



REVIEW ARTICLE

KEYNES AND HIS BATTLES

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A review article based on the book by Gilles Dostaler, 'Keynes et ses Combats' (Paris, 2005), translated by Niall Mann, and published by Edward Elgar, Cheltenham, 2007, 374 pp.

By the time he died on 21 March 1946, John Maynard Keynes had become world-famous but had nonetheless lost his most important battles.

Following the World War I, as the British Treasury's representative at the Versailles peace conference, Keynes was unable to convince the victors that their reparations demands on Germany would be economically impossible and politically disastrous. *The economic consequences of the peace* (1919) established his reputation as an unusually effective essayist. However, though respected, in the 1920s and 1930s he never really persuaded the Treasury that elimination of unemployment was possible – probably because he argued that permanent full employment would require a 'somewhat comprehensive' social and political control of private investment. Subsequently, *The general theory of employment, interest and money* became, from 1936, the foundation for an expected, though unconsummated, revolution in Economics and in policy-making. Then, in the 1940s at Bretton Woods, leading the British delegation, Keynes failed again to ensure that the new international institutions (the World Bank and the International Monetary Fund) should prioritise full employment and stability rather than financial austerity and free trade. This last lost battle was an extension of an earlier failed campaign against a return to the Gold Standard in the 1920s – both had been Keynesian attempts to mitigate the deflationary biases in orthodox policy.

These were real disappointments; and they are the running theme of Gilles Dostaler's book. Together, they offer insights into the

unsatisfactory nature of economic policy and its intellectual environment which persists now. The associated policy controversies set the tone for the postwar evolution of capitalism – hopeful, but never quite as prosperous, magnificent or beneficent as it might have been. Dostaler is a French Canadian historian of economic thought and a sense of melancholy is never far from the surface in his book.

For a time after 1945, the political implications of Keynesian theories and policies seemed to be working their way through to a different form of managed capitalism. It would be, the optimists supposed, less capricious, more regulated, integrating a stronger role for government and other public institutions, with steadily-expanding welfare guarantees, more democracy and a more inclusive social capital to which an engaged populace was expected to contribute.

A virtuous circle was imagined between the constitutive elements of the postwar mixed economy – high employment, high and secure incomes, high levels of public and private activity, high degrees of equality and a sustained dedication to the institution-building that would underpin all of it.

The subsequent six decades comprised thirty 'Keynesian' years and thirty years of comprehensive repudiation of Keynesianism. This rupture confirms the positive, as much as the contradictory, repercussions of attempts to subject modern economies to an activist progressive policy regime. It is instructive to consider the optimists' expectations.

First, notional commitments to full employment defined many postwar governments. Second, there was an accompanying presumption that policy processes in the capitalist polities would reliably prescribe the requirements of national economic management. Third, an emerging literature offered intellectual defences of the idea of the mixed economy, as something more transformative than well-managed capitalism. Fourth, the rapid development of welfare states and public budgets after 1945 implied that income compensation arrangements would become a powerful counter-cyclical force in development. (Income security was soon seen as an adjunct to democratic political stability itself.) Finally, there was a gradual expectation, initially submerged though increasingly apparent, that conservative and social democratic political regimes or

movements would each benefit from the mutually-supportive role of the different elements of Keynesian economic management.

Even though Dostaler does not accept that Keynesian policy was responsible for the long boom, the 1945-74 developments did seem to presage a more or less structural evolution towards a potentially deliberated 'mature capitalism' – a capitalism both wealthy and democratic, reconciling equality with prosperity, with a capacity to institutionalise societal mastery over market processes, seemingly irrespective of ideological or volitional complexion. The developments also re-introduced into economic thinking an empathy for the historical and empirical approach to analysis that had flourished in Germany in the second half of the nineteenth century but which had been purged from mainstream discourse by the more formal and deductive 'marginalist revolution', especially in the English-speaking countries. The movement from the 1870s to redefine Economics as the 'science of allocation' (of universal relevance), instead of a systematic enquiry into wealth and productive activity (implying a more context-specific scope), was temporarily in abeyance.

