THE ECONOMIC THEORIES OF JOHN MAYNARD KEYNES

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THE ECONOMIC THEORIES of John Maynard Keynes formulated in his book, *The General Theory of Employment, Money and Interest,* published in 1936, modify his former theories and are a reflection of the general crisis of capitalism, which was aggravated by the economic crisis of 1929.

The victorious Socialist revolution in Russia, accompanied by the revolutionary upheaval in many countries in the rest of Europe, made him fearful for the survival of capitalism on the European continent. He wrote in 1919:

> In continental Europe the earth heaves and no one but is aware of the rumblings. There it is not just a matter of extravagance of "labor troubles"; but of life and death, of starvation and existence, and of fearful convulsions of a dying civilization.*

Keynes was more optimistic as far as England was concerned. He believed that the English workers would pull British capitalism out of its postwar crisis. However, the mass unemployment which followed the crisis of 1929, and the struggles of the workers for bread and jobs, made Keynes fearful of the revolutionary implications of these struggles.

Before dealing with the economic theories of Keynes it is important to discuss briefly his philosophy and method.

THE PHILOSOPHY AND METHOD OF KEYNES

The main moving force of society, according to Keynes, is psychology. The regulating force of capitalist society is the "psychological characteristic of human nature."* The average man is "strongly addicted to the money-making passion."** Without this passion, without the activity of the huckster and his willingness to take a chance, there would be no progress. The money-mad capitalists are sensitive individuals. Their nervous systems are easily affected. They are, according to Keynes, subject to hysteria, and even their digestions and their reactions to the weather affect their actions.

Luckily, says Keynes, the "waves of irrational psychology" are not permanent. There are periods when the outlook for gain is encouraging, and then the capitalists act quite rationally.

The method of Keynes is rooted in his philosophy; it is subjective and non-historical. His economic system

* John Maynard Keynes, *The Economic Consequences of the Peace,* Harcourt, Brace, New York, 1940, p. 4.

* John Maynard Keynes, *The General Theory of Employment, Interest, and Money,* Harcourt, Brace, New York, p. 91. (Hereinafter referred to as *The General Theory.*

** *Ibid.,* p. 374.

is an isolated, "closed" system, operating in all historic periods and epochs. He does not deal with monopoly and imperialism. His failure to do so is a conscious one, since it permits him to avoid a discussion of the worst features of capitalism and the main causes of its decay and of imperialist wars and fascism. Keynes' followers try to present him as an enemy of the vested interests, while the truth is that Keynes was their staunch defender. "I am sure," he wrote, "that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas . . . it is ideas, not vested interests, which are dangerous. . . ."*

PRODUCTION AND EMPLOYMENT

Keynes' economic theories are those of the vulgar economists. He follows Alfred Marshall and borrows from the under-consumptionist school. His theories deal only with secondary phenomena of capitalist production and exchange.

Keynes' description of the capitalist process of production is meager. He merely states that the capitalist buys all the necessary means of production and hires labor. The wages paid for labor and management are the "factor cost"; the wear and tear of machinery and what the capitalist buys from other capitalists is the "user cost." The capitalist "maximises" his profit; in other words, he seeks to employ only that amount of labor which will yield the highest profit. If the employment of additional workers will reduce the "marginal efficiency of of capital," (*i.e.*, the amount of profit), then no more workers can be employed. ". . . the amount of employment," Keynes writes, "is indeterminate except in so far as the marginal disutility of labour sets an upper limit."*

Industry reaches the "equilibrium level of employment" when no more workers are hired and none are fired. Keynes' "equilibrium level of employment" is misleading, since it does not mean the abolition of unemployment.

The "income" or profit of the capitalist, Keynes writes, "We can . . . define . . . as being the excess of the value of his finished output sold during the period over his prime cost."** How the capitalist obtained this excess of value over cost, we are not told.

Keynes conceals the fact that the source of the excess value over the cost price is the surplus value created by labor. In this way he tries to hide the nature and source of capitalist exploitation and the basic contradictions of capitalism.

