fill the gap between net income and consumption presents a problem which is increasingly difficult as capital increases each time we secure today's equilibrium by increased investment we are aggravating the difficulty of securing equilibrium tomorrow.³⁴

Laissez-faire capitalism was both the pinnacle of human achievement and doomed to collapse under the weight of its internal contradictions. The dynamics that had brought the bourgeoisie to power were undermining their current position and Keynes set out to develop a theory that could stabilise the system and manage the transition. Reflecting on Soviet Russia, Keynes famously stated that he could never "adopt a creed which, preferring the mud to the fish, exalts the boorish proletariat above the bourgeois". He crystallized his reformist politics in the same analysis, admitting "I can be influenced by what seems to me to be justice and good sense; but the class war will find me on the side of the educated bourgeoisie". For all

³⁴GT: 105

of his talk on the objectionable aspects of capitalist society, Keynes was ultimately a bourgeois snob and whilst he could glimpse the problems that undermined capitalism he could never fully unpack them.

Theoretical limitations

MPC

With his theory of a steady decrease in the marginal propensity to consume (MPC) Keynes partly exposed the irrationality of a society based on social production and private accumulation. Convinced that consumption was the ultimate goal of capitalist expansion, Keynes was perplexed by the fact that an ever greater proportion of the surplus was being turned into capital. But from a Marxist perspective this is immediately intelligible given the nature of capitalist society. Consumption is derivative in any society driven by the logic of accumulation, whilst an ever increasing stock of equipment is nothing more than the physical embodiment of a process built on exploitation.

Keynes' political perspective meant that he never questions the legitimacy of capitalist production, preferring instead to fasten onto the disproportions between consumption and investment. He also introduces a 'fundamental law of psychology' to explain why aging capitalism consumes less of its income. This essentially moves the explanatory burden away from the class relations of a capitalist society towards the behaviour of rich consumers and it helps to explain the naiveté of Keynes' prescriptions. The idea that we should redistribute income from savers (capitalists) to consumers is akin to arguing that you can starve an anorexic back to health. Profit is the fuel that drives capitalism and Keynes' assertion that redistribution

will improve the situation fundamentally misunderstands the nature of capitalist relations. The problem was not so much *underconsumption* as *overproduction* with only a reassertion of the rate of profit convincing the capitalists' to reinvest.

Liquidity Preference

A similar error emerges in Keynes' discussion of liquidity preference. Keynes is no doubt onto something when he highlights the destabilizing effects of financial markets, but he significantly overextends the analysis by focusing on the psychological merits of liquidity. According to the General Theory the specific behavior of financial intermediaries is best explained by a 'fundamental psychological factor' as the rich consistently prefer liquidity (savings) to investment³⁵. This makes the investment decision seem far more precarious than it actually is as it leaves out the powerful logic of capitalist competition. Keynes understands that a capitalist society must always find ways to consume its output. What he misses is the logic of accumulation which drives the capitalists to reinvest.

Competitiveness bestows key advantages in the race to accumulate, and whilst a number of capitalists may choose to hoard and/or speculate, the bulk of them will be driven to expand. Interest is not a reward for refusing to hoard, it is the price the ruling class charges for bestowing the ability to engage in the production of surplus value. Granted some of this capital may find its way into unproductive speculation, but it is simply not true that capitalists' generally prefer to hold liquidity. This is really only true in the conditions of a crisis and/or in the conditions of a falling rate of profitable return. Class relations rather than psychological proclivities

³⁵GT: 247

can best explain the reluctance to invest as the accumulation of capital makes it progressively harder to squeeze enough profit.

Falling MEC

Like Marx, Keynes highlights an historical relationship between an expanding stock of capital assets and a decreasing return on productive investment. Keynes never actually explains why this must be so³⁶. But his scarcity theory of value implies that it is at least partly due to a declining level of physical productivity³⁷. Meanwhile the products of capital also lose value (become cheaper) as they lose their ability to command a premium (economic rent). Having earlier focused on the role of *ideas* (the laws of psychology), Keynes now relies on *physical* abundance causing disproportionalities. He sees capitalism not as a system of exploitative relations, but as a system of technical possibilities - with the optimum level of capital investment potentially being managed by the bourgeois state. Keynes' earlier myopia in relation to accumulation is here reproduced in relation to exploitation.