Keynes himself never abandoned formalism completely but his preference was for a policy-oriented discipline using intuitive and interpretive techniques. He understood economic activity as a struggle to transform reality, he saw progress as moral as well as economic and he thought that any economy contained unanalysable aspects that therefore demanded an 'artistic sensibility' as well as rationalist enquiry. The physicist Max Planck quipped that the study of economies was too complex for his kind of science. Consequently, in common with other heterodox traditions in the history of economic thought, the Keynesian method allowed organic analogies; and Keynesian policy favoured (nationally-specific) experimentation. These ideas were consistently held and extended throughout his lifetime but to a considerable extent derived from the 'presuppositions of Harvey Road' – the family's Cambridge-oriented (and largely conservative) sense of the public duty of the educated, the milieu in which his parents had encouraged an elitist combination of respect for tradition and intellectual non-conformism (chs 3 & 4).

Such paradoxes defined the worldview of his friends and acquaintances too – both in his youth (particularly through his intimates in the Bloomsbury group) and later. The list of his associates is informative: George Bernard Shaw, Bertrand Russell, Aldous Huxley, Lytton Strachey, Ludwig Wittgenstein, G.E. Moore, George Rylands, Leonard Woolf, Leslie Stephen, Virginia Woolf, Vanessa Bell, Clive Bell, Quentin Bell, Duncan Grant, Roger Fry, Rupert Brooke, T.S. Eliot, E.M. Forster and D.H. Lawrence; also Sidney & Beatrice Webb, H.G. Wells and William Beveridge. Through his wife, Russian ballerina Lydia Popokova, from 1925, there was Henri Matisse, Pablo Picasso, Salvador Dali, Ernest Ansermet, Leonide Massine, Ninette de Valois, Frederick Ashton, Vaslav Nijinsky and Sergei Diaghilev; also Igor Stravinsky and Sergei Prokofiev.

There was also Rudolf Hilferding, Max Weber (a participant at Versailles), Albert Einstein, Maxim Gorky, Max Planck, Carl Melchior and Benedetto Croce, and the Swedish industrialist Marcus Wallenberg. And of course, Woodrow Wilson, Georges Clemenceau, Lloyd George, Jan Smuts, Stanley Baldwin and Ramsay MacDonald, Winston Churchill, Lord Beaverbrook and, eventually, Clement Atlee, FDR, Harry Dexter White and John Foster Dulles. Keynes even corresponded with Lenin and indirectly with Freud and was related (through his brother Geoffrey's marriage) to the Darwin family.

What appears to have united artists and social scientists, politicians and policy-makers, musicians and social critics was a discursive temper – while alert to the possibility of setback and pusillanimity, they all encouraged forward-thinking as a vocation in the arts, science and politics.

Dostaler's account of Keynes' life is obviously neither the first nor the most comprehensive, but it exemplifies again the capacity of scholarship on Keynes to reflect its subject's compassion, intelligence and willingness to re-think conventional understandings. *Keynes and his battles* is beautifully, passionately, written and it clearly delineates Keynes' struggles to forge an analytical method appropriate to its subject matter – modern economies with a history of evolution towards possibilities unimaginable to logical enquiry. Three chapters are devoted to ethics and the influence of Bloomsbury on Keynes' methodological

approach to economic knowledge; and another to Keynes' aesthetic preoccupations (– he sponsored painters such as William Roberts and Duncan Grant, was a trustee of the National Gallery and founded the Arts Council of Great Britain).

Many Australian Keynesians (among them Geoff Harcourt, John Nevile, Rod O'Donnell, Athol Fitzgibbons, not to mention members of the immediate postwar generation) have made substantial and internationally-recognized contributions to the academic study of economic policy and economic philosophy. Nonetheless, their combined impact on policy during the past 30 years of unemployment and structural change has been largely insignificant. Their politically-active colleagues regarded them as irritants.

