The educated bourgeois

By Martin Thomas

JOHN Maynard Keynes, who died 50 years ago this year first came to fame in 1919 with a pamphlet that denounced as unworkable the Allies' plan to make defeated Germany pay huge amounts in compensation for World War 1. He was active not only as an economic theorist but also as a journalist, civil servant and political figure on the fringes of the Liberal Party.

Through his book, *The General Theory of Employment, Interest and Money* (1936), he fundamentally shifted the terms of orthodox debate on economics.

By the 1920s, orthodox economics had developed a whole theoretical system based on the balancing of supply and demand.

At a very high wage, everyone would be keen to work, but the additional production to be got by hiring an extra worker would not be sufficient to make it worthwhile. At a very low wage, demand for labour would be high but many workers would not consider it worth the trouble. Balance would be reached when the wage was just equal to the additional production got by hiring an extra worker, and just not high enough to persuade the idle and reluctant who remained jobless to offer themselves for work.

For an orthodox economist, therefore, the only possible cause for unemployment (beyond the temporary 'between jobs' type) was wages getting stuck at too high a level. As Keynes put it, such an economist "may sympathise with labour in refusing to accept a cut in its money wage... but scientific integrity forces him to declare that this refusal is, nevertheless, at the root of the trouble".

In fact, most of the economists did not sympathise with labour at all! Their theory was designed to prove that profit was the "natural" reward of capital, and that wages were fixed "naturally" too, so that a fight for better wages could do no good and might even do harm, by causing unemployment.

Their "dismal science" was also designed to prove that governments could do nothing much against unemployment or poverty. When trade unionists demanded better wages or more aid for the jobless, the Treasury would reply: it can't be done! The budget must be balanced! The free market must have its way! Labour governments in 1924 and 1929-31 echoed what the Treasury "experts" told them.

Keynes was no socialist, but he was liberal-minded and instinctively disrespectful of complacent orthodoxy. He argued that unemployment was not caused by high wages, or any other quirk. It was a chronic disease of free-market capitalism.

In the orthodox theory, as Keynes put it, "money makes no real difference except frictionally." It figures only as a convenient token to facilitate exchange, not as a store of value. Keynes looked more closely at the role of money.

He showed that, far from automatically balancing supply and demand, the capitalist free market could, and would, produce unsaleable stocks of goods on one side, and needy people unable to buy those goods for lack of cash on another, while piles of idle cash were held by the rich.

Total market demand is made up by consumption and investment. Investment in machinery and equipment, Keynes argued, is determined by the rate of profit which capitalists expect from that investment.

> *"Keynes was a snob in his political views. Against Marxism he wrote: 'How can I adopt a creed which, preferring the mud to the fish, exalts the boorish proletariat above the bourgeois and the intelligentsia...?'"*

That expected profit rate, he thought, was generally low in mature capitalism. (He explained profits as being due to the 'scarcity' of capital: as capital became more plentiful, profits had to decline). At any shock, expectations of profit fall lower still.

Result: a decline in investment. And closely following on that decline will be an increase in the general desire to hold wealth in the form of cash, rather than lending it at interest. The rate of interest will be forced up, worsening the decline of investment by making it harder for entrepreneurs to borrow.

The decline in investment will lead to a much bigger decline in overall effective demand, and therefore in employment, through a process which Keynes called the "multiplier". £1 million less demand for equipment, for example, will mean £1 million less income for workers and capitalists in industry. That in turn will mean less demand for the consumer goods otherwise bought by those people. Suppose they would have spent 80% of the £1 million on consumption, and saved the rest. Then there is a loss of £800,000 in demand for consumer goods.

That in turn means a further £800,000 loss in incomes; and following on from that, yet another loss in demand, £640,000 this time... When the process has worked itself through, then in this example the total loss of demand is £4 million. And there is a corresponding loss of jobs.

Prices and wages chase each other down a spiral. And, with the rich holding on to their cash, the demand for luxuries and for investment goods remains low, too.

There are counteracting factors; but Keynes saw no reason to suppose that they would be enough to push investment up to a level allowing full employment.

"So, failing some novel expedient, there is no answer to the riddle, except that there must be sufficient unemployment to keep us so poor that our consumption falls short of our income by no more than the equivalent of the physical provision for future consumption which it pays to produce today".

What did Keynes propose? A willingness by central banks to increase the supply of cash in times of downturn, and thus to keep the rate of interest low, would help. That would not, however, be enough. The state must undertake additional investment. If it does so, the multiplier works the other way. £1 million extra spent by the state will produce £4 million total boost to demand, and a corresponding boost to employment.

For the state to "overspend" is not therefore folly: in a slump it is the wisest policy. To balance the government budget is folly.

As the "scarcity-value of capital" falls, the state will gradually have to take a commanding role in investment. "A somewhat comprehensive socialisation of investment will prove the only means of securing an approximation to full employment". This would, however, preserve much of capitalism: it would, indeed, be "the only practicable means of avoiding the destruction of existing economic forms in their entirety" by socialism.

Keynes was something of a snob in his political views. Against Marxism he wrote: "How can I adopt a creed which, preferring the mud to the fish, exalts the boorish proletariat above the bourgeois and the intelligentsia...?" Against the Labour Party his chief complaint was the importance within it of "the trade unionists, once the oppressed, now the tyrants, whose selfish and sectional pretensions need to be bravely opposed".

"Ought I, then, to join the Labour Party", he asked himself. "Superficially that is attractive. But looked at closer, there are great difficulties.

"To begin with, it is a class party, and the class is not my class. 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".