In Marx the drive to accumulate is both the reason for an ever expanding stock of capital *and* the declining rate of profitability. In Keynes this is lost to a theory that mixes technical relations, group psychology and political naiveté. Having previously argued for radical redistribution, Keynes now seems to think that you can sustain the capitalist system without any capitalists. This is the only conclusion to a system without profits, as the stock of capital is supposedly to be raised to the point at which it commands no return (beyond cost and supervision). The entire *raison d'être* of capitalist society would end in a

whimper, as the class of exploiters sat back and watched their power disintegrate.

That this has failed to materialise is hardly surprising. Capitalism came into the world 'dripping from head to toe in blood and dirt' and it is highly unlikely to leave without a similar struggle³⁸. All of this leaves Keynes' political prescriptions in dire straits and his analysis of demand management is no less problematic.

Effective Demand

According to the General Theory every euro spent by the state should more than pay for itself through the investment multiplier. If this were correct deficit spending would be endlessly sustainable as the debts of the bust would easily be settled in the subsequent boom. Over the last 80 years state involvement in the economy has increased dramatically, but so too has the levels of public debt. Far from settling their commitments through expansionary policies, the state has accumulated debt in ever greater quantities. The last thirty years in particular have seen the levels of debt simply exploding as the state tries to defend the interest of the ruling classes. In spite of this capitalism is undoubtedly in long term decline. Keynesianism has not been able to stave off crises and this, more than any theoretical weaknesses, exposes the limitations of the General Theory.

Historical Weaknesses

For almost forty years after its publication the ideas first put forward in the General Theory were widely believed to have stabilized capitalism. Even the arch conservative, Richard Nixon, famously declared that 'we are all Keynesians now' in his ac-

³⁶Alexander, 1940: 127

³⁷ibid

³⁸Marx, 1954: 712

ceptance of demand management in the early 1970's. The crisis of the 1930's had given way to the post-war boom and the ability to intervene in the economy was credited with providing the conditions for capital to accumulate.

In reality the Keynesianism of the *General Theory* had never been truly tested. Roosevelt's 'New Deal' most closely resembled the Keynesian ideal, as a massive public works programme was initiated in the early 1930's. This policy had some early successes, but by 1937 the US economy was back in recession. The Keynesian stimulus was simply too small to be effective. In the end it was not the states ability to stimulate *consumption* that saved capitalism, but its ability to stimulate *waste* and *destruction*. The crisis conditions of the 1930's led inexorably to conflict, as the most advanced capitalist states geared themselves for war. Nazi Germany took the lead, reducing its unemployment levels of by over 7 million people as it rearmed and restructured. This was soon mirrored by the war economies of the US, the UK and the Soviet Union. Capitalism had finally found a way to recover. But it was not through the progressive reforms hoped for by Keynes, but through the imperialist rivalries of contending ruling classes.

All-out warfare provided the conditions for the state to take over large parts of the capitalist economy. Private interests had to be subordinated to defeating the enemy and just as Keynes had envisaged, the state could accomplish things that private capital simply couldn't. The war effort increased production to full capacity, stimulating novel technologies and reducing unemployment. Industrial (military and civilian) production increased exponentially alongside new infrastructural

projects initiated by the state. In these conditions effective demand was no longer a problem, but it was *the previous destruction of capital values that sustained the boom long after the war had ended*.

The Great Depression had seen a massive destruction of capital values as prices plummeted and corporations went to the wall. According to Andrew Kliman, the prices of goods and services fell in the US by 25% between the years of 1929 and 1933³⁹. The prices of the fixed assets of US corporations fell by 23%, whilst the national wealth fell by around 59%⁴⁰. This led to the destruction of massive swathes of capital value which were further compounded by the physical destruction of the Second World War. It was the combination of these two phenomena that led to a sharp recovery in the rate of profit as the amount of capital stock per productive labourer plummeted⁴¹. The depth of the previous crisis set the stage for the strength of the subsequent boom.

Capitalism emerged from the war completely reinvigorated just at the moment that the entire European continent needed reconstruction. In all of this it was the rhythm of accumulation that truly mattered. It is true that the state played a key role in harnessing the energies of the private sector, but the boom would have been impossible without the previous destruction of capital values, whilst the nature of the states intervention was strictly determined by the class realities of the capitalist system.