The story is just as depressing in the UK where some, like Keynes himself, reached the House of Lords – Nicholas Kaldor, Thomas Balogh, John Eatwell. The stranglehold on policy by the dominant institutions (treasuries and central banks, the financial sector and, more recently, the academy itself) has grown progressively stronger, confirming Keynes' 1930s judgement that a worm 'has been gnawing at the insides of modern civilisation and is responsible for its present moral decay' (p.22 in Dostaler).

The most prominent of contemporary paradoxes is one that Keynes understood implicitly – the capacity of modern capitalism to generate enormous wealth alongside insouciance towards slumps and unutilised resources and prolonged unemployment. This concern with social cohesion and its opposite featured already in the economics of both the more radical Karl Marx and the more conservative Joseph Schumpeter. However neither of these schools shared or developed counter-cyclical policy prescriptions – Marx because he refused to accept that the 'capitalist state' could be genuinely democratic; Schumpeter because he was avowedly less dirigiste than Keynes. All three traditions recognized, however, that 'solutions' would be ceaselessly dogged by chronic tendencies to under-investment (pp.190-195). (Dostaler nonetheless highlights Burke's influence on Keynes' anti-materialist understanding of well-being – p.89.)

The so-called revolution was 'bastardised', as Keynes' disciples put it, by the steady victories of orthodoxy over interventionist ideas through the 1950s and 1960s. From these missed opportunities we can discern the key political phenomenon of the 'age of affluence': apparently effective interventionist political ideas are readily stripped of cogency, to be assigned anachronistic or utopian status by the bulk of responsible economic commentary. This is an intellectual world away from the position that Keynes would have wanted or presumed (pp.256-257).

That political and intellectual hopes were not fulfilled during the postwar boom, that the Keynesian momentum was forfeited, in part accounts for the political and intellectual malaise that beset us in the long recession of the post-1974 period. Perhaps surprisingly, in view of the relentless expansion of politically-mandated activity in the twentieth century, contemporary academic political science has produced little accumulated knowledge or consensus on the possibilities and limits of politics – the surge of 'state failure' writing over the past five or six decades and 'state capacity' scholarship since the 1980s, notwithstanding. Because both Marxism and public choice theory have been equally cynical about policy-making, institution-building and state-building, academic commentary has been responsible for the most alarming misjudgements.

What democratic politics should do about economic direction is rarely matched by research into what it has achieved or in what respects it has failed. In the second of two 'Interludes', the book discusses the uneasy relationship between Keynes and political activity during the interwar period: the period when he produced oft-cited essays such as 'Am I a Liberal?' and 'Economic possibilities for our grandchildren'.

In the 2000s, baseline knowledge of what an economy is, of the long term consequences of growth and transformation, of how we judge whether an economy is in crisis or not, or even of whether and how policy should respond to structural change in other than an accommodative manner are all still as incomplete, unsatisfactory and contested as in 1936 or 1946.

Dostaler appreciates (while others celebrate) that Keynesian ideas have been in decline since 1974 and that this has been the period of globalisation, industrial restructuring, manufacturing decline and

underutilisation of labour. For contemporary Keynesians the incongruity is complete – Keynes' ideas, intended to positively influence the level and structure of employment, were abandoned precisely when they were most pertinent. In the popular imagination, they were inherently national in orientation and could not survive the globalisation (cross-national financial movements, rapidly increasing trade and off-shore investment) that has characterised the past thirty years. In more critical accounts, national political priorities became less committed to national cohesion, equality, evenly-distributed consumer affluence and the integration of labour into macroeconomic policy-making that had appeared to be part of postwar compromises almost everywhere.

In fact, the intellectual and political displacement had more to do with discourse and fashion than economic imperatives: the countries most in conformity with the liberal, anti-Keynesian vogue have not been those with the best performances (ability to control unemployment and inflation) in these years. Nations prepared to develop unusual institutional responses to recession and to use political powers for industrial upgrading have succeeded. Keynes himself was aware of internationalisation but favoured self-sufficiency: a 'luxury we can afford if we happen to want it.'

This is a matter of ongoing controversy not only within Keynesian circles; although Marxists and liberals have been more or less on the same side, against the Keynesians.