Keynes treats capitalist economy as a static economy in which the influence of technological development does not operate. But technological development is utilized by the capitalists to increase the productivity and intensity of labor. Increased pro-

* *Ibid.*, pp. 383-384.

* *The General Theory*, p. 26.
** *Ibid.*, p. 53.

ductivity results in the production of a greater volume of commodities with a relatively smaller number of workers. The greater production of value also results in a greater mass of surplus value, and, hence, of profit. The employment of a smaller number of workers, which accompanies the increased production of surplus value, and the huge accumulation of capital leads to the creation of a permanent army of unemployed workers. Says Marx:

> . . . in fact, it is capitalistic accumulation itself that constantly produces, and produces in the direct ratio of its own energy and extent, a relatively redundant population of laborers, *i.e.*, a population of greater extent than suffices for the average needs of the self-expansion of capital, and therefore a surplus population.*

The unemployed workers compete for jobs with the employed. This competition tends to reduce wages and the standard of living for all workers. Keynes and his followers, in setting out to discover the cause of unemployment, and find a cure for it under capitalism, ignore this major contradiction of capitalist production, stated above by Marx.

REAL AND NOMINAL WAGES

Keynes criticized the older schools of bourgeois economics for ignoring the problem of real wages and centering their attention on the problem of nominal wages. The pre-Keynesian school of vulgar economists advocated the reduction of nominal wages to their lowest minimum as the only source of increased profits, of greater accumulation of capital and extended production, and, therefore, of a greater volume of employment. Keynes argued that such a policy may benefit some capitalists, while it may be harmful to others who cannot force wages down. The real method of increasing the profits of the capitalist class, he stressed, is the method of reducing the real wages of the workers: "When money wages are rising . . . it will be found that real wages are falling; and when money wages are falling, real wages are rising."* He further argued that when real wages decline, profits increase; and increased profits raise the "marginal efficiency of capital," which results in an increase in the volume of employment. According to Keynes, "an increase in employment can only occur to the accompaniment of a decline in the rate of real wages."**

What Keynes advocates is high prices and inflation as a means of increasing the profits of the capitalist class and reducing the income of the working class.

It is worthy of note that in discussing prices Keynes leaves out of consideration monopoly prices, thus making it appear that monopoly prices are the exception. With monopoly prices left out of consideration, Keynes' whole discussion of prices serves only as a smokescreen

* Karl Marx, *Capital*, Vol. I, International Publishers, New York, pp. 643-644.

* *The General Theory*, p. 10.
** *Ibid.*, p. 17.

to cover up the role of monopoly capitalism. His theories also serve as ammunition for the misleaders of the working class.

The inflationary method of reducing wages by raising prices, Keynes finds politically safer than direct wage cuts. According to Keynes, workers seldom fight against rising prices, whereas they put up a struggle against reduction of money wages. He says that "a movement by employers to revise money-wage bargains downward will be much more strongly resisted than a gradual and automatic lowering of real wages as a result of rising prices."* Furthermore, Keynes claims that, "Every trade union will put up some resistance to a cut in money-wages, however small. But . . . no trade union would dream of striking on every occasion of a rise in the cost of living. . . ."**

KEYNES' THEORY OF CONSUMPTION

Keynes finds that there is a "gap" between production and consumption which forms one of the contradictions of the capitalist system. He says that "the larger our incomes, the greater, unfortunately, is the margin between our incomes and our consumption."*** According to him, this contradiction is produced by the "psychological law" of consumption.

A major factor, he says, in creating a "gap" between production and consumption is the behavior of the "wealth-owning class." Another factor that deepens the "gap" between production and consumption is the activity of the Wall Street speculators, who extend their personal expenditures in flush times and curtail them in times of slack or crisis, for "a rising stock-market may be an almost essential condition of a satisfactory propensity to consume . . ."*

Needless to say, Keynes does not solve the contradiction between production and consumption, because he cannot comprehend the basic contradiction of capitalist production—the contradiction between the social character of production and the private appropriation of the results of that production. The "wealth-owning class," its ravenous appetite notwithstanding, cannot overreach itself and consume all the products of modern industry and agriculture.