Yet the main leaders of the labour movement embraced Keynes's theories eagerly. Here was a respected man of science giving support to the view that wage cuts were not the answer to unemployment, and support to their demands for public spending. Here was an alternative to the assaults of the Tories, free from the horrors of revolutionary socialism.

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In one sense Keynes was more pessimistic about capitalism than Marx was. Keynes thought capitalism was sinking into a permanent slump, as the rate of profit fell, while Marx argued that capitalism would continue to lurch through booms and slumps as long as the working class did not overthrow it.

Keynes's extreme "pessimism", however, allowed him to conclude that there would be no alternative for the bosses but to accept an increasing role of the state in investment and the "euthanasia of the rentier" — the quiet death of the inactive capitalist who lives off dividends or interest without playing any part in industrial management.

Once the bosses had accepted that, the new state-regulated capitalism would be stable. Thus Keynes transformed his pessimism into optimism.

He complained that "the difficulty is that the capitalist leaders in the City and Parliament are incapable of distinguishing novel measures for safeguarding capitalism from what they call bolshevism", but clearly believed that it was only mental rigidity, not anything more fundamental, which held up the "capitalist leaders" from adopting his "moderately conservative" recommendations.

For Marx, there was no chance that the profiteers would quietly fade away. For Marx, profits are not determined by technology or nature. They are not an index of the "scarcity of capital" (and, in fact, Marx argued, the whole idea of a long-term "scarcity" or "excess" of capital is a confusion).

Profits are determined (within limits — but very broad limits) by the class struggle. If profits fall, the profiteers will try to restore them by cutting wages and speeding up labour. They may succeed. If the workers do not overthrow capitalism, then eventually, backed up by the pressure of mass unemployment on the employed workers, the bosses will succeed.

They will lay the basis for a new boom. In that boom, yet again, the accumulation of capital will lurch ahead of the market and the possibilities of profit-making, and the conditions will be created for another slump. The whole process contains vast complexities — many different factors may be the immediate cause of a slump — and the idea of regulating it smoothly by a careful expansion of state investment is fantasy.

For all that, "Keynesian" policies of increased state spending may indeed "work" in the short run to pull the economy out of slumps. The conditions which lead capitalists to subordinate their interests to a "socialisation of investment" by the state are not, however, those of the liberal regime which Keynes hoped for. The most thorough putting into practice of Keynes's recommendations came not through the bright idealists of the New Deal but through the hard-faced men who administered the war economies of 1939-45. When the labour movement embraced Keynes's theories, it tied itself to the chariot of state capitalism, not socialism.

After World War 2, a new bloodless, bowdlerised Keynesianism emerged. The question of falling profits was pushed out of the picture — in the boom of the 1950s and '60s, it looked as if that could be done safely — and the problem was redefined as one of short-term dips in investment below the level needed for full employment, to be corrected by short-term running adjustments to monetary, tax and state spending policies.

Keynesian economists argued that their policy of adjustments to public spending had made capitalism stable. Events were to indicate that the truth was rather the opposite. More than the Keynesian public spending policies permitting capitalist prosperity, it was the capitalist prosperity permitting the public spending policies.

From the early 1970s, capitalism lurched into stagnation and acute instability because of a general decline in its rates of profit and decrease in the viability of its international trading and financial arrangements.

Now "Keynesian" public spending brought with them a long list of problems for the capitalist state.

Keynes's had always been a theory which took the national economy as its basic unit, in an epoch when capitalism is increasingly an integrated international system. Considerations about foreign trade, capital flows, and so on can easily be added to the Keynesian scheme — and, indeed, Keynes himself was an expert on international trade — but the international framework is an extra factor tacked onto the national unit, rather than being the starting point of analysis.

This flaw took its toll in the 1970s. Profits do not come from the natural "scarcity value" of capital: they are an expression of surplus value, the value produced by labour in excess of the amount paid in wages. Public spending is a deduction from that surplus value, it therefore tends to reduce profits. Capitalist states with high public spending tend to lose out in international competition.

Increased public spending and increased employment strengthen workers' fights for higher wages. In a situation where capitalists are desperately striving to reverse a fall in their profit rates, they generally respond by trying to outstrip the higher wages by higher prices. There is an inflationary spiral. Public spending boosts also push up prices directly. Inflation and low interest rates are liable to lead to balance of payments problems.

"Keynesianism" became discredited in the 1970s. It was ousted by new versions of the old pre-Keynesian dogmas. Yet Keyne's criticism of those dogmas has still not been answered.

The Black Tower

Say that the men of the old black tower,
Though they but feed as the goatherd feeds,
Their money spent, their wine gone sour,
Lack nothing that a soldier needs,
That all are oath-bound men;
Those banners come not in.

There in the tomb stand the dead upright,
But winds come up from the shore:
They shake when the wind roar,
Old bones upon the moutain shake.

Those banners come to bribe or theaten,
Or whisper that a man's a fool
Who, when his own right king's forgotten
Cares what king sets up his rule.
If he died long ago
Why do you dread us so?

There is the tomb drops the faint moonlight,
But wind comes up from the shore:
They shake when the winds roar,
Old bones upon the mountain shake.

The tower's old cook that must climb and clamber
Catching small birds in the dew of the morn
When we hale men lie stretched in slumber
Swears that he hears the king's great horn.
But he's a lying hound:
Stand we on guard oath-bound!

There in the tomb the dark grows blacker,
But win comes up from the shore:
They shake when the winds roar,
Old bones upon the mountain shake.

WB Yeats