Within a few months of each other in 2006, John Kenneth Galbraith and Milton Friedman both died. There can scarcely be a more graphic reminder of the utter discord that prevails in economic thinking and policy advice than the chasm between these two – a rupture in which Keynesianism has of course been implicated. But it's been a methodological as well as a political one. Keynes and Galbraith, and many conservatives subsequently, opposed the view that an abstract formulation of the market system could ever usefully guide policy.

From the 1940s to the 1980s, F.A. Hayek accused Keynes of ignoring the 'great truths' of inherited scholarship. This critique became the essence of the liberalism of Milton Friedman and James Buchanan too (the latter attempting to embed public spending in anti-democratic constitutional

limits). 'Socialist extravagance' was said to be the unintended by-product of Keynesian policy, and that permanent restraints on political ambitions were warranted. For Keynes' critics, full employment was not always preferable to unemployment if the former encouraged ill-discipline in an activist polity. By the time of the Thatcher period, inflation, trade unions, incomes policies and out-of-control fiscal policy could be exhibited as evidence of the long-anticipated sclerosis of what an earlier biographer, Robert Skidelsky, disparaged as the 'Keynesian mandarinat'.⁷

For the second time, laissez faire doctrines were re-asserted. Just as the social liberalism of J.S. Mill, L.T. Hobhouse, John Hobson and Joseph Rowntree was forgotten (pp.96ff), pre-Keynesian (and utopian) theories of money and monetary policy, improbably, thwarted the evolutionary development of new political institutions and innovative techniques of economic management. The conjunction of prosperity and stabilisation measures officially dissipated.

The Keynesian critique of monetarism (inflation is primarily a monetary phenomenon and that 'fiscal discipline' can contain it) – from which emerged Keynes' famous utterance of 1923 that 'in the long run we are all dead' – was one of the most significant victims of the iatrogenic counter-revolution (pp.166-175). Instead, anti-Keynesianism triumphed from the 1970s, almost delineating the new political ethos broadly as well as reasserting the mantle of economic policy orthodoxy. Keynesians were infuriated by the intellectual shift, seeing it as the revocation of a long term civilising trend towards institutionalised and deliberated politics and as a resurgence of a sort of 'religious and moral fundamentalism'.

Dostaler observes that, in the famous final sentence of the 'General Theory', Keynes greatly 'overestimated the role of ideas and the power of reason' (p.258). Political intractability in the face of the necessity of institutional development remains one of the most significant lacunae in Keynesian approaches to politics and policy-making.

An under-appreciated dimension of Keynesian thought is its analysis of labour (chapter 7). Keynes held, as did Veblen and the christian socialists before him, to a plausible version of the classical labour theory of value: without human labour, nothing gets done (p.178). For the institutionalists

and 'social economists' in the 1890s, this implied that policy ought always to ensure that labour be as well-remunerated, as safe, as participatory and as enjoyable as possible. Keynes, of course, saw these propositions as political obligations which he wanted extended to the responsibility for making labour as *regular* as possible (p.178). For Dostaler, this context for Keynes' assertion of the primacy in a decent society of full employment is important: something so crucial to the generation of societal prosperity should be insulated from volatile, unregulated and even long term structural trends. Unemployment, Keynes claimed, was more a function of organisational and institutional conditions than of a breakdown of conformity with market strictures, which, in this area at least, were morally inadmissible. Low or flexible wages were counter-productive, even if the struggle against the market elements of the 'labour market' would be a matter of humanity's evolution (pp.193-200). Keynes was not to know, though he would not have been surprised, that all the low-unemployment countries in the decades after the mid-1970s have been high wage economies.