Keynes further argues that the "psychological law" of consumption leaves a portion of the national income in the hands of individuals in the form of money. If this money is hoarded, or kept as liquid capital, full employment cannot be reached. To reach full employment it is essential that "savings" be invested. Without new investments there cannot be extension of production and employment of new workers. Keynes therefore establishes a law for full employment. This he calls "the principle of effective demand." Effective demand is established when the sum spent on individual con-

* *Ibid.*, p. 264.
** *Ibid.*, p. 15.
*** *Ibid.*, p. 105.

* *Ibid.*, p. 319.

sumption and the sum invested equal the current national income. If both sums fall short of the national income and a part is hoarded in the form of money, full employment is not possible.

But, Keynes continues, the flow of investments, especially of new investments, which he considers of major importance, meets with obstacles. The replacement of the old worn-out capital does not, by itself, add to the volume of employment. The volume of employment can be materially increased by extended production in the basic or capital goods producing industries. Investments in these industries are long-term investments, the return upon which cannot be calculated at the present time because nobody knows what the state of consumption will be in the future or whether the commodities produced by the new industries will find a market. Therefore, Keynes considers investments in capital goods industries to be regulated by the state of confidence of investors in the future, that is, confidence that the invested capital will bring profits now and in the future.

> There are not two separate factors affecting the rate of investment, namely, the schedule of the marginal efficiency of capital and the state of confidence. The state of confidence is relevant because it is one of the major factors determining the former . . .*

THE RATE OF INTEREST

The lack of confidence that investment will bring profits, Keynes believes, makes the public hesitate to part with its cash. This reluctance makes loan capital dear, as it tends to raise the rate of interest. A high rate of interest compels the industrial capitalist to part with a large part of his profit and lowers the "marginal efficiency" of capital, that is, reduces the rate of profit. When the rate of profit is low, there is no inducement for the entrepreneur to engage in production and give employment to workers. Hence, to Keynes, the high rate of profit is the main obstacle to full employment.

According to Keynes, the obstacle to the easy flow of money into investment channels is due to the state of mind of the public, which is reluctant to part with its cash unless a great inducement is offered. In other words, "the rate of interest is a highly psychological phenomenon."* This tendency of the public to hold on to its money instead of investing it, is peculiar to human nature, and is of ancient origin. Says Keynes:

> . . . there has been a chronic tendency throughout human history for the propensity to save to be stronger than the inducement to invest. The weakness of the inducement to invest has been at all times the key to the economic problem.**

Keynes avoids a discussion of the role of corporations, of Big Business, in the accumulation and control and

* *Ibid.*, p. 149.

* *Ibid.*, p. 202.

** *Ibid.*, pp. 347-348.

ownership of the wealth of the nation. According to him, corporations and financial institutions are guided in their activities by substantially the same "psychological laws" he ascribes to individuals.

Keynes writes:

> Apart from the savings accumulated by individuals, there is also the large amount of income, varying perhaps from one-third to two-thirds of the total accumulation in a modern industrial community such as Great Britain or the United States, which is withheld by Central and Local Government, by Institutions and by Business Corporations—for motives largely analogous to, but not identical with, those actuating individuals . . ."*

Keynes thus conceals the role of monopolies and trusts and presents a false picture of present-day, *i.e.*, monopoly, capitalism.

KEYNES' THEORY OF CRISES

Unable to explain the crisis of capitalism by the economic laws that regulate capitalist production and exchange, Keynes vainly seeks refuge in his philosophy. He argues that if psychology can produce bad results, then perhaps there are "hypothetical psychological propensities" which "would lead to a stable system."**

Keynes therefore suggests that the use of a "multiplier" may correspond to the "psychological characteristic of human nature." Divested of all verbiage the "multiplier" means only that if industry cannot supply employment, some outside means should be found to supply it, such as war production or government projects for the unemployed financed with borrowed funds. This should provide employment, not only for the workers employed on the projects, but for many more, affecting different industries in a chain reaction. These government expenditures would increase the "effective demand" and lead to new investments, thus stabilizing the system for a short period.