According to Keynes capital abundance should be increased in the civilian goods industries until it became so abundant as to become unprofitable. In reality, it was only when the profit rate had been sufficiently restored that capitalism could

³⁹2012: 22

⁴⁰ibid

⁴¹Mattick: 1969

recover. Nowhere was there a sharp redistribution of income towards labour. State intervention remained a tool of ruling class interests, deployed to stimulate large scale capital projects and military superiority.

In the decades after the war the reconversion towards civilian technologies proceeded alongside a comparatively small reduction in military spending. A ‘permanent arms economy’ replaced the laissez-faire capitalism of the 1920’s as the Cold war protagonists vied for geo-political superiority. This helped to legitimate a continuing role for state intervention, but there were also a number of additional benefits associated with a central co-ordinating institution. Because of its size the state can organize capital projects (infrastructure, energy etc) that are beyond the reach of much of the private sector. State induced investments of this variety stimulate capitalism by providing a basis for the hiring and exploiting of extra human labour power. Alongside this the state began to “ensure the international competitiveness of the different components of the national capitalism, consciously restructuring industry, shifting surplus value from one sector of the economy to another [and] endeavouring to even out cyclical fluctuations⁴².”

All of these attributes helped capitalism to recover, but it was the levels of military spending that really made the crucial difference. For Keynes continuing levels of military spending would have been an anathema (he died in 1946 and so didn’t get to witness them). After all, he believed that the capitalist economy should facilitate ever greater levels of consumption through the increasing development of the means of production. In the event

it was the means of destruction that were actually developed. Harman estimates the levels of military spending quadrupled in the USA and increased significantly in the UK and the Soviet Union throughout the 1950’s⁴³.

The military logic for this expansion should be obvious, but from a Marxist perspective it also had an important effect on the rate of accumulation. Military spending is a form of waste expenditure as it produces nothing useful for the next round of production. The surplus value used to produce military hardware is either stockpiled or used in battle. Either way it is not reinvested and this leads to a general slowdown in the rise of the organic composition of capital (the ratio of constant capital or ‘outlay’ to variable capital or wages - the MEC in Keynesian terminology). Arms spending also provided a ‘Keynesian’ stimulus in-so-far as it brought human labour power under the control of capitalist firms. This increased employment and growth throughout the economy without the usual increase in the rate of accumulation. According to Harman, the “levels of surplus value remaining in the hands of private capital *after* the state had taken its share for arms was actually *higher* than before”⁴⁴. But “with so much potentially investable surplus going on arms, it was not surprising that the level of civilian investment remained low and the organic composition of capital rose only slowly from the low level to which it had been reduced by slump and war”⁴⁵.

Contrary to Keynes it was the relative scarcity of capital rather than its abundance that created the conditions for capitalism’s recovery, but only so long as the profit rate remained healthy. The

⁴²Harman, 1982: 63

⁴³ibid: 79

⁴⁴ibid: 79

⁴⁵ibid: 80

arms economy could slow down the rise in the organic composition of capital, but it couldn't arrest it. Capital was still accumulating and over time the universal laws of capitalist production began to reassert themselves. By the 1970's the rate of profit had fallen considerably. On top of this, competition had grown considerably as Germany and Japan caught up with their rivals.

Neither Japan nor Germany had been permitted to engage in military spending, leaving their respective capitalist's to engage in a frantic level of accumulation. This undoubtedly increased the organic compositions of their national capitals but it also reduced the prices of their output. Starting from such a low base, capitalist production remained viable and with cheaper goods than their militarized counterparts the logic of economic competition began to overwhelm the logic of military competition. The permanent arms economy had reached its limits and the problems that emerged merely confirmed this.

The crisis of the 1970's was 'Keynesian' only in the sense that the state increased spending in response to a falling rate of accumulation. In previous periods this may have helped stabilize the situation. In the 1970's it merely increased the levels of existing prices without stimulating economic activity. Stagflation was the visible manifestation of a faltering economy, but rather than pinning the blame on the system, right wing ideologues attacked (relatively) progressive policies that had never been implemented.