Many of the implications of these ideas were developed not by Keynes himself (p.255) but by 'post-Keynesians'. In the decades after 1946, new generation Keynesians including Joan Robinson and Michal Kalecki in Cambridge predicted that, because the Keynesian lessons concerning social control of investment remained unlearned, unwanted fluctuations in economic activity and a return to recession, the denial of 'cumulative prosperity', were inevitable (p.189). On cue, in 1974, it happened, albeit headlined by simultaneous unemployment and inflation. This established the post-Keynesians as primary advocates of incomes policy – to control inflation, but also to control the conflict over income distribution which was its ultimate cause. There was always a Keynesian explanation for unemployment and inflation, together with a set of mutually-compatible institutional solutions. There was equally suspicion towards others: especially the Keynesian contempt for monetary policy as a means of economic regulation.

From the start post-Keynesians saw post-1974 inflation as a result of institutionalised conflict (whereby unemployment didn't prevent unions bargaining up wages, and falling sales didn't prevent businesses increasing prices) and not as a consequence of increases in the 'quantity

of money' or public spending. Incomes policy has been just as abhorrent to the official family of policy custodians as control of investment, despite the history of successful attempts to make the level and distribution of income subject to policy, not least in Australia.

We no longer have institutional prophylactics against the tendency for productive capacity to outrun employment; and the chronic excess capacity that exists in almost every branch of production has been ignored (p.188).

Post-Keynesians' ambivalence towards rationalism (p.33) derives largely from its denial of most law-like regularities in mature capitalist economies – except for market-generated crises – mainly because uncertainty pervades the calculation of decision-makers. Post-Keynesian issues (for example, budget deficits, incomes policies, redistributive wage-setting arrangements, de-commodification, and the state as employer of last resort) should have become the basis of political campaigns, debates and progressive thinking. Instead they succumbed to the intellectual spoliation known as the 'third way' in the 1990s (p.120). Actual developments in policy, including in Australia, ran ahead of a disinterested academy. Little evidence exists from OECD countries that good economic performance is impeded by high taxes, high wages, strong trade unions, generous welfare systems or public investment.

The key to Keynes' own politics was his endorsement of capitalism alongside his distrust of markets: the market sends inappropriate signals, urging investors to desist when more is needed and to be exuberant when restraint is warranted. Keynes described himself, repeatedly, as a liberal socialist (p.80). This position, common among institutionalists and economic sociologists, justified a prudential anti-rationality and experimentation. (In other anti-formalist traditions these ideas are rendered as 'the market is a good servant but a bad master'.) It also informed probably the most disputatious element in post-Keynesian thinking – the so-called 'Cambridge controversies in the theory of capital', covered rather too briefly by Dostaler (pp.199-200). These signalled the lack of agreement over the meaning of capital – if capital cannot be defined or measured (because of the conceptual difference between amounts of finance, physical productive equipment and the social conditions that allow the various elements of production to be

combined), how can profit be its legitimate reward? Hence, even for Marxists, the interests of capital are increasingly hard to define. Kalecki argued that capitalists' desire to control their environment was sure to undermine their profitability.

The tendency for policy-makers to support only those institutional interventions which facilitate market-generated adjustment is the most prejudicial legacy of pre-Keynesianism – both barbarous and based on superstition (p.211). Times of structural change need imply neither political impotence nor a competitive 'race to the bottom' – if appropriate institutional structures exist.

Risk and uncertainty are central elements of capitalism and of the market mode of adjustment, but this does not make them elemental to human progress: cumulative prosperity depend more on each polity's capacity to lock-in past technological accomplishments than on flexibility (p.260). This entails constantly increasing commitments to longterm infrastructure investment. As we become wealthier an increasing proportion of our income can be, and needs to be, diverted away from immediate consumer consumption and towards collective consumption in the forms of roads and telecommunications, energy and housing, health and education, environmental repair and regeneration, water conservation and relocation, and a plethora of types of public amenity.

Although the intellectual activity we might have expected from post-Keynesian and institutionalist writings hasn't really emerged, the 'trend of things' is towards such 'Keynesian and evolutionary' developments anyway. Dostaler's book helps us conclude that there is more than one way to institutionally manage an economy. Global pressure to keep polities 'weak-in-principle' seems to have failed, even if a significant contractionary bias in conventional policy remains – and with it the prospects of yet another slide from lop-sided and somewhat decadent affluence to a low-investment future.

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