Keynes suggests that the capitalists could stabilize the system by investing their money "in building mighty mansions to contain their bodies when alive and pyramids to shelter them after death." Even to "'dig holes in the ground'" and seek buried fortunes would increase "the real national dividend of useful goods and services."* Keynes envied ancient Egypt, which he claimed had no unemployment problem because that country kept its people busy building pyramids and hunting gold.**

Keynes' "contribution" to the theory of crises does not add anything to what has been written on this subject by other bourgeois economists. The main cause of the crisis, according to Keynes, is a "sudden collapse in the marginal efficiency of

* *Ibid.*, p. 108.
** *Ibid.*, p. 250.

* *Ibid.*, p. 220.
** *Ibid.*, p. 250.

capital."* Collapse is brought on by ignorant trades and optimistic speculators on the stock exchange. Their calculations as to future profits miscarry and, "when disillusion falls upon an over-optimistic and over-bought market,"** a crash follows. Recovery depends on the re-establishment of the "marginal efficiency of capital," but attempts to restore this "marginal efficiency" meet an obstacle in the "uncontrollable and disobedient psychology of the business world."***

Keynes is disturbed by the fact that a gang of stock exchange gamblers and speculators can wreck the economy of a country, and he demands the intervention of the government, of a government which the same crew controls. But Keynes fails to disclose the secret as to why there is a stock exchange and what makes it possible for a set of monopolists, bankers, brokers, and government officials to wreck the economy of a nation.

This secret was long ago disclosed by Marx who said that the stock exchange is a place where "the little fish are swallowed by the sharks and the lambs by the wolves."

Besides his own pseudo-theory of crises, Keynes presents other bourgeois theories to explain the causes of crises. He modifies Jevons' theory, which ascribes the cause of crises to the periodically occurring changes in the sun spots. Good crops result when, because of these changes, weather is good, and bad crops when, also as a result of such changes, weather is bad. The income of the farmer, increased in years of good harvest and decreased in years of poor harvest, affects the rate of investment. The changing rate of investment produces fluctuation in production generally and leads to crisis. A surplus of agricultural products leads to deflation and interferes with recovery. Recovery is slow, due to the deflationary effect of a "redundant stock." To achieve more rapid recovery, Keynes advises destruction of stock. Keynes was very much satisfied with the policy of the New Deal, which subsidized the destruction of agricultural products.

Keynes thus separates industry from agriculture, which he considers to be governed by the laws of nature. But, in fact, no such separation exists. The economic laws governing industry also govern agricultural production. What is more, capitalism penetrates agriculture, not only in capitalist countries, but also in colonial and semi-colonial countries, transforming agricultural production in colonial and semi-colonial countries into an appendage to the industrial production of the imperialist countries. Capitalist imperialism introduces the plantation system and peonage. With the aid of the feudal elements and native fascists, it seeks to suppress all resistance of the native population, and to prevent the development of industry and of

* *Ibid.*, p. 315.
** *Ibid.*, p. 316.
*** *Ibid.*, p. 317.

diversified agriculture in these countries.

THE THEORY OF UNDERCONSUMPTION

The theory of underconsumption is accepted by bourgeois economists as the most plausible explanation of crises, and is widely prevalent in the labor movement. Samuel Gompers, for example, made it the official theory of the American Federation of Labor. The Reconstruction Program adopted by the A. F. of L. in 1919, stated:

> Unemployment is due to underconsumption. Underconsumption is caused by low or insufficient wages. Just wages will prevent industrial stagnation and lessen periodical unemployment.*

The followers of Keynes propose to solve the problem of overproduction by "socializing demand." Their program calls for the capitalists to carry on production and for the government to provide a constant demand for commodities. However, a capitalist state cannot insure the demand for commodities. The demand of each class is determined by the position it occupies in social production. The effective demand of the working class cannot fundamentally be greater than the wages it receives.