Keynesianism had promised a more equal income distribution. Neoliberalism set out to reverse this logic by attacking labour and freeing up capital controls. Laissez-faire was resurrected as the official state ideology but without any real reduc-

tions in official state spending⁴⁶. What did happen was a reorientation of the state to support accumulation through privatisation, liberalisation and stabilization (of inflation) (The Washington consensus). The state would now play a major role in increasing exploitation, integrating capital markets, reducing welfare supports, expanding the relations of accumulation (particularly into China) and helping capital to reorganise internationally.

This helped to reverse the fall in profitability, but only with a massive surge in public indebtedness. Debt essentially replaced military spending, as cheap credit helped sustain demand in the face of attacks on wages and conditions, whilst the integration of capital markets allowed the rich to make profits from loans and speculation. Hundreds of millions of Chinese workers were also sucked into the capitalist system, but the underlying problems never went away.

Overaccumulation has been a chronic problem since the 1970's and the active interventionism associated with Keynesianism has only served to make matters worse. Capitalism has traditionally renewed itself by destroying value, but since the 1970's this process has largely been interrupted by a combination of state refinancing and state guarantees⁴⁷. Instead of smoothing out the contradictions of accumulation, the state has contributed to their accentuation, as 'too big to fail' becomes the by-word of state policy everywhere. Despite all of its ingenuity the latest crisis is a testament to the fact that state intervention is reaching its limits. Keynes' great merit was to foresee a time when capitalism could not survive without the support of the state. Perhaps this latest crisis will prove that even this may not be enough to save the system he always supported.

⁴⁶Mattick, 2011: 72

⁴⁷Kliman, 2012: 24

Conclusion

The General Theory marked the highpoint of bourgeois political economy in the 20th century. By challenging the assumptions of vulgar economy, Keynes gained insights that went far beyond the static utopia of Say's Law. Capitalism was destined to change as it ages rendering a fully employed equilibrium progressively more difficult to achieve. Keynes rightly traced these problems to the nature of the investment decision, but his class perspective limited his theoretical achievement. As a supporter of the ruling classes, Keynes could glimpse the problems of investment without ever fully unpacking them.

For Keynes labour was the source of all production in a capitalist society but the bourgeoisie were the vanguard of all social progress. This meant that exploitation could never be admitted. It also meant that Keynes' political prescriptions were extremely implausible. Understanding the significance of a falling return on investment, Keynes argued for a managed transition to a form of state capitalism. The mixed economy would be a transitory stage on the way to a society characterised by capital abundance and plentiful *consumption*. That this never materialised is hardly

surprising given that capitalism is based on the exploitation of the working masses at a sufficiently high level to sustain profitability. Without this the system tends towards crises characterised by a fall in production and in consumption.

Unable to admit this Keynes is effectively asking for the end of capitalism in the interests of the bourgeoisie! But rather than destroying the basis of capitalist profits, the ruling class has done everything possible to sustain them. Over the last 80 years state intervention has always been done in the interests of our rulers. Waste and destruction have increased exponentially as large scale destruction has accompanied wholesale attacks on the conditions of labour. Nowhere has income redistribution been on the cards except when moving from the poorest to the richest. Keynes' solutions may never have been possible; but the problems he diagnosed were very real. Accumulation becomes increasingly difficult as capitalism ages and state interventions have not been able to resolve the contradictions of capitalist production. Military spending and public debt have merely helped to extend the rule of the bourgeoisie. Our job is to break this rule with a revolution of the working classes.

References

- Alexander S.S (1940). 'Mr. Keynes and Mr. Marx'. *The Review of Economic Studies* Vol 7 No 2 p. 123-135.
- Harman, C (1982). *Explaining the Crisis - A Marxist Re-appraisal*. London. Bookmarks.
- Keynes, J. M (1997) *The General Theory of Employment and Money*, New York Prometheus Books.
- Kliman, A (2012) *The Failure of Capitalist Production - Underlying Causes of the Great Recession*, London. Pluto Press.
- Marx, K (1954) *Capital Volume One- A Critique of Political Economy*, Moscow Progress Publishers.

Mattick, P (1969) *Marx and Keynes - 'The Limits of the Mixed Economy'*, London. Merlin Press.

Mattick P (2012) *Business As Usual - The Economic Crisis and the Failure of Capitalism*, London Reaktion Books.