In actual fact, to socialize demand, production must be socialized, for the mode of distribution is subordinate and corresponds to the mode of production. In the words of Marx:

> Distribution is itself a product of production, not only in so far as the material goods are concerned, since only the results of production can be distributed; but also as regards its form, since the definite manner of participation in production determines the particular form of distribution, the form under which participation in distribution takes place.*

Those who ascribe the main cause of crises to underconsumption fail to explain *why* there is underconsumption in capitalist society. In this way they cover up the differences between the capitalist mode of production and other modes of production. They thereby conceal the basic contradiction of capitalism and the revolutionary implications of this contradiction. As Engels said:

> . . . unfortunately the under*consumption of the masses, the restriction* of the consumption of the masses to what is necessary for their maintenance and reproduction, is not a new phenomenon. It has existed as long as there have been exploiting and exploited classes. Even in those periods of history when the situation of the masses was particularly favorable, as for example in England in the fifteenth century, they underconsumed. They were very far from having at their disposal for consumption their own annual total of production. Therefore, while underconsumption has been a constant feature in history for thousands of

* *American Federation of Labor—History, Encyclopedia, Reference Book,* A. F. of L., Washington, 1924, Vol. II, p. 255.

* Karl Marx, *A Contribution to the Critique of Political Economy,* Charles H. Kerr, Chicago, 1909, p. 284.

years, the general shrinkage of the market which breaks out in crises as the result of surplus of production is a phenomenon only of the last fifty years. . . .*

Overproduction is due to the social character of production and the private appropriation of the results of that production.

> The contradiction between social production and capitalist appropriation reproduces itself as *the antithesis between the organization of production in the individual factory and the anarchy of production in society as a whole.***

Planning in separate, individual industries by the trusts does not diminish the anarchy of production. These plans cannot extend to the whole of society, so that while order may prevail inside the factory, anarchy rages outside. Thus, Lenin wrote:

> The statement that cartels can abolish crises is a fable spread by bourgeois economists who at all costs desire to place capitalism in a favourable light. On the contrary, when monopoly appears in *certain* branches of industry, it increases and intensifies the anarchy inherent in capitalist production *as a whole.****

Keynes and his followers make no differentiation in the nature and features of crises in the different epochs of capitalism. The economic crises of the epoch of monopoly have new and special features that did not apply in the epoch of free competition. Cyclical crises in the twentieth century take place in the epoch of the decline of capitalism, in the period of the general crisis of capitalism. They engulf the entire capitalist world and are of longer duration, making recovery more difficult. Furthermore, as Stalin stated in 1930:

> In the course of development of the economic crisis, the industrial crisis in the chief capitalist countries has not simply coincided, but has become *interwoven* with the agricultural crisis in tht agrarian countries, aggravating the difficulties and predetermining the inevitability of a general decline in economic activity. Needless to say, the industrial crisis will intensify the agricultural crisis, and the agricultural crisis will protract the industrial crisis, and this cannot but lead to the deepening of the economic crisis as a whole.*

KEYNES' REMEDIES

The theories of Keynes again demonstrate the bankruptcy of bourgeois political economy. After erecting a huge theoretical structure, Keynes is compelled to confess that the maintenance and preservation of the capitalist system cannot be left in the hands of the capitalists. The State must take an active part in the direction and regulation of capitalist econony. Keynes writes:

> I expect to see the State, which is in a position to calculate the marginal

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* Frederick Engels, *Anti-Duhring*, International Publishers, 1939, p. 312.
** *Ibid.*, p. 299.
*** V. I. Lenin, *Collected Works*, International Publishers, Vol. XIX, p. 104.

* Joseph Stalin, *Leninism*, International Publishers, 1933, Vol. II, p. 314.

efficiency of capital-goods on long views and on the basis of the general social advantage, taking an ever greater responsibility for directly organising investment. . . .*

Keynes leaves to the State the management of the flow of investment into production and the regulation of consumption; the management of industry itself is left in the hands of the capitalists.

> It is not the ownership of the instruments of production which it is important for the State to assume. If the State is able to determine the aggregate amount of resources devoted to augmenting the instruments and the basic rate of reward to those who own them, it will have accomplished all that is necessary.**

What Keynes wants is to place the burden of rebuilding the decayed English industries on the shoulders of the people. He further expects the State to guarantee profits to the capitalists. If guaranteeing the profits of the monopolists will make it necessary to "socialize" certain industries, Keynes raises no objections. He advises the capitalists to accept a certain amount of nationalization, if necessary, and thus save the capitalist system. "The world," he says, "will not much longer tolerate unemployment. . . ."

Keynes does not seem to be too certain that his remedies would save capitalism, or that his theories would shed any light on the future of the capitalist system. In 1937, Keynes wrote: ". . . our knowledge of the future is fluctuating, vague, and uncertain." Even about "the position of private wealth-owners in the social system in 1970 . . . there is no scientific basis on which to form any capable probability whatever. We simply do not know."*

Compare this with the penetrating analysis of British capitalism made in 1885 by Frederick Engels:

> . . . the manufacturing monopoly of England is the pivot of the present social system of England. Even while that monopoly lasted, the markets could not keep pace with the increasing productivity of English manufacturers; the decennial crises were the consequence. . . . How will it be when Continental, and especially American, goods flow in ever-increasing quantities — when the predominating share, still held by British manufacturers, will become reduced from year to year? Answer, Free Trade, thou universal panacea. . . . Capitalist production *cannot* stop. It must go on increasing and expanding, or it must die. Even now, the mere reduction of England's lion's share in the supply of the world markets means stagnation, distress, excess of capital here, excess of unemployed workpeople there. What will it be when the increase of yearly production is brought to a complete stop?
>
> Here is the vulnerable place, the heel of Achilles, for capitalistic production. Its very basis is the necessity of constant expansion, and this constant expansion now becomes impossible. It

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* *The General Theory,* p. 164.
** *Ibid.,* p. 378.

* *The New Economics,* [essays by various authors] edited by Seymour Harris, New York, 1947, pp. 184, 185.

ends in a deadlock. Every year England is brought nearer face to face with the question: either the country must go to pieces, or capitalist production must.*

Engels' analysis is a brilliant example of how Marxism, the science of the working class, can see and foretell the march of events.

Engels clearly saw the general line of development of the capitalist countries. He foresaw the outlines of the present struggle between the United States and Britain, although he could not of course predict in 1886 the specific conditions in which the antagonisms between them would take place. With prophetic insight Engels in 1886 forecast the reality of today. He wrote:

America will smash up England's industrial monopoly—whatever there is left of it—but America cannot herself succeed to that monopoly.*

Today the American imperialists have embarked on a policy of world domination, and Britain, as Engels predicted, is forced to play a subordinate role. Under the Truman Doctrine and the Marshall Plan, American imperialism, with Britain as junior partner, is preparing a third world war for the destruction of the U.S.S.R. and the new European democracies in order to dominate the world. But in pursuing the course of Hitler, American imperialism will not meet with any more success than did German imperialism.

The eclecticism of Keynes cannot help save capitalism from doom. All its tinkering with a decaying economic system will not prevent the triumph of Socialism.

* Frederick Engels, *The Condition of the Working-Class in England in 1844*, George Allen & Unwin, London, 1920, Preface to the 1892 Edition, pp. xvi-xvii. (Quoted by Engels from his article "England in 1845 and 1885," in the *London Commonweal*, March 1, 1885.)

* Karl Marx and Frederick Engels, *Selected Correspondence, 1846-1895*, International Publishers, p. 443.